JOHNSTON, KINNEY & ZULAICA LLP

Litigation Risks for Trust Departments: Crashes, Plagues, and Plagues of Litigators

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Topics

1. Investment Risks: Inflation, Plagues, plagues of lawyers, the Covid Components to inflation which won't respond to quantitative tools
2. economic dampers: zero interest rates and the post-war experience
3. Gamma Scalping and Fed investments in fixed income securities--$7 Trillion problem
4. Duty to Diversify—the Wellington model?
5. ERISA cases
6. Elder Abuse and Undue Influence
7. Delaware Doppelgänger States lower standards and promote risk
8. Multistate trust disputes
9. Duties of prudence, loyalty, and obligations to monitor performance and seek lower fees

Investment Risks in an inflationary world

- The Federal Reserve has finally decided that rising prices are not a transitory event. Faced with low unemployment rates, rising wages, and inflation at every level of the economy, we will soon face 50 basis point rate increases as well as the liquidation of financial assets which the Fed acquired to resolve the risks posed when major players hedged their bets with ETF's and mutual funds. While Larry Summers can not claim victory in his predictions of inflationary consequences from deficit spending, there are other major factors contributing to inflation and supply chain interruptions.
- From 1941 until 1951, the Federal Reserve "enforced rate ceilings at two and sometimes three points on the Treasury yield curve." B. Bernanke and V. Reinhart, "Conducting Monetary Policy at Very Low Short-Term Interest Rates" The Federal Reserve Board, January 14, 2004 at 4. Between 1941 and 1951, intermediate terms bonds lost principal value adjusted for inflation in every year except 1949. 2015 Ibbotson SBBI Classic Yearbook at 73.
- During the same period, long term treasuries lost their inflation adjusted value in 7 of the 11 years until the policy of holding down rates was terminated in 1951. Hence the trustee faced with current low interest rate/high inflation environment faces the risk of loss of some principal as well as insufficient income for the income beneficiary. The 60/40 portfolio is unsustainable.
- While Warren Buffet can invest in "equity bonds" by investing in a diversified portfolio of dividend aristocrats, European blue chips, and Japanese trading companies, the average investment manager or lay trustee will find it harder to provide steady income to beneficiaries and riskless income flows. A hard landing recession will pose great risks for most investors.
- Unfortunately there are multiple issues driving inflation, against which the Fed has no swords to wield. The Wall Street Journal on April 11, 2022 reported that "Global and sea freight routes have become more expensive and less reliable during the pandemic. In March, just 7% of sea shipments from Asia to North America arrived on time, while 6% were on time for the Asia-to-Europe route eeSee data shows. Even the big companies with bargaining power can expect to pay contract freight rates around five times higher than in 2019. Fresh Covid-19 lockdowns in China and coming wage negotiations with West Coast dockworkers in the U.S. spell further trouble ahead."

Covid is a major contributor to inflation

- Covid has impacted economies world wide and interrupted supply chains as China and other countries face closure or work restrictions on companies whose work environments are impacted.
- Even mRNA vaccines face waning effectiveness after six months from vaccinations or boosters.
- Third world countries have extreme shortages of vaccines and anti-viral medications, offering breeding grounds for new variants such as the South African Omicron.
- Until Europe and the US help to provide sufficient vaccines, the Third world will export variants of Covid to a city near you, and your schools.

Limited effectiveness of vaccines

- An October 14, 2021 article in Nature describes the effectiveness of the mRNA vaccines used in America and Europe, versus the older inactivated vaccines used by China and sold throughout the third world.
- CoronaVac and Sinopharm inactivated virus vaccines had initial WHO reports that CoronaVac effectiveness was 51% and Sinopharm 79 %, close to the Oxford – AstraZeneca viral-vector vaccine at 63%. The mRNA vaccines in America had much higher effectiveness, leading many developing countries to use such mRNA vaccines for boosters after using inactivated virus treatments.
- The WHO reported that "As against other available vaccines, Sputnik V showed a three to seven times decline in virus neutralizing activity against Omicron. Data showed that Sputnik V provided **11.8 times decline in VNA versus 41 and 49-84 times reduction for Covid-19 vaccines of Pfizer-BioNTech and Moderna, respectively.** Dec 20, 2021
- Ineffective vaccines and low vaccination rates will foster new variants and lead to morbidity and extensive medical care around the world and here as well.

Under vaccinated and under protected

- Large portions of the world are under vaccinated, leading to fertile grounds for new and dangerous variants. The Omicron variant likely developed in unvaccinated HIV victims in South Africa, adding upper respiratory infections to rapid transmission capabilities.
- While America and Europe have quite effective vaccines (and anti-viral treatments), Chinese and Russian vaccines have much lower effectiveness. Hence larger portions of their populations, particularly those with underlying medical conditions, suffer high morbidity and infection rates which are not so apparent in the US. Similarly, developing country manufacturers often cannot provide the PPP and protections for tightly packed workers necessary to restrict infections and reliance on understaffed medical establishments. Even in America, rural communities have allowed hospitals and medical facilities to degrade, as their overworked local nurses, technicians and doctors move to better resourced urban medical centers or those in other States.
- Moreover, exhausted medical professionals have been retiring or moving out of intense treatment wards for general medical positions, leaving hospitals and critical care wards understaffed. The supply chain for medical professionals is an expensive and time consuming one and foreign professionals have been exhausted as well and higher salaries in the US will not lure them here.
- The pace at which variants can spread from India or China or Africa will threaten the more developed economies but also severely impair economic supply chains in the third world. Increasing federal rates and liquidating quantitative easing assets will not solve supply chain costs.

Long Haul symptoms may impact more than 6%

- While elderly, obese, or persons with high blood pressure or respiratory problems or compromised immune systems may face deadly consequences, the recovery from Covid may be most taxing and may have long term medical consequences for younger folk. Yale Medical School professionals estimated that 80% of cases may be mild, but examination of patients treated in Yale New Haven Hospital showed serious consequences for those infected, even if their do note get pneumonia or suffer adverse immune responses which flood their lungs with fluid and require mechanical assistance in breathing.
- The mutated virus can attack the brain and nervous system, it can target the kidneys which have ACE2 receptors, and it targets the lining of the lungs with devastating effect. Patients can suffer from fatigue for months after the initial treatment and end of active fever and symptoms. The lungs of patients—young and old—may suffer permanent injury which can impair the functioning permanently in some cases. There are good reasons for multi-million dollar athletes to avoid being in contact with sweaty and hard breathing opponents in a shortened sport season—better to wait until better treatments or a vaccine can be made available. The damage to the lining of the lungs can be observed in an MRI which shows the ravaged cells as "Ground Glass Opacities" which are grey or lighter colored patches of injured cells. The functioning of the lung may be permanently impacted, much as heavy smokers or persons subjected to pollution can have impaired lung function. Hence the Millennials and Alphabet generations who shrug off the risk may find themselves with major problems in 30 years when their remaining lung tissue is injured by smoking things or breathing pollution.

Post-acute sequelae of Covid (PASC)

- More than half of the 236 million people who have been diagnosed with COVID-19 worldwide since December 2019 will experience post-COVID symptoms — more commonly known as "long COVID" — up to six months after recovering, according to **Penn State College of Medicine** researchers. The research team said that governments, health care organizations and public health professionals should prepare for the large number of COVID-19 survivors who will need care for a variety of psychological and physical symptoms.
- **OCTOBER 13, 2021**
- **By Tracy Cox**

Serious neurological and psychiatric Outcomes

- A study of 236,379 Covid survivors in England published in The Lancet in May of 2021 showed large percentages of patients continued to suffer neurological and psychiatric problems after their initial infections. Among 236,379 patients diagnosed with COVID-19, the estimated incidence of a neurological or psychiatric diagnosis in the following 6 months was 33·62% …, with 12·84% …receiving their first such diagnosis. For patients who had been admitted to an ITU, the estimated incidence of a diagnosis was 46·42%... and for a first diagnosis was 25·79%.... Regarding individual diagnoses of the study outcomes, the whole COVID-19 cohort had estimated incidences of 0·56%...for intracranial haemorrhage, 2·10%... for ischaemic stroke, 0·11% .. parkinsonism, 0·67%... for dementia, 17·39%...for anxiety disorder, and 1·40%... for psychotic disorder, among others. In the group with ITU admission, estimated incidences were 2·66%... for intracranial haemorrhage, 6·92%... for ischaemic stroke, 0·26% … for parkinsonism, 1·74% … for dementia, 19·15% … for anxiety disorder, and 2·77% … for psychotic disorder. Most diagnostic categories were more common in patients who had COVID-19 than in those who had influenza (hazard ratio [HR] 1·44, 95%..., for any diagnosis; 1·78…, for any first diagnosis) and those who had other respiratory tract infections …, for any diagnosis; 1·32, …, for any first diagnosis). As with incidences, HRs were higher in patients who had more severe COVID-19 (e.g., those admitted to ITU compared with those who were not: 1·58, …, for any diagnosis; 2·87, 2·45–3·35, for any first diagnosis). Results were robust to various sensitivity analyses and benchmarking against the four additional index health event sections. Vol 8, The Lancet, May 2021:

1-Year Outcomes for hospital Survivors of Covid

- Vol 398 The Lancet, August 28, 2021
- Among 236 379 patients diagnosed with COVID-19, the estimated incidence of a neurological or psychiatric diagnosis in the following 6 months was 33·62% …with 12·84% … receiving their first such diagnosis. For patients who had been admitted to an ITU, the estimated incidence of a diagnosis was 46·42% … and for a first diagnosis was 25·79% ….. Regarding individual diagnoses of the study outcomes, the whole COVID-19 cohort had estimated incidences of 0·56% … for intracranial haemorrhage, 2·10% … for ischaemic stroke, 0·11% … for parkinsonism, 0·67% … for dementia, 17·39% … for anxiety disorder, and 1·40% … for psychotic disorder, among others. In the group with ITU admission, estimated incidences were 2·66% … for intracranial haemorrhage, 6·92% (6·17–7·76) for ischaemic stroke, 0·26% (0·15–0·45) for parkinsonism, 1·74% (1·31–2·30) for dementia, 19·15% (17·90–20·48) for anxiety disorder, and 2·77% (2·31–3·33) for psychotic disorder. Most diagnostic categories were more common in patients who had COVID-19 than in those who had influenza (hazard ratio [HR] 1·44, 95% CI 1·40–1·47, for any diagnosis; 1·78, 1·68–1·89, for any first diagnosis) and those who had other respiratory tract infections (1·16, 1·14–1·17, for any diagnosis; 1·32, 1·27–1·36, for any first diagnosis). As with incidences, HRs were higher in patients who had more severe COVID-19 (e.g., those admitted to ITU compared with those who were not: 1·58, …, for any diagnosis; 2·87, … for any first diagnosis). Results were robust to various sensitivity analyses and benchmarking against the four additional index health events.
- We are facing serious long-term health consequences from Covid infections, particularly after hospitalizations. Whether these survivors will suffer serious debilitating conditions is simply unknown. It will take years to determine the outcomes and the impairments and financial costs involved. Whether the upper respiratory infections from Omicron and its progeny will impact neurological performance is not yet know. Wear your masks.

