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***A “pure heart and an empty head” are not enough to  
avoid liability for breach of a fiduciary duty.<sup>1</sup>***

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<sup>1</sup>*Reich v. Valley National Bank of Arizona*, 837 F. Supp. 1259, 1273 (S.D.N.Y. 1993).

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***When Affluent Trust Beneficiaries Ask for Even More — Special Considerations for Trustees of Trusts with High-Maintenance Beneficiaries***

Recent court decisions from Tennessee and Texas illustrate the difficulties facing fiduciaries whose beneficiaries wish to maintain “Tara-like”<sup>1</sup> lifestyles. As you will discover below, information flow and balance were key to the decisions.

**1. *Wherry v. Union Planters Bank, N.A.* (Tennessee Court of Appeals)**<sup>2</sup>

Mrs. Archer, the grantor, funded her living trust in 1964 with \$1.7 million. Archer, named herself as the sole lifetime beneficiary and her estate as the residual beneficiary. The trust allowed her to draw on the corpus, which she did regularly. Over three decades, Archer directed the trustee-bank to distribute thousands of dollars from the trust to her each month. Archer never held a job or provided for herself financially. She employed cooks, maids, butlers, and chauffeurs paid directly from the trust. Archer also directed the bank to make substantial monetary gifts to family members. In all, the trust distributed nearly \$2.3 million at Archer’s direction from 1964-1999. At her death, the trust terminated and was worth about \$880,000.

After her death, Archer’s niece and nephew sued the trustee for more than \$108 million claiming, among other things, that the bank was negligent and failed to properly manage their aunt’s trust.

The court dismissed the case (affirming summary judgment for the bank) based on the doctrine of ratification. In defining this doctrine, the court held that a legally competent beneficiary who has full knowledge of an investment and accepts or approves it, cannot challenge that investment later. Key to the court’s conclusion were these facts: (1) Archer made herself sole beneficiary and retained unfettered power to draw funds from the trust; (2) for three decades she received monthly statements from the trustee describing in detail the trust’s activities; (3) she granted the trustee-bank absolute discretion over the management of the funds; and (4) she never protested any investment decision by the trustee-bank over the 35-year life of the trust.

*Wherry* illustrates that keeping beneficiaries informed not only fulfills independent fiduciary duties, but may also support a defense of ratification in a later suit by disgruntled beneficiaries.

**2. *Keisling v. Landrum* (Texas Court of Appeals)**<sup>3</sup>

Mrs. Keisling married Alfred Keisling three years before Alfred’s death. During those three years, the couple main-

tained two homes and a cabin, owned five vehicles, and traveled extensively. When Alfred died, his entire estate was held in trust for the benefit of Mrs. Keisling and his children from an earlier marriage. Mrs. Keisling was the primary beneficiary of the trust.

The relevant portion of Alfred’s trust stated:

*The primary purpose of [this trust] shall be to provide for the support, maintenance, and health of my wife in the standard of living to which she is accustomed at my death. If my wife’s own income and other financial resources from sources other than from this trust are not sufficient to so maintain her in such standard of living, the Trustee shall distribute, from time to time, as much of the current trust net income, or accumulated trust net income, as shall be necessary to so maintain her. If my wife’s own income and other financial resources, together with distributions of current and accumulated trust net income from this trust, are not sufficient to maintain her in such standard of living, then the Trustee shall distribute as much of the trust corpus as shall be necessary to so maintain her.*

After Alfred’s death, Landrum, the trustee, (a good friend of Alfred and his first wife) refused to make distributions to Mrs. Keisling. The trustee believed that Mrs. Keisling should not receive distributions until she exhausted all of her “other financial resources,” which, to the trustee, meant everything except *one* home and *one* vehicle. Mrs. Keisling filed suit, but the trial court agreed with the trustee, finding the trust language quoted above was ambiguous and that “other financial resources” in the husband’s trust meant income and assets, except for one home and one vehicle. Mrs. Keisling appealed, protesting that she was left with two “illogical choices: either stretch every dollar as far as possible or sell off all of her assets.”

The primary issue on appeal was the meaning of “other financial resources” in the trust. The battle lines were drawn with dueling “experts.” Mrs. Keisling’s expert testified that “income” means compensation and “financial resources” means cash flow from other assets, like social security and pension payments, and annuity contracts. This expert relied on the Restatement (Third) of Trusts (2003), Section 50, which we discuss further in a separate article of this newsletter.

Expert witnesses for the trustee and Alfred’s children included a trust officer, and Alfred’s attorney, who drafted the

<sup>1</sup>*Id.*

<sup>2</sup>*Wherry v. Union Planters Bank, N.A.*, No. W2006-00256-COA-R3-CV, 2007 Tenn. App. LEXIS at \*3 (unpublished opinion).

<sup>3</sup>(2007), 218 S.W.3d 737, *petition for review denied*, 2007 Tex. LEXIS 480 (Tex. June 1, 2007).

very trust at issue. Both stated that Mrs. Keisling must first exhaust her cash, bank accounts, stocks, bonds, and extra homes and vehicles before she would be entitled to trust distributions. The remaining home and car, they argued, did not have to be exhausted because these “provided basic maintenance support.”

On appeal, Mrs. Keisling won. The Texas Court of Appeals concluded that language in the trust unambiguously stated Alfred’s intention to maintain his wife’s high standard of living and the court ordered the trustee to make the distributions. The court found the trial court and trustee’s interpretation of the trust “nonsensical.” It further determined that Alfred did not intend his trust to be a mere “parachute to protect [his wife] from poverty after she had exhausted all of her own assets.” Then, adopting the view in the Restatement (Third) of Trusts, the court, as a matter of law, held that “other financial resources” means “income and other periodic receipts, such as pension or other annuity payments and court-ordered support payments.”<sup>1</sup> But the court was not finished.

The court declared that, even though the trust’s language imposed a duty on the trustee to “distribute the trust’s income and principal to [Mrs. Keisling] to maintain her in the lifestyle to which she is accustomed, we recognize that [a trustee] has a competing responsibility to manage the trust prudently and responsibly to preserve it for [beneficiaries’] future support and maintenance.” That balancing of *current* versus *future* support and maintenance needs is especially difficult when trustees deal with beneficiaries “accustomed to a high standard of living.”

According to the *Keisling* Court, in a case like this, trustees do not have to give into a beneficiary’s “every support and maintenance whim,” but nor should they exercise “unbridled” discretion. Instead, trustees “must act in a manner commensurate with the purposes of the trust” and base their decision on whether to distribute income or principal from a support trust on several factors, such as: (1) the trust estate’s size; (2) the beneficiary’s age, life expectancy, and condition of life; (3) the beneficiary’s present and future needs; (4) the beneficiary’s individual wealth and other resources available to him or her; and (5) the beneficiary’s present and future mental and physical health.

In concluding, the *Keisling* Court said that because the purpose of Alfred’s trust is to “provide for his wife’s high standard of living both now and in the future,” the trustee is required to use “discretion in distributing funds so that the trust is not depleted rapidly and wastefully.” The court’s admonition to the trustee applies to all trustees: when a trust imposes a duty

on the trustee to support beneficiaries presently and in the future, the trustee must exercise prudent discretion and balance the beneficiaries’ *current* support and maintenance needs with the duty to preserve the trust for the beneficiaries’ *future* support and maintenance.

### ***May Banks Rely on Apparently Valid Broad Powers of Attorney? – Case Law and Legislative Reform Update***

As you undoubtedly are aware, by creating a power of attorney a person (the principal) grants another person (the attorney-in-fact or agent) the authority to act on his or her behalf. A power of attorney becomes “durable,” if it allows the agent to act on the principal’s behalf, even if the principal becomes legally incompetent.