- *When South Dakota allowed a huge motorcycle rally against the advice of the CDC, the participants (unmasked and eschewing distancing from their fellows, confident in their independence, muscles and motors to beat any "flu") spread the virus to 22 States in weeks.*
- *Here the reality of rural States comes into play. Their dispersed populations and minimal contact with foreign visitors (except in meat and poultry processing), led local leaders to let the economy rip. However, decades of decay in the rural hospitals and emigration of skilled medical personnel to larger, better paying urban hospitals, placed these States in peril. Student debt provided a huge inducement for rural talent to move to big State college and university towns, and then migrate to higher pay in large urban centers elsewhere.*
- *Walmart and Big Box stores have stripped small towns of their local banks, supermarkets, hardware stores, auto dealerships, and now online commerce has brought low prices to rural populations at the expense of local businesses. Rural America has exported their children, not products.*

Sheltering in suburbs may revive rural communities

- The brain drain from rural areas or States may be ameliorated by the ability of professionals to locate to hospitable and cheaper areas on the periphery of urban centers. The investment of infrastructure dollars into wired high speed internet or satellite coverage may bring higher income workers back into rural communities.

Gamma Scalping leads to Fed Scalping

- The Prudent Investor Act almost universally adopted by the States does not actually require that modern portfolio theory be followed. Restatement Third of Trusts§ 90 Com e(1) at 303: “What has come to be called ‘modern portfolio theory’ offers an instructive framework for understanding and attempting to cope with nonmarket risk. The trustee’s normal duty to diversify in a reasonable manner, however, is not derived from or legally defined by the principles of any particular theory.” “There are no universally accepted and enduring theories of financial markets or prescriptions for investment that can provide clear and specific guidance to trustees and courts. Varied approaches to the prudent investment of trust funds are therefore permitted by the law. This does not mean, however, that the legal standard of prudence is without substantive content or that there are no principles by which the fiduciary’s conduct may be guided and judged. A trustee’s approach to investing must be reasonably supported in concept and must be implemented with proper care and skill, and caution. Furthermore, although theirs of investment provide some conflicting signals, they also offer some consistent themes with respect to matters on which there is general agreement. §90(f) at 208.
- There are a variety of other approaches to allocating assets which have strong econometric support, from Fama and French’s five factor theory, to Ibbotson’ Quality analysis, which looks at intrinsic factors as well as liquidity factors to allocate assets, and Shiller’s Narrative Economics. Ibbotson, T. Izzorek, P. Kaplan and J. Xiong have published “Popularity” which looks at a variety of factors including liquidity to explain the performance of stocks (the Popularity Asset Pricing Model, PAPM). At the same time, we are seeing Modern Monetary Theory arising to justify deficit spending which in classical theories would lead to inflation and unemployment.
- The real risk is whether the structure of a portfolio unduly concentrates risk, fails to meet the investment guidelines of the Trust or ERISA plan, or whether the trustee failed to monitor the performance or efficiency of a portfolio.

Gamma Scalping leads to

- One class of beneficiaries of the 2017 Tax Act are the banks and investment banks and hedge funds which use exchange traded funds to harvest gains from movements in underlying securities. These entities attempt to hedge their risk by selling puts and call based on underlying indices, such as S&P 500 fund SPY. These ETFs are market weighted, so that more than 20% are reflecting the prices of the FAANG stocks which have been thriving for years with the boosts from index fund inclusions. The purchase of puts and/or calls using ETF shares thus act to stabilize the prices of the constituent stocks, but large movements in prices can also destabilize markets.

- Gamma is the symbol used to reflect the change in the value of the ETF in question. A trader may attempt to collar a price range for the index by writing both a put and a call on the index. The value of such puts and calls change as they approach the expiration dates, so the market player attempts to cover such collars to reap the best price, commonly known as "Scalping Gamma." *see* "The Invisible Forces Exacerbating Market Swings" (https;//www.wsj.com/articles/the-invisible-forces-exacerbating-maket-swings-11582804802), February 27, 2020. The article concluded that such trading with ETF hedges may result in "magnifying volatility when it appears. That scenario may have been on display this week because of what is called short gamma positioning, in which traders buy shares when prices are rising and sell when prices are calling. Gamma measure how much the price of an option accelerates when the price of the underlying security shifts." *see also* "Investors Big and Small are wagering hundreds of billions of dollars on market moves" June 12, 2020, (https://www.wsj.com/articles/volatility-is-everywhere-the market-tactic-that's-driving -stocks-haywire-11591977978).

Quantitative Easing is Squeezing the Fisc

- Similar strategies have been used for decades to time the sale of bonds whose value fluctuates with changes in interest rates as a bond approaches its payout. The value will fall to the surrender price ultimately, but in the years or months prior to expiration there have always been opportunities to harvest the current value at an opportune point in that declining value curve by selling early.

- Here artificial intelligence and computer programs can be utilized to maximize the value or minimize the losses involved in such gambits to shave the edges off the coins by scalping the gamma.

- When the Covid virus crash hammered the market, one of the first issues pounced on by the Federal Reserve was the liquidation of ETFs holding bond portfolios. Leveraged investors wanted to move to cash, particularly when the main tactic of the Fed was to drop interest rates, skewering the value of the underlying bonds. No one in the professional elite of financial traders and the amateurs playing these games wanted to take losses. So, to prevent a liquidity problem (remember the last economic War in 2008?) the Fed started buying bond ETFs to provide the liquidity for the players deserting the fray for cash.

In 2008, the fed and federal government acted as the bankruptcy lender for AIG and GM, but got stock in the underlying companies once they emerged from bankruptcy. If you ignore the time value of the federal money, the US purportedly made a profit. But when Mr. Powell bought ETFs, there is no one to reimburse any losses. The Fed (and we voters) take the hit. To avoid a run on ETF's used as hedges by investment firms, Powell backed up such securities by buying up assets to stabilize the market and prevent a crisis such as that involving Russian debt.

As of April 6, 2022, the Fed held $2 trillion of 1 to 5 year treasury securities, $1 Trillion of 5 to 10 year treasuries, and $1,403,251,000 in treasuries over 10 years duration. It also held $2,648,837,000 in mortgage-backed securities. All of these are at face value.

Liquidating these securities is going to be painful. But will it stop inflation?

This may be a very hard landing for the economy and fiduciaries holding fixed interest instruments.

Margin debt as of February 28, 2022 was $835 billion. Robin Hood made investors for large numbers of the younger cohorts who have no wounds from the 2008 Great Recession and who could chase memes with impunity. When the Fed hammers interest rates, Professor Powell may teach the younger generation a lesson involving risk.

You had better be prepared if the hard landing lands on your beneficiaries.

Duty to Diversify (or not): Read the Fine Print

Matter of Wellington Trust (October 10, 2018) 85 N.Y.S. 3d 497, 185 A.D. 3d 809.

- Trust created by Wellington founder Herbert G. Wellington Sr., with son Herbert Jr. appointed with sole and absolute discretion to invest, and power to direct and remove trustees without cause. The trust contained provisions allowing retention of original assets and waiving any duty to diversify. The Trust invested 98% in large cap stocks, with major holdings in three stocks, consistent with the Wellington investment model. Such investments resulted in an increase in corpus value of 1,750%. *Id.* at 502. Herbert Jr. resigned in 2004 and filed an accounting along with JP Morgan, with a final accounting filed after the death of the remaining income beneficiary. After the resignation of the directing trustee, JPM acquired some small cap investments. One of the remainder persons sued for investment breach. In a nonjury trial the Court found no breaches by Herbert Jr. or by JPM. The decision was affirmed by Appellate Division. Good defensive language and better investment performance.

Matter of Trust of Ray D. Post, (Aug. 15, 2018) 2018 WL 3862756, (N.J App. Div).

Post created a trust in 1975 with 2550 Shares of the common stock of AT&T, 304 shares of Exxon, and a $4,500 AT&T bond. Valley National Bank acquired the initial corporate trustee. The initial bank trustee signed a fee agreement to be paid 5% of income. Trustor and wife received the net income until the death of the spouse. The corpus was then to be placed in trusts for two granddaughters. When settlor died in 1989 the value of the trust was $483,172, consisting of shares of Baby Bells ad 2432 shares of Exxon, and 2,200 shares of ATT. Valley became the trustee in 1993 and started taking a statutory fee in addition to the agreed upon 5% of income. Settlor's niece, who had an MBA from Harvard, became the executor. She and her sister alleged that they had not been shown the terms of the trust regarding investments and trustee compensation. Trust terms provided that original assets could be retained "without liability for loss or depreciation" and trustee compensation was based on a letter agreement with the settlor. Valley's in-house counsel wrote a memo regarding the adoption of the UPIA in 1997. Outside counsel for the trustee opined that the trust language did not relieve Valley of the duty to diversify, but that the trust language did not "deprive [Valley] of power to sell the stock." Outside counsel suggested that Valley notify the widow and granddaughters of the intended portfolio changes and "seek out their consent or other points of view. Finally, to fully protect itself for its course of action, [Valley] could file an action…judicially…and seek authorization to deviate from the language of the rust and diversify the portfolio." *Id.* at *2.

Damages for Modifying the Investment Plan!

The granddaughters claimed not to have seen the terms of the trust. The trustee after the death of their grandmother sought the permission of the granddaughters for a new portfolio "30% fixed income and the balance …in equity growth positions." *Id.* at *3. The granddaughters signed the approvals. A four-year delay ensued during which the Trustee asked the beneficiaries what sort of accounting they would approve, but neither beneficiary agreed to waive a formal accounting. After being served with the final accounting, a counterclaim was filed for breach of fiduciary duty, negligence, conversion and breach of implied duty of good faith and fair dealing. John Langbein opined that keeping the portfolio with Exxon and Baby Bells was "under-diversified" and that Valley had a duty to diversify. *Id.* at *4. The Court held that the date for diversification was May 2, 2008 when Valley sent the beneficiaries a copy of the Trust and the portfolio value on that date. A damage trial was held and awarded $520,548 of damages along with prejudgment interest and a denial of commissions from 2010 onward. On appeal, the Court held that the retention language required the trustee "to seek authorization from the court before selling the trust's corpus [under a New Jersey statute, case law, and Restatement Second of Trusts § 167(1).] *Id.* at *8. The Court upheld the damage awards and denial of commissions.

Mutual Fund with 25% Concentration

- *Muri v. National Indemnity Co.* (2019) ___F. Supp. 3d___ (D. Neb, 6/18/2019), 2019 WL 2513695.
- ERISA claim by NIC employee for damages for imprudence and breach of duty of loyalty for losses when Sequoia investment fund alternative lost money when its 25% concentration Valeant crashed.
- The Court held that the managers were entitled to monitor public information regarding the travails of Valeant and did not breach their duty of prudence. The Court rejected breach of loyalty claims that NIC allegedly looked to its parent company, Berkshire Hathaway, in not changing the Valeant concentration. No evidence was presented to show that obtaining opinions from BH employees about Valeant "was intended to benefit Berkshire Hathaway, or that anything the Committee did actually had the effect of benefiting Berkshire Hathaway." 2019 WL 2513695 at *8.