#### **1. Risks Involved with Honoring Broad Durable Powers of Attorney**

As some financial institutions have unfortunately discovered, the durable power of attorney (DPOA) has its drawbacks. But these drawbacks are not new. More than a decade ago, two scholars summarized the risks:

Agents can and on occasion do misuse their authority, including outright theft of the principal’s property. . . . Agents can use their granted authority, such as a power to make gifts, in legally defensible, but ethically questionable ways. . . . The problem of misuse . . . seems to be confined to a small percentage of [DPOAs], but when it does occur, it is often quite serious.<sup>2</sup>

It is of little wonder why banks and financial institutions routinely reject validly-executed powers of attorney. Often financial institutions reject these documents in good faith to prevent fraud because suspicious circumstances are present. At some institutions, rejection of powers of attorney is a regular practice, used to avoid all potential liability associated with fraudulent misuse.<sup>3</sup>

#### **2. Must a Bank Honor a Power of Attorney?**

In response to financial institutions’ “arbitrary refusal” to accept powers of attorney, some states have revised their power of attorney statutes.<sup>4</sup>

<sup>1</sup>Rest. 3d. Trusts § 50 cmt. e(2).

<sup>2</sup>Dobris, Sterk, & Leslie, ESTATES AND TRUSTS, 966 (3d. ed. 2007) (quoting English & Wolf, *Survey Results: Use of Durable Powers*, PROBATE & PROPERTY 33 (Jan.-Feb. 1996)).

<sup>3</sup>Healy, *Powerless: The Problem of Maenhoutd and the Much Needed Michigan Uniform Power of Attorney Act*, MICHIGAN PROBATE & ESTATE PLANNING, 26 (Summer 2007).

<sup>4</sup>TAX, ESTATE & FINANCIAL PLANNING FOR THE ELDERLY § 13.03 (2007).]

Alaska<sup>1</sup>, California<sup>2</sup>, Florida<sup>3</sup>, Illinois<sup>4</sup>, Indiana<sup>5</sup>, Minnesota<sup>6</sup>, New York<sup>7</sup>, North Carolina<sup>8</sup>, Pennsylvania<sup>9</sup>, and South Carolina<sup>10</sup> all have statutes that require financial institutions to accept valid powers of attorney (meaning executed in conformity with the laws of the jurisdiction) and impose a variety of penalties and liabilities for failure to do so. At least one state court has concluded that, even when there is no statute requiring acceptance of a power of attorney, it is still unlawful to dishonor a valid power of attorney as an “unqualified” matter of routine practice.

In the Kansas case *Maenhoudt v. Stanley Bank*<sup>11</sup>, a 90-year-old woman signed a broad DPOA naming her niece as attorney-in-fact. The niece attempted to make withdrawals from her Aunt’s accounts, but the bank refused to accept the DPOA. The niece’s actions seemed suspicious. Furthermore, when the bank’s employees observed the Aunt in person, they doubted her legal capacity.

As an initial matter, the Kansas Court of Appeals held the Aunt’s legal capacity as it was after the DPOA was executed was irrelevant to the issue of whether the bank should honor the niece’s request for a withdrawal of funds. The court stated that a principal’s capacity is relevant only at the time when the power of attorney is executed; not at the time it is later presented to carry out a transaction.

Next, the court addressed the bank’s refusal to honor the DPOA presented by the niece. The court held generally that a financial institution is not required to honor every DPOA, but held that in Kansas, an unqualified refusal to honor a power of attorney is unlawful. It went on to state that a financial institution may rely on a power of attorney “as long as there are no circumstances that would indicate a potential of misappropriation of the principal’s funds.”

The court further held that when presented with a DPOA or trust agreement, a “financial institution has a duty to: (1) compare the signature on the power of attorney with the customer’s signature on file; (2) obtain proper identification from the person seeking withdrawal as the person designated as the attorney-in-fact; and (3) determine whether the requested transaction was within the scope of the [DPOA].”

<sup>1</sup>Alaska Stat. § 13.26.353(c).

<sup>2</sup>Cal. Prob. Code §§ 4306(A) & 4406(A).

<sup>3</sup>Fla. Stat. Ann. § 709.08(11).

<sup>4</sup>755 Ill. Comp. Stat. Ann. P 45/2-8.

<sup>5</sup>Ind. Code Ann. § 30-5-9-9.

<sup>6</sup>Minn. Stat. Ann. § 523.30.

<sup>7</sup>N.Y. Gen. Oblig. Law § 5-1504.

<sup>8</sup>N.C. Gen. Stat. § 32A-41.

<sup>9</sup>20 Pa. C.S. § 5608.

<sup>10</sup>S.C. Code Ann. § 62-501(F)(1).

<sup>11</sup>(2005), 34 Kan. App. 2d 150, 115 P.3d 157.

<sup>12</sup>See, e.g., 755 Ill. Comp. Stat. Ann. P 45/2-8; 20 Pa. C.S. § 5608(b).

<sup>13</sup>See, e.g., Alaska Stat. § 13.26.353(b).

<sup>14</sup>(2005), 162 Md. App. 495, 875 A.2d 222.

<sup>15</sup>(Ohio App. 10 Dist.), 2005-Ohio-6473 (unpublished opinion).

Ultimately, *Maenhoudt* was remanded to determine the validity of the power of attorney, whether the bank compared the signatures, and whether the bank had actual or constructive knowledge that the niece was perpetrating a fraud. However, the case suggests that an apparently valid power of attorney may not be cavalierly dismissed by a financial institution.

So what are we left to do? Agents sometimes misuse authority given them in powers of attorney. Financial institutions often refuse to honor them to protect themselves from liability. The recent cases discussed below suggest that financial institutions relying on a valid power of attorney will (to some degree) be shielded from liability (in some states).

### 3. What is a Bank’s Potential Liability if it Honors a Power of Attorney?

Unfortunately, few states have statutes specifically exempting financial institutions from liability when they rely in good faith on a power of attorney<sup>12</sup>, or they rely on the “reasonable representations of an attorney-in-fact.”<sup>13</sup> However, even where there is no legislative act providing such qualified immunity, state courts have begun to recognize third-party immunity.

In *Vinogradova v. Suntrust Bank*<sup>14</sup>, the Maryland Court of Appeals concluded that a DOPA by its own broad language sanctioned a bank’s reliance on its terms and insulated the bank from any liability. The case arose after Vinogradova, an unsophisticated investor, executed a DPOA to an acquaintance and that acquaintance (acting as attorney-in-fact/agent) reduced Vinogradova’s retirement account from \$207,000 to \$20,000. Vinogradova argued that the bank should be held responsible to her for the dishonest acts of her attorney-in-fact. The court disagreed and held that the bank did not breach its fiduciary duty because the broad power of attorney gave the attorney-in-fact the authority to take the actions that resulted in substantial monetary losses. Recently, the Ohio Court of Appeals in *Gupta v. Lincoln National Life Insurance*<sup>15</sup>, agreed with the *Vinogradova* Court’s conclusion when it considered whether an insurance company could be held liable for a husband’s actions when he acted pursuant to an unrevoked valid power of attorney without his wife’s knowledge.

In 1987, Mrs. Gupta signed a general power of attorney appointing her husband, Mr. Gupta, as her agent. In 2001, Mrs. Gupta separated from her husband, but never revoked the power of attorney. In response to a letter requesting the withdrawal of funds from Mrs. Gupta’s retirement account, the insurance company provided a loan application. Mr. Gupta completed the application and submitted it to the insurance company. The insurance company, upon noticing that the signature on the loan application did not match the signature on file at Mrs. Gupta’s business, called the Gupta residence. Mr. Gupta

answered the phone and explained to the insurance company that he had indeed completed the application and was authorized to do so pursuant to his wife's power of attorney, which he then faxed to the insurance company. A few days later, the insurance company processed the loan application and tendered a check for \$50,000 made payable to Mrs. Gupta. When Mrs. Gupta discovered the loan transaction had been made without her knowledge, she asked the insurance company to restore the money to her account. When the company refused and insisted on repayment of the loan, Mrs. Gupta filed suit (we can only assume her husband was judgment proof), but lost at the trial level.

The appellate court affirmed the judgment for the insurance company. Regarding financial institutions' reliance on valid powers of attorney, the Ohio Court of Appeals reviewed the recent court decisions on the issue and summarized what it considered to be "the law" on this issue in this way:

While the law sets forth that the conduct of a holder of a power of attorney who engages in self dealing transactions without authority or ratification of the principal is actionable, the law does not set forth that the conduct of a third party is actionable when the conduct was undertaken upon reliance of a valid power of attorney.