Burden of Proof in ERISA Cases

Brotherston v. Putnam Investments 907 F. 3d 17 (1st Cir. 2018), *cert. den.* (2020)140 S.Ct. 911 (mem.)

- This is one of a number of ERISA class actions dealing with alleged breaches of the duty of loyalty where the pension plan utilized proprietary mutual funds or other investment vehicles which purportedly underperformed and charged unreasonable fees but were retained nonetheless. Such cases look at these issues from the perspective of the breach of loyalty but also from claims of a breach of prudence where the fiduciaries allegedly failed to monitor and remove underperforming and excessively expensive proprietary mutual funds.

Trial Court Relied on *Hecker* to Reject Loyalty Claim Regarding Use of Proprietary Funds

- "Nor is it sufficient merely to point to a defendant's self-dealing, such as the investment of plan assets in their own mutual funds. See Dupree v. Prudential Ins. Co. of Am., No. 99-8337, 2007 WL 2263892, at *45 (S.D. Fla. Aug. 10, 2007) ('Simply because [the plan sponsor] followed such a practice ... does not give rise to an inference of disloyalty, especially where these practices are universal among plans of the financial services industry.'). In fact, the Department of Labor explicitly allows, and courts have upheld, financial services institutions' practice of offering their own investment products to their own sponsored plans. See, e.g., *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009) (finding 'no statute or regulation prohibiting a fiduciary from selecting funds from one management company); Participant Directed Individual Account Plans, 56 Fed. Reg. 10,724, 10,730 (Mar. 13, 1991) (to be codified at 29 C.F.R. pt. 2550) (noting that it would be 'contrary to normal business practice for a company whose business is financial management to seek financial management services from a competitor').

2017 WL 2634361*3.

Burden of Proof in ERISA

- The Court then looked at what happens to the burden of persuasion when the plaintiff demonstrates a prima facie case of breach of the duty of loyalty: The Court noted that there is a split in the circuits: the 4th, 5th, and 8th Circuits shift the burden to the defendants, while the 2nd,6th, 9th, 10th and 11th circuits refused to adopt burden shifting in ERISA cases. 2017 WL 2634361 at *5.
- Subsequently, the First Circuit in reviewing a later *Brotherston* ruling concluded that the burden should shift to the fiduciary. 907 F. 3d 17, at 39. *see also Wildman v. American Century Services LLC, infra*, 362 F.Supp.3d 685, 700 (W.D. Mo. 2019).
- The denial of certiorari in the face of the conflict among the circuit raises questions about possible changes in the harsh tests promulgated by the supreme court in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014).
- The tactic of using allegations of breach of prudence and failure to monitor may have gained some traction in escaping the *Dudenhoeffer pleading barriers as will be discussed* infra.

First Circuit Ruling in *Brotherston*

- And because ERISA cases rarely involve jury instructions, it is likely that very few cases will actually leave the question of causation "in evidentiary equipoise." *Id*. at 58, 126 S.Ct. 528. So it would not be farfetched to chart a third route by defaulting to Schaffer's ordinary rule on the burden of proof while nevertheless requiring the fiduciary to first put forward its view of what likely would have happened but for the alleged fiduciary breach. Neither party, though, has briefed such a middle ground. More importantly, we have many decades of experience with the allocation of the burden of proof called for routinely by trust law, with no evidence of any particular difficulties, unfairness, or costs in applying that rule in the few cases in which it actually makes a difference. *Cf. Metropolitan Life Ins. Co. v. Glenn*, 554 U.S. 105, 113, 128 S.Ct. 2343, 171 L.Ed.2d 299 (2008) ("[W]e note that trust law functions well with a similar standard."). We therefore opt for a well-trodden path rather than risk introducing unforeseeable complexities with a more novel approach.

First Circuit Ruling in *Brotherston*

- For the foregoing reasons, we align ourselves with the Fourth, Fifth, and Eighth Circuits and hold that once an ERISA plaintiff has shown a breach of fiduciary duty and loss to the plan, the burden shifts to the fiduciary to prove that such loss was not caused by its breach, that is, to prove that the resulting investment decision was objectively prudent. *See Tatum,* 761 F.3d at 363; *McDonald*, 60 F.3d at 237*; Martin*, 965 F.2d at 671. In so ruling, we stress that nothing in our opinion places on ERISA fiduciaries any burdens or risks not faced routinely by financial fiduciaries. While Putnam warns of putative ERISA plans forgone for fear of litigation risk, it points to no evidence that employers in, for example, the Fourth, Fifth, and Eighth Circuits, are less likely to adopt ERISA plans. Moreover, any fiduciary of a plan such as the Plan in this case can easily insulate itself by selecting well-established, low-fee and diversified market index funds. And any fiduciary that decides it can find funds that beat the market will be immune to liability unless a district court finds it imprudent in its method of selecting such funds, and finds that a loss occurred as a result. In short, these are not matters concerning which ERISA fiduciaries need cry "wolf."

907 F.3d at 39.

SCOTUS clearly did not want to resolve this clash among the Circuits which involves econometric issues, so the field was left to well-heeled plaintiffs firms who gathered the financial data to meet the daunting test set by the Justices.

The good news is that the retirement plan of your alma mater has now been forced to monitor the expenses and self-dealing of outside management firms. Good for alums, bad for investment managers. Given the fragmented approaches in the various circuits, these often are fact intensive legal decisions. There have been some victories for fiduciaries and advisory firms as shown below, but many more expensive lessons for fiduciaries and their advisors.

Tax Preparation Fees

- *Henderson v. BNY Mellon NA*, (May 14,2019) ---F. Supp. 2d--- 2019 WL 1466931 (on remand from 1st Cir). Settlement of $10 million for class members plus 10 years of free tax returns for allegedly improperly charging more than tax preparation charges from PricewaterhouseCoopers.
- This settlement resolved a case where the trustee had engaged PWC to prepare tax returns—a common practice for the industry to shift from tax preparation in house to utilizing major accounting firms to prepare the initial tax returns. Some trustees bundled tax preparation into a single fee charge, others treated it as an extraordinary expense not covered by a basic trustee fee (either specifically negotiated on the initial intake by new business officers or upon changes in State law. Hence some of these cases involve multiple time periods and fee structures. California had changed its probate code to require a court order to modify an initial trustee fee agreement, leading to class action litigation. Some of those initial plaintiff counsel have continued to raise such tax preparation fee class action claims in other trusts and other jurisdictions.
- The settlement here came after the trial court had ordered certification of the class.

Banks v. Northern Trust Corp. (9th Cir. 2019) 929 F. 3d 1046, cert. den. ___S.Ct.___2020 WL 873825 (mem),___F.Supp.3d___ 2020 WL 1062144 (3/19/2020)

- The *Banks* case deals with State law claims of excessive fees for tax preparation as well as other alleged breaches. It has now been resolved after remand to the District Court granting summary judgment to Northern Trust on tax preparation fees.

- This is a diversity case so that California law applies. The suit sought a class action in State Court for a class of less than 50 plaintiffs in order to escape the SLUSA bar on security law claims. The initial counsel had acted in earlier suits which made similar claims against Wells Fargo.

- The trial court had dismissed the class action as being barred by SLUSA, but then the 9th Circuit reversed, relying on the Supreme Court's decision in *Chadbourne & Parke v. Troice*, 571 U.S. 377 (2014), which raised a unique exception to the application of SLUSA.

Banks v. Northern Trust Corp.(9th Cir. 2019) 929 F. 3d 1046, cert. den. ___S.Ct.___2020 WL 873825 (mem)

The 9th Circuit reversed the dismissal. The synopsis of its argument follows:

1. On question of first impression, allegations concerning trustee's imprudent investments did not constitute activity "in connection with" purchase or sale of securities under Securities Litigation Uniform Standards Act (SLUSA);
2. SLUSA did not preempt beneficiary's state-law management fee claims asserting that trustee improperly charged tax-preparation fees, failed to maintain records justifying those costs, and overcharged fixed-fee trusts; and
3. Beneficiary stated state-law management fee claims asserting that trustee improperly charged tax-preparation fees, failed to maintain records justifying those costs, and overcharged fixed-fee trusts.

A Narrow Exception to Prevent State Class Actions

The Ninth Circuit held:

- "The Supreme Court twice has spoken about SLUSA and its "in connection with" requirement. In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 126 S.Ct. 1503, 164 L.Ed.2d 179 (2006), the Court stressed that the 'in connection with' requirement should be interpreted broadly, as '[a] narrow reading of the statute would undercut the effectiveness of the [PSLRA] and thus run contrary to SLUSA's stated purpose,' which is to prevent state-law class actions from end-running the PSLRA. *Id*. at 86, 126 S.Ct. 1503. The Court explained that 'it is enough that the fraud alleged "coincide" with a securities transaction — whether by the plaintiff or by someone else' — to meet the 'in connection with' requirement. *Id*. at 85, 126 S.Ct. 1503." 929 F.3d at 1050.

Narrow Exception! Broad Interpretation

- *Troice* dealt with an unusual case where the plaintiffs purchased certificate of deposit, which were not securities, but allegedly were backed by securities which were traded on a national exchange:

- *"*The plaintiffs in *Troice* alleged that the defendants induced victims to purchase uncovered securities (certificates of deposit that are not traded on any national exchange) by falsely stating that covered securities (securities traded on a national exchange) backed the uncovered securities. *Id*. at 380, 134 S.Ct. 1058. The Court held that SLUSA did not preclude the claims because the statute required 'misrepresentations that are material to the purchase or sale of a covered security.' *Id.* at 387, 134 S.Ct. 1058. In discussing materiality, the Court addressed the 'in connection with' requirement, which demands 'a connection ... where the misrepresentation makes a significant difference to someone's decision to purchase or to sell a covered security.' *Id.* at 387, 134 S.Ct. 1058 (citing *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 36–40, 131 S.Ct. 1309, 179 L.Ed.2d 398 (2011) (stating that a misrepresentation or omission is 'material' if a reasonable investor would have considered the information significant when contemplating a statutorily relevant investment decision))." *Id.* At 1051.

Narrow Exception! Broad Interpretation

The 9th Circuit dealt with a trustee of trusts which the plaintiffs were income or remainder beneficiaries. The Court cited the holding in *Troice* as follows:

- "The Court also held that, under SLUSA, '[a] fraudulent misrepresentation or omission is not made "in connection with" ... a "purchase or sale of a covered security"' unless that fraudulent conduct 'is material to a decision by one or more individuals (*other than the fraudster*) to buy or sell a "covered security." ' *Id*. at 387, 134 S.Ct. 1058 (emphasis added). The Court stressed that 'the '"someone" making that decision to purchase or sell must be a party other than the fraudster.' *Id*. at 388, 134 S.Ct. 1058. 'If the only party who decides to buy or sell a covered security as a result of a lie is the liar, that is not a "connection" that matters.' *Id.*"

This Decision Opens the Possibility of Excluding All Trust Transactions from SLUSA

- Here we are dealing with proprietary mutual funds purchased by the trustees for trusts in which the potential plaintiffs are the beneficiaries.