In summarizing the law the *Gupta* Court relied on *Vinogradova* (discussed above), *Vogelgesang v. U.S. Bank*<sup>1</sup> (holding that there was no liability on behalf of a bank when the bank acted pursuant to a valid power of attorney) and *Demerath v. Knights of Columbus*<sup>2</sup> (holding that a life insurance company had no duty to inquire about the change of beneficiary form when it acted pursuant to a valid power of attorney) for support.

#### 4. Does the Bank have a Duty to Inquire?

The *Gupta* Court also considered the separate issue of whether a financial institution, before honoring an agent's request for a withdrawal of funds, has a duty to determine if the agent is engaging in self-dealing. To a collective sigh of relief from financial institutions, the Ohio Court of Appeals declared "no such duty exists" and reasoned: "[T]o impose such an onerous requirement on financial institutions would not only be impractical, but would essentially eliminate the power of attorney as a useful tool in the transaction of business of any elderly, disabled, absent, or otherwise incapacitated individual."

<sup>1</sup>(2005), 92 Ark. App. 116, 211 S.W.3d 575.

<sup>2</sup>(2004), 268 Neb. 132, 688 N.W.2d 200.

<sup>3</sup>*Empire Trust v. Cahan*, 274 U.S. 473.

<sup>4</sup>*Townsend v. Williger* (N.D. Ohio Mar. 16, 2006), No. 5:05-CV-02540, 2006 WL 721395 at \*8 (unpublished opinion).

<sup>5</sup>O.R.C. Chapter 1337; M.C.L. §§ 5501-5505.

<sup>6</sup>MICHIGAN PROBATE & ESTATE PLANNING 34 (Summer 2007).

Relying on the above language from *Gupta* and a 1927 U.S. Supreme Court decision<sup>3</sup>, a federal court sitting in Ohio recently declared that "[a] bank receiving a valid power of attorney has no duty to investigate every action that the holder of that power of attorney takes to ensure that each action is proper."<sup>4</sup>

#### 5. Summary of Current Ohio and Michigan Law

Ohio and Michigan statutes<sup>5</sup> are silent as to whether a financial institution *must* honor a valid power of attorney and whether the financial institution can be held liable for damages to the principal or the principal's successors in interest after honoring the document. As a practical matter, institutions may face a lawsuit from the designated agent if they refuse to accept the power of attorney. Another concern is whether an institution incurs liability for honoring the power of attorney when the agent engages in self-dealing, acts beyond his or her scope of authority, or otherwise acts unlawfully.

Ohio banks are somewhat fortunate, because, as explained above, recent court decisions interpreting Ohio law conclude that a bank, as a third party, is not liable for the unlawful actions of an agent and that the bank has no duty to ensure whether each of the agent's actions are lawful.

Michigan financial institutions, however, are not so fortunate. In Michigan financial institutions "have no protection from liability if, after honoring a power of attorney, it is demonstrated that the document had been revoked or that the agent had overstepped authority granted by the document."<sup>6</sup>

Since Ohio banks have *some* protection from third-party liability which Michigan banks currently do not enjoy, Michigan banks may need to be more cautious before accepting a power of attorney. In the absence of more state-specific direction, banks that are uncertain how to proceed can follow the guidance of the Kansas Court of Appeals in *Maenhoudt* by: (1) comparing the signature on the power of attorney with the customer's signature on file; (2) obtaining proper identification from the person seeking withdrawal to ensure they are indeed the designated agent; and (3) determining whether the requested transaction was within the scope of the power of attorney.

#### 6. New Uniform Power of Attorney Act Ready for States' Consideration

In 2006, the Uniform Law Commission completed the Uniform Power of Attorney Act (UPOAA) in an effort to re-

solve differences in state law. The UPOAA is a mere model act, and its provisions must be adopted (in whole or part) by individual states before those states are bound by its provisions. The UPOAA has superseded the Uniform Durable Power of Attorney Act of 1979 which at one time was followed by all but a few jurisdictions.<sup>1</sup> One problem with the 1979 Act is that it did not resolve whether one must accept a valid power of attorney and whether that person or entity can be protected from liability and if so, on what grounds. The new UPOAA, however, resolves these and other issues.