- The beneficiaries rely on the terms of the trust and the duties of loyalty and prudence imposed on the trustees by State statutes, in this case the UPIA in California. Their reliance is part of the basic structure of these trusts.

- Here the 9th Circuit says that there was no reliance whatsoever, since the alleged "fraudster" was the trustee. To say that the trustee acted only for itself in purchasing shares of the proprietary mutual funds or paying expenses for tax preparation for the trust is nonsense.

- The fact that Banks was a beneficiary of an irrevocable trust makes no difference to the beneficiary's reliance on the investment decisions of the trustee, which could be challenged for imprudence of self dealing in the probate court, or in an action removed by a bank to federal court based on diversity.

This Decision Opens the Possibility of Excluding All Trust Transactions from SLUSA

Despite citation to post-*Troice class action claims* finding SLUSA preclusion, the Court hewed to its reliance on the fraudster exception and applied it to Northern:

- "Northern would like us to read *Dabit* without considering its clarification in *Troice*. But we will not render *Troice* meaningless the way that *Game of Thrones* rendered the entire Night King storyline meaningless in its final season. *Troice* directly supports our conclusion that a trustee's misconduct — over which a beneficiary of an irrevocable trust has no control — cannot constitute misconduct 'in connection with' the sale of covered securities where 'the only party who decides to buy or sell a covered security as a result of a lie is the [trustee].' *Troice*, 571 U.S. at 388, 134 S.Ct. 1058."

- Here the Court is attempting to render the whole structure of trustee duties in investment decisions meaningless by ignoring the real power of beneficiaries in irrevocable trusts to control the trustee actions after the fact by surcharge or removal, or before the actions or practices continue, by seeking equitable relief for breaches of prudence or disloyalty in the future.

Other Claims for Excessive Fees and Elder Abuse Held to be Plausibly Alleged

- The trial court had dismissed all claims on SLUSA grounds which the appellate court reversed. It then looked to the motion to dismiss below, to consider plausibility and other defenses for the trial court to consider on remand.
- Northern also attacked the claims of excessive fees and elder abuse claims against Northern Trust Corporation (the parent company) as being conclusory and lacking substance.
- "The FAC also alleged that the $900 tax-preparation fee was previously part of the regular trust administration fee but subsequently became a separate cost, without approval by a probate court. The FAC alleged that, '[a]s time has progressed, and despite the benefits of computerization and technology capabilities at Northern Trust, the fees charged have increased' without explanation. The FAC also asserted that Northern did not provide any information about when, how, or why it began charging tax-preparation fees. The FAC contended these combined allegations amounted to breach-of-trust violations: '[t]his uniform practice of charging excessive and improper fees violates the duties of loyalty and prudent administration by placing [Northern's] own financial interest above the interest of Plaintiffs and members of the proposed Tax Preparation Class.'
- "These detailed allegations meet *Twombly*'s plausibility requirement and amount to more than conclusory labels." *id.* at 1056.

Other Claims for Excessive Fees and Elder Abuse Held to be Plausibly Alleged

Here the 9th Circuit articulated the fiduciary duties making the trustee liable to claims of breach (while claiming the trustee was acting only for itself):

- "A trustee must administer a trust according to its instrument and the laws of trusts, *see* Cal. Prob. Code § 16001, and may only incur appropriate and reasonable costs. *See* Cal. Prob. Code § 16050. Trustees are under a continuing duty to account for dealings with trust property and to provide those accountings to the beneficiaries on demand. *See In re Estate of De Laveaga*, 50 Cal.2d 480, 326 P.2d 129, 133 (1958); *see also* Cal. Prob. Code § 16062. A trustee's violation of its duty is a breach of trust. *See* Cal. Prob. Code § 16400."*Id.*

District Court Summary Judgment

- The District Court granted summary judgment on alleged breach of fiduciary duty regarding use of proprietary index funds, finding that their performance closely tracked their benchmarks. It found that """the existence of a cheaper fund does not mean that a particular fund is too expensive in the market generally or that it is otherwise an imprudent choice." *Meiners v. Wells Fargo & Co.*, 898 F.3d 820, 823–24 (8th Cir. 2018). In fact, "fiduciaries are required to consider factors beyond price when choosing investment options." *Patterson v. Capital Grp. Cos., Inc.*, 2018 WL 748104, at *5 (C.D. Cal. Jan. 23, 2018); *White v. Chevron Corp.*, 2016 WL 4502808, at *9 (N.D. Cal. Aug. 29, 2016) ("Fiduciaries have latitude to value investment features other than price (and indeed, are required to do so)"). *Banks v. Northern Trust Corp.* ---F. Supp.3d___ (C.D. Cal.), 2020 WL 1062144 at *6.

Tax Preparation Fees

- The Court found that the trust documents provided for a 60 basis point fee plus "a fee provision for 'reasonable compensation' for extraordinary services.'" 2020 WL 1062144 at *7.

- Other claims were dismissed in the absence of any finding of a breach of fiduciary duty.

- The beneficiaries had received annual statements under California law with notice to bring claims within three years of such accountings. The Court held that claims prior to 2012 were barred by the statute of limitations. The elder abuse claim was dismissed for failure to bring a claim within its 4-year statute of limitations. 2020 WL 1062144 at *8-9.

ERISA Winners and Losers

- *Allen v. Wells Fargo* (2020) 907 F.3d 767. Failure to plausibly allege that the plan fiduciaries chose not to disclose company's unethical sales practices so as not to jeopardize their own breaches of duty. With dismissal of the basic breach of duties, claims of failure to monitor and breach of loyalty fell as well.
- *Tobias v. Nvidia Corp* (9/13/2021 N.D. Cal.) 2021 WL 4148706. This case involved claims that Fidelity utilized proprietary mutual funds with higher costs and low performance. Detailed discussion of multiple causes of action, leading to dismissal of several, but with right to amend. A harbinger of other cases to come from STEM State courts.
- *In re Linked In ERISA Litigation* (11/16/2021 N.D.CA) 20221 WL 5331448. Another Fidelity case, where allegations of break of the duty of loyalty support breach of prudence from alleged excessive management fees. Leave to amend class action complaint.
- Reetz v. Lowe's Companies, Inc. (10/12/2021 W.D. N.C.) 2021 WL 4771535. This ERISA class action case was settled, and here the Court approves the settlement and submits findings of fact involving investment manager Aon and allegation that it had allegedly breached its fiduciary duty by seeking to have Lowe's change the Plan's investment structure and menu of investment options not did it violate ERISA in efforts to "cross-sell" its delegated fiduciary services. The Court ruled in favor of Aon, but affirmed other claims against Lowe's and its investment committee. Detailed examination of current case law across the country.
- *Turner v. Schneider Electric Holdings, Inc.* (2021 D. Mass.) 530 F.3d 127. Another STEM State decision with detailed discussion of pleadings plausibly alleging claims dealing with selecting or monitoring investment funds and breaches of duties of loyalty and prudence.

Elder Abuse Claims!

- California has a detailed elder abuse statute, carrying with it an attorney's fee provision for a successful plaintiff (but no reciprocal right to recover such fees for a successful defendant). *See* D. Campisi and E. Winet, Elder Abuse Liability, The Practical Lawyer, April 2019, at 22 *et seq*.

- The use of State elder abuse statutes to attack trust companies and other trustees opens a new area of risk.

- We will discuss general undue influence claims next:

Elder Abuse Claims!

The 9th Circuit in *Banks* denied dismissal of the elder abuse claims in remanding the case to the District Court:

> "Finally, Northern argues that Banks' opening brief did not address the district court's dismissal of the elder abuse claims and the claims against NT Corp., Northern's corporate parent. Banks responds that the district court dismissed all those claims based solely on SLUSA preclusion, which is why its opening brief focused on the inapplicability of SLUSA preclusion. Further, Banks' opening brief argued the district court erred by summarily dismissing the complaint because it should have considered the FAC on a claim-by-claim basis. *See Proctor v. Vishay Intertech., Inc.*, 584 F.3d 1208, 1228 (9th Cir. 2009) (holding that 'SLUSA does not require the dismissal of all non-precluded claims appearing in the same complaint as a precluded claim'). As SLUSA does not preclude the elder abuse claims or the claims against NT Corp., and because the briefing provides no other basis for dismissal, we also reverse the dismissal of those claims." *Id.*

A Plague of Undue Influence and Elder Abuse

- The Comptroller of the Currency in March of 2015 explained the various reporting requirements of banking institutions:
- First, banks must file Suspicious Activity Reports, or SARs, with the Treasury Department's Financial Crimes Enforcement Network if they identify suspicious activity meeting the SAR reporting thresholds.... Indeed, in 2011, the Financial Crimes Enforcement network, also known as FinCEN, issued guidance instructing financial institutions to file SARs when they suspect that older customers are being subjected to financial elder abuse.... [B]etween March 2012 and the end of 2014, depository institutions filed over 27,000 SARs involving suspected elder financial exploitation.
- Remarks by Thomas J. Curry before the National Community Reinvestment Coalition, March 2015 at 3-4.
- In June of 2018, the SEC issued a report analyzing the extent of financial exploitation of the elderly demonstrating the pervasiveness of reported acts of financial elder abuse: Stephen Deane, Elder Financial Exploitation Why it is a concern, what regulators are doing about it, and looking ahead. June 2018 (SEC Office of the Investor Advocate).
- The IRS now provides a listing of State elder abuse and financial protection statutes. See https://www.justice.gov/elderjustice/prosecutors/statutes.

Recent Cases Involving Elder Abuse and Undue Influence

Parson v. Miller (VA, 2018), 822 S.E. 2d 169. The Supreme Court of Virginia dealt with a jury verdict finding undue influence in the creation of a will which left decedent's house and assets to a niece who had spent substantial time caring for her aunt. The Supreme Court held that the trial court had erred in stating the burdens imposed on the contestant and defendant, holding that the trial court should have directed a verdict in favor of the defendant at the close of evidence. The Supreme Court reversed the trial court decision, finding that the trial court had misapplied the presumption of undue influence and its application in this case.

Recent Cases Involving Elder Abuse and Undue Influence

- The Texas Court of Appeals in *Estate of Russey* (2/28/2019), not reported in S.W. Rptr. 2019 WL 968421 affirmed the order of the Court after a bench trial denying admission of a will and granting an application for independent administration of the estate. 2019 WL 968421 at *2.

- The elements to establish undue influence in Texas follow the common law of most States: "Undue influence implies the existence of a testamentary capacity subjected to and controlled by a dominant influence or power. *Rothermel v. Duncan*, 369 S.W.2d 917, 922 (Tex. 1963). To establish undue influence, a contestant must show the following: (1) the existence and exertion of an influence; (2) the effective operation of such influence so as to subvert or overpower the mind of the testator at the time of the execution of the testament; and (3) the *Id.* Influence is not undue unless the free agency of the test execution of a testament which the maker thereof would not have executed but for such influenster was destroyed, and a testament produced that expresses the will of the one exerting the influence. *Id.*

Recent Cases Involving Elder Abuse and Undue Influence - *Estate of Russey*

- The Texas Supreme Court has set forth a ten -factor list (which is nonexclusive!) for the consideration of the trier of fact:

  "(1) the nature and type of relationship existing between the testator, the contestants, and the party accused of exerting such influence;
  (2) the opportunities existing for the exertion of the type or deception possessed or employed;
  (3) the circumstances surrounding the drafting and execution of the testament;
  (4) the existence of a fraudulent motive;
  (5) whether there had been a habitual subjection of the testator to the control of another;
  (6) the state of the testator's mind at the time of the execution of the testament;
  (7) the testator's mental or physical incapacity to resist or the susceptibility of the testator's mind to the type and extent of the influence exerted;
  (8) words and acts of the testator;
  (9) weakness of mind and body of the testator, whether produced by infirmities of age or by disease or otherwise; and
  (10) whether the testament executed is unnatural in its terms of disposition of property."

Natural Law for Succession of Property in Texas

- Texas triers of fact can look at an untrammeled range of natural affection as a baseline status for a testator: "The philosophy of law allows untrammeled range for natural affection. *Craycroft v. Crawford*, 285 S.W. 275, 278 (Tex. Comm'n App. 1926, holding approved; judgment adopted). One of the main objects of the acquisition of property by the parent is to give it to his child; and that child in turn will give it to his, in this way the debt of gratitude we owe to our parent is paid to our children. *Id.* Thereby, each generation pays what it owes to the preceding one by payment to the succeeding one. *Id.* This seems to be the natural law for the transmission of property. *Id.* Any departure from that course, though it may not be uncommon or unusual, is unnatural. *See Morse v. Morse*, 279 S.W. 806, 807 (Tex. Comm'n App. 1926, holding approved).

Undue Influence: Lowest Class of Sound Mind to Marry?

- *Matter of Hua Wang* (*Berk)* (NY Surr. June 27, 2018) 2018 WL 319410060 Misc. 3d 1207(a), (Sur, N.Y.) Caregiver for 99-year-old sought to obtain elective share following death of her client based on a concealed wedding. After a 37-day trial (lots of money), the surrogate rejected the claim of the caregiver for an elective share of the decedent's estate as his wife. The Court held that the standard of capacity for marriage "is whether the person was able to understand the nature, effect and consequences of the marriage (*Leving v. Dumbra*, 198 AD2d477….Marriage is a civil contract, to which the consent of the parties capable in law of making a contract is essential." *Id.* at *1. The Court concluded found "a plethora of credible evidence presented that decedent suffered from diminished mental capacity that rendered him incapable of understanding the nature, effect and consequences of the marriage to petitioner or consenting to the marriage." *Id.*at *2.

The Court held that:

> Once it is shown that a confidential relationship existed between petitioner and decedent, an inference of undue influence arises which requires the beneficiary to come forward with an explanation of the circumstances of the transaction (*Bazigos v. Krukar*, 140 AD3d 811 [2d Dept. 2016]). Petitioner's allegations regarding the romantic and loving relationship that developed between decedent and petitioner were insufficient to convince this court.

Id. at *3.

Trustee Has Standing to Enforce Undue Influence Claim

- The United States District Court for the Middle District of Alabama allowed a family Foundation to enforce undue influence claims against a holder of a power of attorney for the widow. *Robert N. Brewer Family Foundation v. Huggins* (M.D. Ala, 2019)___F. Supp.3d___ 2019 WL 6873655. The Foundation was a contingent remainder person of the widow's estate and was held to have standing to sue the individual trustee of the decedent's and the widow's estates.

- As in many recent cases, this case involves the law of multiple States—here the trusts were governed by Florida law, the Court in Alabama obtained jurisdiction when the widow moved to Alabama and then to an assisted living facility in that State.

De Facto Trustee Under Florida Law

- "Plaintiff cites Florida precedent holding that "every man is a trustee whose business is to advise concerning or to operate the business of another," *Quinn v. Phipps*, 93 Fla. 805, 823, 113 So. 419, 425 (1927), and "a fiduciary relation [is] implied in law when 'confidence is reposed in one party and a trust accepted by the other.' " *Capital Bank v. MVB, Inc.*, 644 So. 2d 515, 518 (Fla. Dist. Ct. App. 1994) (internal citation omitted). While laudable sentiments, neither holding occurs within the context of trusts and estates law.

- However, there is one published case from Florida that does support Plaintiff's proposition. The concept of a "de-facto trustee" was articulated by the Third District Florida Court of Appeal in *Brigham v. Brigham*, 11 So. 3d 374, 387 (Fla. Dist. Ct. App. 2009). The case includes a set of facts eerily like those at bar: a wealthy widow died with an estate that would have been worth $3 million if not for the financial malfeasance of her daughter-in-law, who managed the widow's accounts and received hundreds of thousands of dollars from the estate. This daughter-in-law did not wield the power of attorney but due to her involvement in the financial management of the estate, she was deemed a de facto trustee of the widow's revocable trust and further found to owe corresponding duties to the settlor. *See id.*

De Facto Trustee Under Florida Law

- Under Florida law, the complaint sufficiently states a claim that Rex Huggins was the de facto Trustee of Christine's trust. Not only did he have complete control over her assets, but he regularly drew on them, spending hundreds of thousands of dollars. For the last two years of her life, every aspect of Christine's existence was under the control of Rex Huggins. The facts as alleged in the complaint are that Christine was hallucinating, talking to dead people, and couldn't remember who anyone was. Due to the general sentiments of the Florida Supreme Court in *Quinn* and the more specific holding of the Third District in *Brigham*, this Court concludes that, as a matter of Florida law, the complaint sufficiently states a claim that Rex was the de facto Trustee of the Christine Brewer Revocable Trust and possessed duties commensurate with that position. 2019 WL 6873655 at *4.
- The Court then held that a vested contingent remainder person can sue to enforce the trust after the interest has vested. *Brundage v. Bank of America,* 996 So. 2d 877 (Fla. Dist. Ct.App. 2008) Since no Florida court had considered whether a contingent beneficiary obtained standing after the interest vested, the District Court considered decisions in multiple other States to conclude that such standing existed. 2019 WL 6873655 at *5
- The Court then concluded that the Foundation has plausibly alleged embezzlement and other breaches entitling it to relief. 2019 WL 6873655 at *6.
- The Court denied the defendants' motion to dismiss.

Uniform Fiduciary Act Defense

- The District Court in Nevada ruled in favor of the bank with respect to claims that it was responsible for embezzlements from an account held at the bank in *Dunham Trust Co. v. Wells Fargo Bank, N.A.*, ___F. Supp 3d___ (D. Nev. 2019) 2019 WL 5684172 (10/31/2019).
- “In states like Nevada that have adopted the UFA, the scope of a bank's liability to a trust is governed under the UFA's provisions, not common law principles. *Guild v. First Nat. Bank of Nevada*, 553 P.2d 955, 957 (Nev. 1976). A bank will only be held liable if ‘if it receives the deposit or pays the check by the fiduciary with [1] actual knowledge that the fiduciary is committing a breach of his obligation in making such deposit or in drawing such check or [2] with knowledge of such facts that the Bank's action in receiving the deposit or paying the check amounts to bad faith.’ *Id.* This means that to survive a motion to dismiss, the plaintiff must show that the bank had actual knowledge that the trustee was violating a fiduciary duty or that there were facts known to the bank such that it would be bad faith for the bank not to investigate the trustee's conduct. While the UFA does not define ‘bad faith,’ it does define ‘good faith,’ which is an act ‘done honestly, whether it be done negligently or not.’ NRS 162.020(2). In *Guild*, the Nevada Supreme Court interpreted ‘bad faith’ as requiring ‘purposeful or motivated conduct’ rather than a ‘lack of due care [or] negligence.’ *Guild*, 553 P.2d at 958. Simply alleging facts indicating that a bank behaved negligently or carelessly when conducting business with a trustee is insufficient to advance a claim under the UFA.” In states like Nevada that have adopted the UFA, the scope of a bank's liability to a trust is governed under the UFA's provisions, not common law principles. *Guild v. First Nat. Bank of Nevada*, 553 P.2d 955, 957 (Nev. 1976). A bank will only be held liable if “if it receives the deposit or pays the check by the fiduciary with [1] actual knowledge that the fiduciary is committing a breach of his obligation in making such deposit or in drawing such check or [2] with knowledge of such facts that the Bank's action in receiving the deposit or paying the check amounts to bad faith.” *Id.*

Regulation J and Fla. Statute §674.401

- *Rodriquez v. BB&T Co. (2021 S.D. Fla.) 529 F. Supp. 3d 1309*
- *This case involves defenses to breach of contract claims that BBT breached its duties when various account assets were removed by third parties using wire transfers totaling $861,000. The trial court ruled on summary judgment brought by BBT. The defenses were based on Article 4A of the UCC and allegedly commercially reasonable security procedures. It also argued that Regulation J applied to most of the transactions. There were open disputes about which agreements were entered at various times and whether the BBT had proper documentation as to the application of agreements. The trial court denied the summary judgment as to Count II of the Fourth Amended Complaint. Appeal has been taken to the 11th Circuit.*

Great attention must be given to documenting when bank agreements are presented and executed in order to avoid litigation like this.

Pay on Death Account dispute

- *Hillier v. Fifth Third Bank* (2020, Ct.App. Ohio) 154 N.E. 1266 dealt with claims by the executor that the bank breached its contractual duties by delivering funds from a POD account to a beneficiary rather than to the estate. On appeal, the court ruled that the bank could be held liable for break of contract, that the bank was liable for conversion claim, but that the Bank was not liable for bad faith or negligence claims. Detailed discussion of issues is worth reviewing.

No Contest Clauses Must be Considered

- If a will or trust contains a no contest or *in terrorem* clause, care must be taken to avoid triggering the penalty involved. At the same time, the trust company must take advantage of such clauses when it is prudent to do so in order to protect the other beneficiaries of the trust who would have been injured had the party prevailed.
- The Supreme Court of Wyoming dealt with this issue in *Gowdy v. Cook* (Wy. 2020) 455 P. 3d 1201. There beneficiaries sued attorneys who drafted the trust and subsequently served as the trustee and trust protector under the terms of the trust.
- Wyoming is one of the States seeking to become Delaware Doppelgängers by creating favorable tax regimes and offering no state income taxes, self-settled spendthrift trusts, dynasty trusts, silent trustees, and the waiver of multiple fiduciary duties for those whose seek to enforce their whims after death on their beneficiaries for hundreds of years.
- The trial court rejected the claims of the beneficiary and the supreme court upheld the denial as well as affirming the enforceability of no contest clauses in Wyoming.