A key feature of the UPOAA is that it protects from liability persons who accept an “acknowledged” power of attorney in good faith.<sup>2</sup> The official Comment to the model act explains that “Section 119 permits a person to rely in good faith on the validity of the power of attorney, the validity of the agent’s authority, and the propriety of the agent’s exercise of authority, unless the person has actual person has actual knowledge to the contrary.” The UPOAA does not require the person to investigate whether a power of attorney is valid or whether the agent’s exercise of authority is proper, but it does permit a person to request an agent’s certification of any factual matter and a legal opinion as to any legal matter.<sup>3</sup> Section 120 imposes sanctions for one’s refusal to accept a valid power of attorney but also includes several bases for legitimate refusals.

Since 2006, five states, including Michigan<sup>4</sup>, have introduced the UPOAA for passage with New Mexico already having adopted it.<sup>5</sup>

### ***Lessening a Trustee’s Duty to Diversify – Case Law Update***

The [Fall 2007 issue](#) of *Fiduciary Focus*, discussed three recent Ohio court cases in which corporate trustees were sued for alleged failure to diversify trust investments. Although the trust agreements in those cases contained differing clauses authorizing the trustee in its discretion to retain assets, only one clause was held sufficient to relieve the trustee of its duty to diversify. The common holding from the Ohio decisions is that, “the language of a trust does not alter a trustee’s duty to diversify unless the instrument creating the trust clearly indicates an intention to do so.”

To date, the duty to diversify in the Uniform Prudent Investor Act (UPIA) has still “received little judicial attention in Ohio or elsewhere.”<sup>6</sup> Even so, recent cases from Nebraska

(2005) and Indiana (2006) further aid our interpretation of the UPIA by illustrating two points: (1) some state courts appear more willing than Ohio courts to recognize asset retention clauses in trust agreements as sufficiently lessening a trustee’s duty to diversify; and (2) in deciding whether diversification is prudent, a trustee should consider whether a particular trust asset has a special relationship or special value to the trust’s purposes or to a beneficiary.

### **1. Trust Retention Clauses**

In the Nebraska case, *Brackett v. Tremaine*<sup>7</sup>, the Supreme Court of Nebraska stated that the UPIA’s duty to diversify is merely a “default rule” which may be expanded, restricted, eliminated, or otherwise altered” by a trust agreement. The court went on to hold that the following retention provision in the trust agreement successfully modified the trustee’s general duty to diversify if retention of non-diversified assets would be in the beneficiaries’ best interests:

*[The Trustee has the power] to retain any property, whether consisting of stocks, bonds, other securities, participations in common trust funds, or of any other type of personal or of real property . . . without regard to the proportion such property . . . may bear to the entire amount of the trust . . . intending thereby to authorize the Trustee to act in such a manner as will be for the best interest of the trust beneficiaries . . .*

In the Indiana case, *Americans for the Arts v. Ruth Lilly CRAT*<sup>8</sup>, the court of appeals concluded that a general retention clause combined with an exculpatory provision in the trust agreement were sufficient to lessen the trustee’s duty to diversify. The trust gave the trustee the power:

*[t]o retain indefinitely any property received by the trustee and invest and reinvest the trust property . . . and any investment made or retained by the trustee shall be proper despite any resulting risk or lack of diversification or marketability and although not of a kind considered by law suitable for trust investments.*

<sup>1</sup>UPOAA Prefatory Note; [http://www.nccusl.org/Update/uniformact\\_summaries/uniformacts-s-upoaa.asp](http://www.nccusl.org/Update/uniformact_summaries/uniformacts-s-upoaa.asp).

<sup>2</sup>UPOAA § 119, Comment, text available at <http://www.law.upenn.edu/bll/archives/ulc/dpoaa/2006final.htm>.

<sup>3</sup>*Id.*

<sup>4</sup>Michigan House Bills 5677 (2006) and 4180 (2007).

<sup>5</sup>[http://www.nccusl.org/Update/uniformact\\_factsheets/uniformacts-fs-upoaa.asp](http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-upoaa.asp).

<sup>6</sup>See *National City Bank v. Noble*, (Ohio App. 8 Dist.), 2005-Ohio-6484 ¶31.