No Contest Clauses Must be Considered

The Supreme Court in *Gowdy v. Cook* (Wy. 2020) 455 P. 3d 1201, 1210, held:

- Dennis, in his capacity as trustee, counterclaimed for enforcement of the no-contest provision when Mr. Gowdy requested that the district court enter a decanted trust removing the requirement that a corporate trustee have assets or insurance coverage of at least one hundred million dollars. Dennis asserted Mr. Gowdy's proposed change was an attempt to void, nullify or set aside a provision of the trust. The district court agreed and ruled Mr. Gowdy had forfeited his interest under the trust.
- No-contest or *in terrorem* clauses are valid in Wyoming. *See, e.g., EGW v. First Federal Savings Bank of Sheridan,* 2018 WY 25, ¶ 18, 413 P.3d 106, 110 (Wyo. 2018); *Dainton v. Watson*, 658 P.2d 79, 81 (Wyo. 1983). The intent of the settlor regarding contests to the trust is controlling. *EWG,* ¶ 19, 413 P.3d at 111. Therefore, to resolve this issue, we must interpret the no-contest provision of Ms. Jackson's trust. Interpretation of a trust agreement is a matter of law, which we review *de novo*. *Shriners Hospitals for Children v. First Northern Bank of Wyoming,* 2016 WY 51, ¶ 40, 373 P.3d 392, 405-06 (Wyo. 2016) (citing *Forbes v. Forbes,* 2015 WY 13, ¶ 23, 341 P.3d 1041, 1051 (Wyo. 2015)).
- The meaning of a trust is determined by the same rules that govern the interpretation of contracts. In interpreting a trust, our primary purpose is to determine the intent of the settlor. *Wells Fargo Bank Wyoming, N.A. v. Hodder,* 2006 WY 128, ¶ 21, 144 P.3d 401, 409 (Wyo.2006); *First Nat'l Bank & Trust Co. v. Brimmer,* 504 P.2d 1367, 1369 (Wyo.1973). We construe the trust instrument as a whole, attempting to avoid a construction which renders a provision meaningless. *Id.* "We strive to reconcile by reasonable interpretation any provisions which apparently conflict before adopting a construction which would nullify any provision." *Wells Fargo,* ¶ 21, 144 P.3d at 409. *See also, Purcella v. Purcella,* 2011 WY 124, ¶ 14, 258 P.3d 730, 734–35 (Wyo.2011). *Id.* (quoting *Evans v. Moyer,* 2012 WY 111, ¶ 21, 282 P.3d 1203, 1210 (Wyo. 2012)).

455 P. 3d at 1210.

EGW v. First Federal Savings Bank of Sheridan, (Wy 2018) 413 P. 3d 106

- The Supreme court of Wyoming confirms that (a) in terrorem clauses are enforceable, (b) that good faith and probable cause under UPC §3-905 are not defenses to disinheritance, and (c) that a will provision which disinherits the minor children of an unsuccessful contestant is enforceable and not against public policy.
- In *EGW*, the son of the settlor challenged changes to the trust made in favor of his stepmother and her children during the settlor's lifetime. The son had also later filed a breach of contract claim and undue influence claim against the widow. The trial court granted summary judgment on the contract claim and a jury then rejected the undue influence claim. First Federal served as the successor trustee. The son, acting as 'next friend' of his minor children, sought a declaratory judgment that the in terrorem clause did not apply to his minor children and sought removal of First Federal and damages for alleged breaches of duty to the minors.
- The Supreme Court rejected the claim. Since the son had been disinherited, he could not have had standing for his contest and hence there could be no legal basis for applying the in terrorem clause. Since the claim had been submitted and tried to the jury, there was in fact standing and hence a triggering event.
- There is a clear message here for people who want no interference with their estate plans: come to Wyoming.

EGW v. First Federal Savings Bank of Sheridan, (Wy 2018) 413 P. 3d 106

- The Court cited several Wyoming cases, including *In re Nelson's Estate* (Wyo. 1954) 266 P. 2d 238, 246:

> In this country a man's prejudices form a part of his liberty. He has a right to them. He may be unjust to his children or relatives. He is entitled to the control of his property while living, and by will to direct its use after his death, subject only to such restrictions as are imposed by law. Where a man has sufficient memory and understanding to make a will, and such instrument is not the result of undue influence, it is not to be set aside without sufficient evidence, nor upon sentimental notions of equality.

- The Court looked to *Dainton v. Watson* (Wyo.1983) 658 P. 2d 79, 82:

> In reaching our decision, we, like the district court, find additional strength for our position from the fact that our legislature has chosen not to incorporate § 3–905 of the Uniform Probate Code into the recently enacted Wyoming Probate Code. Chapter 54, Session Laws of Wyoming, 1980. The Wyoming legislature and the committee that helped draft the new probate code were no doubt aware of the Uniform Probate Code and all of its various provisions; yet they chose not to incorporate § 3–905 or anything like it into our statutes. Appellant urges us now to do what the legislature chose not to do; that is, to judicially implement the provisions of § 3–905 into the body of the probate law in Wyoming. That we will not do.

Multistate Trust Disputes

- Because of the allure of lowered standards and the mobility of upper income persons, one often sees trust companies dealing with trusts disputes where the law of multiple States must be analyzed in order to determine the risks facing the bank in question.

- As seen in *Dunham Trust Co.*, a Nevada court may be determining the risks faced by a Nevada sited entity but a trust governed by Florida law which was baked into the trust instrument at his creation.
  - *Huggins* demonstrates the difficulty of the task of analyzing risk where the Alabama court can find no Florida law and must survey cases in multiple jurisdictions to get some sense of the "common law" in an arid legal terrain.
  - Decanting a trust to change the applicable State law governing a trust can simplify some of these problems, but there is litigation over the decanting process from beneficiaries who prefer their ancestor's original legal environment.

Florida Trust, South Carolina situs, South Dakota Law Governing the Estate Planning LLC

- *Wellin v. Wellin*, 430 F. Supp.3d 84 (D.S. C. 2019) dealt with a trust created in Florida and governed by Florida law. Taxes and weather were major considerations for a classmate of Warren Buffett who purchase Berkshire stock at $12 a share. This decision granted summary judgment for the defendants, putting an end to this complex mess.
- As in other cases we have reviewed today, medical necessity sent the settlor and wife to South Carolina for medical care and ultimately for a change of residence.
- The estate plan involved creation of a South Dakota pass through entity to hold Berkshire shares, with the entity owned by children from a prior marriage. The goal was to hold the BRK until its value could be stepped up at death, in order to avoid staggering capital gains taxes. The settlor retained other BRK shares and borrowed money to pay for living expenses due to a typical aversion to paying any taxes, but high expenditures from the "wealth effect" of having estate planning entities with hundreds of millions of dollars of low basis securities—but no easy liquidity.
- When the settlor requested a distribution from the LLC to pay taxes arising from large gifts to the three children, the disputes began. The settlor attempted to swap his entity interests for underlying BRK, resulting in a sale of the entity stock with large capital gains resulting.
- This was the super bowl of trust litigation. There are managers of the pass through entity, executors, trustees, trust protectors and a charitable beneficiary which is the settlor's alma mater, as well as a surviving spouse.

- The Court held:

“All parties agree that the 2013–14 amendments are governed by Florida law because of the 2001 Revocable Trust’s governing law provision. ECF No. 472-1 at 5; ECF No. 491 at 3; ECF No. 492 at 8. ‘A federal court exercising diversity jurisdiction is obliged to apply the substantive law of the state in which it sits, including the state’s choice-of-law rules.’ Volvo Constr. Equip. N. Am., Inc. v. CLM Equip. Co., Inc., 386 F.3d 581, 599–600 (4th Cir. 2004) (citing Erie R.R. Co. v. Tompkins, 304 U.S. 64, 79 (1938)). Under South Carolina choice of law rules, ‘if the parties to a contract specify the law under which the contract shall be governed, the court will honor this choice of law.’ Russell v. Wachovia Bank, N.A., 578 S.E.2d 329, 336 (S.C. 2003). Because the validity of the 2013–14 amendments must be determined by the court performing an interpretation of the 2001 Revocable Trust agreement and all parties agree such an interpretation falls within the scope of the 2001 Revocable Trust’s governing law provision, the court shall perform its analysis under Florida law.” 2019 WL 6909571 at *2.

Substantial Compliance with Amendment Provisions

- "According to Florida law, 'the settlor may revoke or amend a revocable trust ... by substantial compliance with a method provided in the terms of the trust.' Fla. Stat. Ann. § 736.0602(3)(a). All parties concede that the 2001 Revocable Trust has a provision that provides the method for making an amendment to it ("Amendment provision") and that the Amendment provision is not ambiguous. ECF No. 491 at 12; ECF No. 492 at 10, ECF 500 at 5. The court agrees that the Amendment provision is unambiguous, and therefore, the interpretation of the Amendment provision is a matter of law to be resolved by the court." 2019 WL 6909571 at *3.

Could the Nominated Successor Require Delivery of Amendment Executed Prior to Settlor's Death?

- The Court held that the amendment provision was unambiguous and hence went through a detailed analysis of each provision to determine whether the amendment had been timely delivered to the son named as the successor:

"The court must now determine if Keith [settlor] substantially complied with the method for executing an amendment in the 2013–14 amendments. The Estate and Hamilton College argue that the 2001 Revocable Trust never actually defined Peter [son] as the Successor Trustee, only that he should become the Trustee in the event Keith ceased being Trustee or upon Keith's death, and therefore was not entitled to delivery of the 2013–14 amendments. ECF No. 518 at 2; ECF No. 524 at 2. The Wellin children contend that Peter was the successor Trustee and therefore was entitled to the delivery of the 2013–14 amendments for the 2013–14 amendments to be executed. ECF No. 472-1 at 2." 2019 WL 6909571 at *5.

Substantial Compliance by Settlor

- "The Wellin children argue that failure to deliver the 2013–14 amendments to Peter, as successor Trustee, until after Keith's death, the 2013–14 amendments are not valid. ECF No. 472-1 at 7. The Estate and Hamilton College argue that there is no time requirement for when such delivery must be made, and that because delivery was eventually made, the 2013-14 amendments were in 'substantial compliance' with the Amendment provision. ECF No. 491 at 15; ECF No. 492 at 14 n.5. The Wellin children concede that Florida law has not addressed whether delivery after the death of the sole settlor can be in 'substantial compliance' with an amendment provision of a trust. ECF No. 472-1 at 7. 'Substantial compliance is "that performance of a contract which, while not full performance, is so nearly equivalent to what was bargained for that it would be unreasonable to deny the [party] the [benefit]."' Ortiz v. PNC Bank, Nat. Ass'n, 188 So. 3d 923, 925 (Fla. Dist. Ct. App. 2016) (quoting Casa Linda Tile & Marble Installers, Inc. v. Highlands Place 1981, Ltd., 642 So.2d 766, 768 (Fla. Dist. Ct. App. 1994))." 2019 WL 6909571 at *5.

The Court Denies Summary Judgment Allowing the Widow, the Alma Mater and the Host of Fiduciaries to Deal with Potential Remedies

- "Furthermore, throughout the 2001 Revocable Trust there are actions that must occur during Keith's lifetime and other actions that must occur upon Keith's death. ECF 472-4 at 3–14, 16. Therefore, the court finds that the general dispositional scheme of the 2001 Revocable Trust is that when it was the settlor's intent for something to be done during Keith's lifetime, upon his death, or within a certain time frame, the 2001 Revocable Trust specifically enumerates such temporal limitations. The Amendment provision does not enumerate a temporal limit on when a delivery to the successor Trustee must be made for an amendment to be valid. Therefore, the court finds it was not the settler's intent to place a temporal limit on when a delivery to the successor Trustee must be made for an amendment to be valid." 2019 WL 6909571 at *6.
- The Court then denied the children's motion for summary judgment. *Id.*
- ***Determining the risk faced with fiduciaries in a Multi-State environment is a difficult task.***

Pre-Need Plan Litigation

- In past years we have discussed cases involving alleged misconduct in the management of funeral trusts in multiple States which are now subject to recent developments. *Ann Howard & Assoc. v. Cassity* (Nov. 20, 2018) ---F. Supp. 3d---, 2018 WL 6067294 on remand from 868 F. 3d 637 (8th Cir. 2017) deals with funeral plans in Missouri sponsored by NPS, which also had affiliates in multiple other States. *Cassity* is a receiver for The National Organization of Life and Health Guaranty Associations and individual state life and health insurance guaranty associations of Arkansas, Illinois, Kansas, Kentucky, Missouri, Oklahoma, and Texas. When an insurance company becomes insolvent, in many States a guaranty entity seeks to recover losses experienced by the association which reimbursed losses suffered by policy holders.

Pre-Need Plan Litigation

- The Court in the current Missouri matter explained: "This litigation began on August 6, 2009, when Plaintiffs filed a complaint against more than forty defendants, including National City Bank, N.A. and PNC Bank N.A ("Defendants"). After a stay was imposed on July 11, 2011, while a corresponding criminal case progressed, the litigation proceeded on August 22, 2013. A jury trial began on February 2, 2015, and concluded in a jury verdict for Plaintiffs for $35,500,000 in compensatory damages and $35,550,000 in punitive damages. Plaintiffs and Defendants appealed the Court's rulings to the Eighth Circuit Court of Appeals, which affirmed, in part, and remanded, in part, the Court's decisions." 2018 WL 6067294 at *1. The current issues on appeal from trial held after remand from the 8th Circuit were whether the plaintiffs' claims arose in tort, rather than under the laws of trust, whether the cases should have been tried to the court, not juries, and whether the district court had properly disallowed various defenses.

Pre-Need Plan Litigation

- The Court on remand explained that "As to the first two arguments, the Eighth Circuit held a claim is for breach of trust whether through negligence or fraud if the duty violated arises from trust law. *Id*. at 645. The Eighth Circuit explicitly stated: "to the extent PNC is liable to [Plaintiffs] for breach of Allegiant's duties under trust law, the appropriate measure of damages is set forth in § 205." *Id*. at 646. It further held Plaintiffs could recover damages for breaches caused by Allegiant from 1998 to 2004. *Id*. Damages beyond that are not recoverable from Defendants as Allegiant's successors. *Id*." *Ibid.*

- The 8th Circuit held that the trial court had properly struck defendants' investment advisor defenses: """'A trustee always has a duty to ensure that trust assets are invested prudently, whether the trustee is investing the assets himself or monitoring the investment decisions of an investment advisor' *Id*. at 647. It further held that the statute recognized this duty by 'providing that 'in no case' where assets are invested imprudently – investment advisor or no – may the trustee be relieved of liability.' *Id*. at 648. Finally, the Eighth Circuit conclude Defendants' are only relieved of liability if Allegiant ensured the investment advisor invested trust assets within the authority of a reasonably prudent trustee. *Id*." 2018 WL 6067294 at *2. In the current proceeding after remand, the trial court dealt with various motions for summary adjudication before commencing a bench trial.

Banks Get Involved

- The original trustee of the funeral trust was Allegiant Bank, which was later succeeded by National City and PNC. **Instead of investing the funds provided by 21,000 preneed policy holders,** [Allegiant] accepted IOU's from the sponsors of the trust, which could not be fully collected after the sponsors became insolvent despite allegedly funneling money from the trust assets to themselves. "While serving as trustee of the NPS Pre-need Trusts, Allegiant accepted and booked a series of "certificates of debenture" from NPS as trust assets. ECF No. 2683, ¶ 51. Allegiant understood that NPS Pre-need Trusts' debentures were 'IOUs' issued to the trusts by NPS acknowledging NPS owed the trusts money. ECF No. 2683, ¶ 52. Allegiant assigned the debentures a total 'market value' of nearly $17 million. ECF No. 2683, ¶ 53.

Banks Get Involved

- "NPS appointed David Wulf of Wulf, Bates & Murphy as the investment advisor for the NPS Pre-need Trusts in approximately 1987. ECF No. 2680, ¶ 11. PNC testified Allegiant 'relied on the investment advisor' 'to ensure the NPS trust assets were being prudently invested.' ECF No. 2680, ¶ 9. Robert Lock, who monitored the administration of Trust II and Trust III, concluded, based on his own review, 'Mr. Wulf was acting in a capacity of basically just carrying out' the "wishes" of NPS and he 'was acting at the direction of NPS. He was not independent.' ECF No. 2680, ¶ 16. National City acknowledged it had 'concerns' regarding the NPS Pre-need Trusts. When the trusts 'walked out the door' that was 'Fine with [National City].' ECF No. 2683, ¶ 68." *Ibid.*

- NPS then started utilizing group term life insurance policies, supposedly to match the actuarial pattern of the funeral need customers. "In April 2000, Allegiant booked a group term life insurance policy as an asset of NPS Pre-need Trust IV. ECF No. 2683, ¶ 29. Allegiant assigned this group term policy a value of $13,522,337.35, and this purported value never changed during Allegiant's period as trustee. ECF No. 2683, ¶ 29.[5] PNC's disclosed expert, Mr. Terry Long, calculated, at the beginning of Allegiant's tenure, the net value of Trust IV was $33,044,987 and the net value of Trust IV decreased over Allegiant's tenure by $64,275,466. ECF No. 2680, ¶¶ 20, 21. *Ibid.*

In No Case May the Trustee Be Relieved of Liability

- In 2008 the various guaranty associations and receiver entered into a plan of liquidation. At the bench trial in *Cassity*, "Plaintiffs' experts have proffered the following opinions on the total damages, not including any interest: Alleged Trust Losses $104,946,853; Alleged Total Merger Gain/Benefit $236,500,000; Foregone Investment Gains $6,806,861. ECF No. 2675, ¶ 51." 2018 WL 6067294 at *5. Based on the 8th Circuit decision, the trial court held that "in no case where assets are invested imprudently – investment advisor or no –may the trustee be relieved of liability." 2018 WL 6067294 at *

- The trial court dealt with the damage remedies set forth in Restatement (Second) of Trusts §205.

Duty to Diversify
Hugler v. Byrnes, (SDNY 2017) 247 F. Supp.3d 223

- SEC action against ERISA trustee for alleged breaches of loyalty, duty of prudence and duty to diversify. The trustee had invested 95% of the assets in the stock of one non-revenue producing, development stage company in which the trustee was an investor. The SEC sought damages of $314,818, a permanent injunction against the trustee serving as an ERISA trustee, and appointment an independent trustee. The Court stated the duty of loyalty as follows:

Generally speaking, the fiduciary must make decisions “with an *eye single* to the interests of the participants and beneficiaries.” *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982) (“*Bierwirth II*”) (citations omitted) (emphasis added). However, “in the ERISA context, ‘a conflict of interest alone is not a per se breach: “nowhere in the statute does ERISA explicitly prohibit a trustee from holding positions of dual loyalties.”’” I*n re State St. Bank & Trust Co. Fixed Income Funds Inv. Litig.*, 842 F.Supp.2d 614, 649 (S.D.N.Y. 2012) (“*State St. Bank & Trust*”) (quoting *Tibble*, 2010 WL 2757153, at *18 (quoting *Friend v. Sanwa Bank of Cal*., 35 F.3d 466, 468–69 (9th Cir. 1994))). “‘Consistent with this rule, a fiduciary does not breach his duty of loyalty by pursuing a course of conduct which serves the interests of the plan’s beneficiaries while at the same time “incidentally benefitting” the plan sponsor or even the fiduciary himself.’” *Id*. (quoting *Tibble*, 2010 WL 2757153, at *18). In short, any benefit to the plan’s fiduciary must be incidental to a decision that is otherwise independently in the best interests of the plan participants. See *id*.” *Hugler v. Byrnes* 247 F. Supp. 3d at 230.

Clarification of Duty

- The Court cited the implementing regulations in defining the duty of prudence:

Further clarifying the prudent person standard, ERISA's implementing regulations require that the fiduciary give "appropriate consideration" to whether an investment "is reasonably designed, as part of the portfolio ... to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment[.]" 29 C.F.R. § 2550.404a–1(b)(2)(i). As this regulation makes clear, "'trustees must investigate proposed investments with regard to risk and return as well as appropriateness in light of the composition and aims of a fund's portfolio.'" *State St. Bank & Trust*, 842 F.Supp.2d at 646 (quoting *Liss v. Smith*, 991 F.Supp. 278, 298 (S.D.N.Y. 1998)). Moreover, "when a fiduciary has dual loyalties, his independent investigation into the basis for an investment decision which presents a potential conflict of interests must be both intensive and scrupulous and must be discharged with the greatest degree of care that could be expected under all the circumstances by reasonable beneficiaries and participants of the plan." *Donovan v. Bierwirth*, 538 F.Supp. 463, 470 (E.D.N.Y. 1981) ("*Bierwirth I*"), *modified*, 680 F.2d 263 (2d Cir. 1982).

No Reasonable Investigation

- In this case, Plaintiff has presented significant evidence indicating that Defendant failed to complete a reasonable investigation prior to investing in Sarissa. First, Defendant invested in Sarissa despite acknowledging its riskiness. *See* Dkt. No. 40–6 at 4; *see* also Dkt. No. 40–2 at ¶¶ 49–50 (Defendant wrote a letter admitting that Sarissa's status as an over-the counter-stock means that "its regulatory requirements are lower than some investors may deem appropriate," which "could be interpreted as a potential grounds for the purchase of Sarissa stock to be imprudent"). Sarissa is traded on the over-the-counter market, which has less regulatory requirements than a listed exchange and does not require extensive disclosures. The Plan's custodian, Wells Fargo, determined that any trading in Sarissa was imprudent and advised Defendant not to invest in the company. Furthermore, in 2011, when Defendant made the investment, Sarissa was a non-revenue producing, development-stage mining project, which showed negative cash-flow, did not hold regular board meetings, did not have a business plan, was a one-man-show run out of an office building where its CEO operated several other companies, had not extracted any niobium, had not completed the geological work to meet regulations, had no mining infrastructure, needed at least $200,000,000.00 in capital to move forward, and whose management advised Defendant to use false information to circumvent regulations. *See* Dkt. No. 40–2 at ¶¶ 27, 31, 33, 34, 36–38, 43, 44.

Hugler v. Byrnes 247 F. Supp. 3d at 232-233.