<sup>7</sup>(2005), 269 Neb. 376, 693, N.W.2d 514.

<sup>8</sup>(Ind. Ct. App. 2006), 855 N.E.2d 592, *transfer denied*, 869 N.E.2d 451 (Ind. 2007).

The Indiana Court of Appeals relied on one of the Ohio Court of Appeals decisions, *Wood v. U.S. Bank* (2005)<sup>1</sup>, discussed in our last issue. The bank in *Wood* was found liable after the court held that the general retention clause in that trust was not specific enough. The *Wood* court stated that had the settlor wanted to eliminate the trustee's duty to diversify, the settlor could have mentioned that duty in the retention clause or "included another clause specifically lessening the duty to diversify," but he did not.

The Indiana Court of Appeals concluded that the trust provisions at issue in *American for the Arts* (quoted two paragraphs above in italics) contain "precisely the type of language suggested by the *Wood* court, inasmuch as they include a clause explicitly lessening the duty to diversify."<sup>2</sup>

In interpreting the UPIA's duty to diversify, the Indiana Court of Appeals in *Americans for the Arts* borrowed language from one Ohio case, *Wood*, but ignored (or failed to find) two more recent diversification decisions from Ohio which were decided after *Wood* and before *Americans for the Arts* and discussed in our Fall 2007 issue. Would *Americans for the Arts* have been decided differently in an Ohio court?

If there is a unifying theme upon which trustees may rely, it appears to be that "actual results may vary" depending on the facts and the jurisdiction. Where the courts have not found a trustee liable for failing to diversify, the language of the retention clause contained one or more of the following: (1) specific language authorizing the trustee to retain investments even though retention of such non-diversified assets would normally be imprudent; (2) specific language identifying which investments or assets could be retained without regard to diversification; and (3) an exculpatory clause in the trust which specifically relieved the trustee of liability for any investment retained by the trustee in good faith.

### 2. An Asset's Special Relationship or Value to Trust's Purposes or to a Beneficiary

A trustee's statutory duty to diversify under the UPIA requires a trustee to consider various circumstances. These circumstances include "an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries."<sup>3</sup> As noted above, facts sometimes do influence the outcome, as in this next case, where it was the trustee who wanted to diversify trust property for his own purposes.

The Nebraska Supreme Court in *Brackett v. Tremaine*

concluded that an asset's "special relationship or special value" could be used to justify non-diversification of a family farm held in trust so that the farm may be preserved for future family generations. The court found that the beneficiaries of the family farm had a "sentimental attachment" to the farmland and that they "articulated a legitimate interest in maintaining the geographic integrity of the farm that has been in their family for many years." The court was also inclined to rule in favor of retaining the family farm because the trustee was trying to sell part of the farm to himself, no additional income was needed to carry out any specific trust purpose, and none of the beneficiaries were dependent upon the trust for support.<sup>4</sup>

### ***Can a Trustee of a Support Trust Consider a Beneficiary's other Assets or Income Before Making Distributions to the Beneficiary? – Differing Views among the States***

The [Fall 2007](#) issue of *Fiduciary Focus* reported on the case *National City Bank v. de Laville*<sup>5</sup> in which an Ohio Court of Appeals held that a trustee did not have to consider a beneficiary's other sources of income before making payments of principal. There, the court looked beyond the trust (which was silent on the issue) and also considered an antenuptial agreement between the settlor and the beneficiary which expressly stated that the trustee should not take into consideration other income and resources available to the beneficiary.

After reading our summary of *de Laville*, this question has been raised: When a trust instrument does not specifically authorize (or prohibit) a trustee to consider a beneficiary's other sources of income, is the trustee required (or even permitted) to consider such outside sources of income before invading the principal?

In answering this question, all courts agree that the first step is to discern the settlor's intent by looking at the trust instrument to see if it expressly states whether a trustee must, or even may, consider other financial resources. Some courts will also look at circumstances surrounding the creation of the trust to make this determination.

When the settlor's intent is not clear from the trust instrument, the state courts are divided in their analyses, but usually follow one of three approaches. State courts that follow the first approach conclude that a settlor's intent should be determined based on whether the gift in the trust is (a) an absolute gift of support, or (b) a gift of support and maintenance only in

<sup>1</sup>160 Ohio App.3d 831, 2005-Ohio-2431, 828 N.E.2d 1072.

<sup>2</sup>855 N.E.2d at 601.

<sup>3</sup>Uniform Prudent Investor Act § 2(c)(8).

<sup>4</sup>269 Neb. at 384-85.

<sup>5</sup>(Ohio App. 6 Dist.), 2006-Ohio-5909.

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case of actual need. If it is an absolute gift, then the beneficiary's private income *cannot* be considered. If it is a support gift only in case of actual need, then the beneficiary's private income *must* be considered.<sup>1</sup>

The second or "traditional" approach, followed by many state courts is that absent specific contrary language in the trust, a settlor's intent is that a beneficiary's other means *will not* be considered. This traditional presumption was adopted by the Restatement (Second) of Trusts (1959)<sup>2</sup> and until recently was largely recognized as the majority view among the state courts. Ohio courts follow this second, traditional approach, but sometimes mix the first and second approaches together in their published opinions.<sup>3</sup>

Today, however, a third approach among at least a minority of states has been adopted by the Restatement (Third) of Trusts (2003) because it is "more realistic," "of more practical help to courts and trustees," and is the "trend" in the more recent state court cases.<sup>4</sup> This third approach presumes that absent specific contrary language in the trust, a settlor's intent is that other means *will* be considered.

Fiduciaries, including trustees and trust department directors, need to be aware that while a majority of states currently follow the presumption adopted by the Restatement (Second) of Trusts that other income/resources *will not* be considered, recent cases illustrate a shift from this presumption. To avoid uncertainty (and costly legal disputes) a trust instrument should clearly state whether a trustee must, must not, or may consider the needs of the beneficiary's immediate family members or the beneficiary's assets or income, from whatever sources. If a trustee is permitted or required to consider other assets or income, the trust should specify to what degree these other resources should be considered. Trustees should check the language of the trusts they administer to see if they require or permit the trustees to consider other resources. Trustees should also be aware which state law governs the trusts they administer and which (if any) of the three approaches summarized above is followed in that state.

### About Marshall & Melhorn, LLC

Marshall & Melhorn, LLC is a full-service law firm. In addition to our Trusts and Estates group, our firm has the following specialized practice areas:

- Business
- Healthcare
- Immigration
- Intellectual Property
- Labor & Employment
- Litigation
- Medical Malpractice Defense
- Nonprofit
- Tax

### Trusts & Estates Group

A. Thomas Christensen\*  
christensen@marshall-melhorn.com  
419.249.7141

Vaughn A. Hoblet\*  
hoblet@marshall-melhorn.com  
419.249.7108

Thomas P. Killam  
killam@marshall-melhorn.com  
419.249.7124

Paul M. Kraus  
kraus@marshall-melhorn.com  
419.249.7116

Bridgett J. Root\*  
root@marshall-melhorn.com  
419.249.7153

\*Also admitted in Michigan

#### Main Office

Four Seagate  
Eighth Floor  
Toledo, OH 43604  
419.249.7100  
Fax: 419.249.7151

#### Michigan Office

204 S. Macomb Street  
Monroe, MI 48161  
734.457.2444

[www.marshall-melhorn.com](http://www.marshall-melhorn.com)

<sup>1</sup>See, e.g., *Matter of Druck* (N.Y. Sur. Ct.), 2005 NY Slip Op. 25069, 790 N.Y.S.2d 837, *aff'd*, *Goodman v. Estate of Druck* (N.Y. App. 2d Dep't, 2006), 821 N.Y.S.2d 918; *In re Coats Trust* (Mo. App. 1979), 581 S.W.2d 392.

<sup>2</sup>Rest. 2d Trusts § 128 Cmt. e.

<sup>3</sup>*Leyshon v. Miller*, No. 93CA37, 1994 Ohio App. LEXIS 4885 at \*13; *de Laville*, 170 Ohio App.3d at 329.

<sup>4</sup>Rest. 3d § 50 Cmt. e.