Burden of Proof of Prudence

- In this case, Defendant invested 95% of the Plan's assets in one company. The Plan's portfolio has no diversity in types of investments or dates of maturity, nor does it have diversity as to industries or geographic distribution. Furthermore, the vast majority of the Plan's assets are restricted securities, and it would be difficult to liquidate them in the event that Plan participants requested their money. In short, the record overwhelmingly supports a finding that Defendant breached his duty to diversify. Defendant's decisions in 2011 and 2012 took a Plan that was invested in various mutual funds to where it is now, invested nearly completely in one, non-revenue producing, development stage mining company.
- Although a fiduciary may avoid liability for failing to diversify if the fiduciary can show that "it is clearly prudent not to" diversify, 29 U.S.C. § 1104(a)(1)(C), Defendant has not made the requisite showing here. *See State St. Bank & Trust*, 842 F.Supp.2d at 652; *Reich v. King*, 861 F.Supp. 379, 384 (D. Md. 1994) (stating that "Defendants' task is 'not merely to prove that the investment is prudent, but that there is no risk of large loss resulting from the non-diversification'" (quoting *Glass/Metal Ass'n*, 507 F.Supp. at 384)). *id*. at 234-235.

Recent ERISA Cases

- There has been a flood of ERISA cases involving retirement plans of colleges and universities dealing with alleged imprudent investments, failure to monitor and negotiate lower prices from mutual fund families, and failure to minimize the record keeping and other expenses of the plans.

- *Karpik v. Huntington Bankshares, Inc.* ___F. Supp.3d___(S.D. Oh.2019), 2019 WL 7482134 involves a case filed by employees of the bank involving its retirement plan. The defendants include the bank, its directors, and the plan investment committee. The goal is to obtain multiple insurance policies to fund settlements (while facing vigorous defenses paid by such policies) and to pit various witnesses against one another. Claims involve proprietary mutual funds and alleged breaches of fiduciary duties, failures to monitor, and engaging in prohibited transactions with a party in interest which is an ERISA fiduciary. The court dealt with a motion to dismiss by defendants which it granted in part and denied in part. This is a typical result where the parties try to weave through the minefield created by Supreme Court decisions regarding plausibility of allegations and factual findings of failures to monitor, failures to seek lower prices for administrative costs, and self-dealing restrictions.

Huntington Issues

- Corporate officers have a conflict with their fiduciary duty of loyalty to beneficiaries: " There is no balancing of interests; ERISA commands undivided loyalty to the plan participants." 2019 WL 7482134 at *4.

- Continuing duty to monitor and negotiate better fees from fund providers, citing *Tibble v. Edison Int., 135 S.Ct. 1823, 2818 (2015). Id.*

- *DOL PTE 77-3 authorizes proprietary funds. Id.*

- Court allows allegations regarding continued underperformance of proprietary funds despite claims they represent hindsight:

- "Plaintiffs have combined their allegation that proprietary funds in the Plan underperformed comparable fund options with the assertion that Huntington kept those funds in the Plan to obtain a higher price when Huntington sold off mutual fund assets. *Id.* at ¶ 82. The allegations, taken as a whole, are sufficient to state a claim of breach of the duty of prudence. *See Wildman v. Am. Century Servs., LLC*, 237 F. Supp. 3d 902, 915 (W.D. Mo. 2017) (allegations that defendants retained underperforming funds because they were motivated by self-interest supported an inference that the plan was managed 'with a flawed decision making process')." 2019 WL 7482134 at *5.

Huntington Issues

- Plaintiffs plausibly allege that fees were excessive and failed to shed those funds because to do so would cost them profits to its affiliates, citing *Velazquez v. Mass. Fin. Servs. Co*,320 F. Supp.3d252,259 (D. Mass. 2018). "Plaintiffs allege in their Amended Complaint that the fees charged by various Huntington funds in the Plan were 58–340% more expensive than average similar funds, *id.* at ¶ 72, which is sufficient to survive a motion to dismiss." 2019 WL 7482134 at *6.
- "Plaintiffs' allegations line up rather well with factual findings in other cases that have found a breach of fiduciary duty based on overpriced recordkeeping services. In *Tussey v. ABB, Inc.*, 746 F.3d 327, 336 (8th Cir. 2014)…." 2019 WL 7482134 at *8.
- Prohibited transaction claims for the proprietary funds were dismissed under PTE 77-3. 2019 WL 7482134 at *10.

Other ERISA Cases

- The Court in *Munro v. USC*, ___F.Supp.3d___ (C.D. CA, 2019) 2019 WL 7842551 (12/20/2019) class certified in one of multiple cases brought against university retirement plans.
- *Karg v. Transamerica Corp, Trustees of the Aegon USA Inc. Profit Sharing Plan*, ___F. Supp. 3d (N.D. Iowa) 2019 WL 3938471 motion to dismiss denied. "Plaintiffs' complaint, however, alleges a violation of defendants' fiduciary duty of prudence under Section 1104(A)(1)(B). (Doc. 10, at 37); *see Wildman v. Am. Century Servs., LLC*, 362 F. Supp. 3d 685, 701-02 (W.D. Mo. 2019) (describing the different requirements of the duties of loyalty and prudence). Regardless of whether an investment is affiliated with the fiduciary, the fiduciary has an 'obligation to act prudently in monitoring the underlying investments.' *Nelsen v. Principal Glob. Inv'rs Tr. Co.*, 362 F. Supp. 3d 627, 641 (S.D. Iowa 2019) (citation omitted). Plaintiffs' complaint alleges that the selection and retention of 'substandard investment portfolios,' constituted imprudent conduct. (Doc. 10, at 2). Plaintiffs' statement that the allegedly substandard portfolios were 'managed by a Transamerica affiliate, Transamerica Asset Management,' is misconstrued by defendants as the basis for the claim, but the discussion of the management relationship is merely descriptive in nature. (*Id.*, at 2); (Doc. 25, at 26). The propriety of Transamerica offering affiliated funds as part of the Plan has no bearing on whether plaintiffs have stated a claim for breach of the duty of prudence." 2019 WL 3938471 at *5.

Other ERISA Cases

- Flawed Decision-Making Process. "In *Meiners*, the Eighth Circuit found that underperformance in comparison to a meaningful benchmark is itself circumstantial evidence of a flawed fiduciary process, not a separate requirement as defendants claim. *See Meiners*, 898 F.3d at 822-23 (holding that a plaintiff must plead "some circumstantial allegations about methods to show that a prudent fiduciary in like circumstances would have acted differently," and finding that a meaningful benchmark can show that a prudent fiduciary would have selected a different fund (citation and quotation marks omitted)). Taking plaintiffs' allegations as true and drawing inferences in favor of the non-moving party, the Court can reasonably infer from the facts alleged that plaintiffs could be entitled to relief on their imprudence claim." 2019 WL 3938471 at *6.

- "A failure to monitor claim under ERISA requires a plaintiff to allege facts that establish that 1) the defendant had a duty to monitor, as demonstrated by a responsibility for appointing and removing, fiduciaries responsible for the conduct in question; and 2) the defendant "had knowledge of or participated in fiduciary breaches by the appointees." *Kreuger*, 2012 WL 5873825, at *18 (quoting *Crocker v. KV Pharm. Co.*, 782 F. Supp. 2d 760, 787 (E.D. Mo. 2010)). Plaintiffs' complaint alleges, and defendants do not dispute, that "Transamerica and Does 1-20 have the authority to appoint and remove members of the Plan Trustees." (Doc. 10, at 40-41); *see also* (Doc. 25). Plaintiffs' complaint also alleges defendants breached their duty to monitor by failing to remove appointees who allowed the Plan to imprudently invest in the challenged funds, satisfying the second element of an ERISA failure to monitor claim. (Doc. 10, at 41); *see also Krueger*, 2012 WL 5873825, at *18 (holding that allegations that monitoring fiduciaries breached their duty by failing to remove appointees who caused the investment plan to suffer losses was sufficient to survive a Rule 12(b)(6) motion)." 2019 WL 3938471 at *9.

Other ERISA Cases

Moitoso v. FMR LLC et al, ___F. Supp. 3d___ (D. Mass.) 2020 WL 1495938

- Claims for alleged breach of fiduciary duty in continuing duty to monitor and use of proprietary funds not barred by settlement terms, where proprietary funds were not part of brokerage window. Surcharge was warranted based on allegations of failure of sponsor and fiduciaries to investigate recordkeeping fees.

Birse v. Centurylink, Inc. ___F. Supp. 3d___ (D. Colo.) 2020 WL 1062902 at *1.

- Summary judgment granted for Centurylink and CIM investment fiduciary for its ERISA plan regarding proprietary fund options, including target date funds. "Although the Fund trailed its benchmark for the majority of its five-year existence, nevertheless, the Fund provided substantial gains for Plan participants. In fact, "[p]articipants who invested in the Fund throughout its...life received an 83% cumulative return" on their initial investment. (*Id*. at 7)."
- "Based on the robust procedures involved in designing the Fund and Mr. Porten's assessment that those procedures were comprehensive and consistent with industry standards, the Court finds that CIM gave " 'appropriate consideration' to whether [the Fund] '[was] reasonably designed, as part of the portfolio...to further the purposes of the [P]lan, taking into consideration the risk of loss and the opportunity for gain...associated with the investment.'" 2020 WL 1062902 at *4.

Denial of Motion to Dismiss

Pinnell v. Teva Pharmaceuticals USA, Inc., ___F. Supp.3d___(E.D. Pa.), 2020 WL 153870 at *1 denied a motion to dismiss based on allegations showing detailed contemporary industry comparables reflecting excessive fees.

- *"*In 2017, twenty-two of the twenty-seven investment options in the Teva Plan cost more than comparable funds; a comparison of their expense ratios highlights excessive fees borne by Plan participants. For example, the T. Rowe Price Retirement 2035, 2040, 2045, 2050, 2055, and 2060 target date funds had expense ratios of .70 percent and .72 percent, notably higher than the category median fee of .56 percent reported by the Investment Company Institute in 2015. The Fidelity Contrafund and the Cohen and Steers Real Estate Securities Z had .82 percent and .79 percent expense ratios respectively, almost three times the .31 percent median for domestic equity funds. The participants also offer comparisons of Plan investment options to similar, lower-cost alternatives in various tables, such as comparing Fidelity Contrafund's expense ratio (.82 percent) with TIAA-CREF Large-Cap Growth Index institutional share class expense ratio (.05 percent), a passively managed fund, and Vanguard U.S. Growth Fund Admiral Shares expense ratio (.28 percent), an actively managed fund."
- "The Teva Plan also charged excessive recordkeeping fees, or fees paid for the administrative services provided to a defined contribution plan by the plan's recordkeeper. The number of participants in a plan dictates the cost of providing recordkeeping services—prudent fiduciaries leverage jumbo plans by negotiating lower per-participant recordkeeping fees. Plan fiduciaries failed to prudently manage and control the Plan's recordkeeping costs, as the per-participant recordkeeping fee was higher than the appropriate amount levied on jumbo plans."

Restatement Third of Torts tortious interference provisions recognized

- *Barclay v. Castruccio* (2020, Md) 230 A.3d 80.
- *The Restatement Third of Torts has finally seen the light of day. In this case the Court of Appeals of Maryland followed section 19 of this Restatement to recognize the tort of tortious interference with a prospective gift or inheritance. If your jurisdiction is waffling over the validity of a tortious interference claim regarding an inheritance, here is support for the efficacy of such a tort, which in many States had been rejected or restricted.*