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THE SPOTLIGHT

BROUGHT TO YOU BY ROBINS KAPLAN LLP'S
WEALTH PLANNING, ADMINISTRATION, AND FIDUCIARY DISPUTES GROUP

DOLLARS and SEN$E

IN THIS ISSUE:

ROBINS KAPLAN LLP

WELCOME TO THE SPOTLIGHT

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The Spotlight is the result of ongoing collaboration between our national trial practice and estate planning groups, with the goal of providing a forum to discuss the latest news and other issues impacting the trusts and estates community. Whether you are a trustee, beneficiary, trust officer, attorney, financial advisor, or other professional in this area, we hope that you will find this newsletter interesting, informative, and perhaps at times even a bit entertaining.

As leaders and teachers in the field of wealth planning and administration, our attorneys have built a reputation for excellence in meeting the needs of individuals and organizations from basic to complex testamentary planning. We counsel individuals and business owners in all aspects of estate planning and business succession, providing them with peace of mind and reassurance that their legacy is in the best of hands.

Furthermore, should a conflict arise, our fiduciary disputes attorneys are well positioned to resolve the matter with thoughtfulness, creativity, and compassion. Our national reputation for litigation excellence includes wins in the fiduciary arena for trustees and fiduciaries, personal representatives, beneficiaries, guardians, and conservators. Whether litigating fiduciary matters, inheritance issues, or contested charitable donations, we help clients cut through confusion to find a path to resolution.

Is there a topic affecting your practice that you would like us to discuss in an upcoming issue of The Spotlight? Let us know at all_marketing@robinskaplan.com.

– Denise S. Rahne and Steven K. Orloff

UNDERSTANDING FIDUCIARY DUTIES AND OBLIGATIONS IN **INVESTMENT** AND **DIVESTMENT**

BY DAVID MARTINEZ AND NARGESS HADJIAN

Fiduciaries, such as trustees, financial advisors, corporate directors, and fund managers are legally bound to act in the best interests of their beneficiaries and/or clients. Duties owed by fiduciaries, including duties of prudence, diligent monitoring, loyalty, and disclosure often arise in the context of asset investment and divestment. Understanding the contours of these fiduciary duties as shaped by caselaw is important to evaluate potential exposure for breach.

DIVERSIFICATION OF INVESTMENTS AND THE PRUDENT INVESTOR RULE

One of the fundamental principles guiding fiduciary obligations is the duty to invest and manage trust assets, also known as the prudent investor rule.[1] Governed by the Uniform Prudent Investment Act ("UPIA"), the rule requires trustees to exercise reasonable care, skill, and caution in managing trust investments.[2] This includes the duty to diversify the investments so as to minimize the risk of loss, unless it is reasonably determined that it is better not to do so.[3] For instance, a trustee managing a trust fund should avoid concentrating investments in limited vehicles, instead spreading them across asset classes to ensure prudent risk management.[4] However, stock in closely held businesses need not be sold for diversification reasons if the stock has a special relationship to a trust purpose or to the beneficiaries.[5]

However, the duty to diversify is not absolute. Fiduciaries must balance diversification with other factors, such as the specific needs and circumstances of the different beneficiaries, the purposes of the trust, and the nature of the trust assets. Thus, the level of diversification required may vary depending on factors such as the size of the trust, the investment goals, and the risk tolerance of the beneficiaries.

DUTY TO MONITOR INVESTMENTS

Fiduciaries also have a duty to actively review investments to ensure their continued suitability. For example, in *Tibble v. Edison International*,[6] beneficiaries of a defined-contribution retirement savings plan brought an Employee Retirement Income

Security Act ("ERISA") action for breach of fiduciary duties, seeking to recover damages for losses suffered by the plan, among other relief. The Supreme Court held that "a trustee has a continuing duty to monitor trust investments and remove imprudent ones."[7] This continuing duty exists "separate and apart from the trustee's duty to exercise prudence in selecting investments at the outset."[8]

DUTY OF LOYALTY AND CONFLICTS OF INTEREST

The duty of loyalty is another essential aspect of fiduciary obligations. Fiduciaries must act in the best interests of beneficiaries, avoid conflicts of interest, and disclose any potential conflicts to ensure transparency and maintain the trust placed in them. The widely cited case *Meinhard v. Salmon, et al.* established this principle.[9] The court held that the defendant breached his fiduciary duty of loyalty by exploiting a business opportunity for his personal gain that rightfully belonged to the partnership. The court further held that fiduciaries must disclose any conflicts of interest and have an ongoing duty to fully disclosure opportunities that may arise during their fiduciary relationship.

DUTY TO DISCLOSE MATERIAL FACTS

Transparency and full disclosure of material facts are essential components of fiduciary obligations. *Lingsch v. Savage*,[10] a formative California case, established that fiduciaries, such as real estate brokers, have a duty to disclose all material facts to beneficiaries or clients, especially when making investment decisions on their behalf. In this example, the real estate broker was found to have breached its fiduciary duty to disclose material facts to the purchasers, including that the property was in a state of despair and the building had been placed for condemnation by city officials, among other things. The duty to disclose material facts ensures that beneficiaries can make informed decisions based on complete and accurate information. Failing to disclose relevant information may not only lead to a breach of fiduciary duty, but also a finding of fraud.

DIVESTMENT STRATEGIES AND WINDING UP ASSETS

Divestment from certain investments has also become a significant consideration for fiduciaries. In a New York district court case involving an employment benefit fund against an insurer and insurance agent, *Buccino v. Continental Assurance Co., et al.*,[11] the court found that the fiduciaries' failure to advise the investment fund to divest itself of unlawful and imprudent investments resulted in a continuing breach of its fiduciary obligations, giving rise to a new cause of action each time the fund was injured by its continued possession of the investments. Therefore, fiduciaries are obligated to properly divest of assets when reasonably necessary, and the continued failure to do so can result in a continuing breach of the fiduciary duty.

The obligation to properly divest of assets also may arise in "wind-up" scenarios of trust affairs. In a well-known California case, *Sterling v. Sterling*,[12] the court held that the trustee's act of selling a professional basketball team held by a revoked trust was not only a valid exercise of the trustee's power to wind up trust assets, but also in the best interest of the beneficiaries. The sale of assets during the wind-up process was challenged for increasing the trust assets in violation of Section 15407(a)(5). However, the court rejected this notion, instead noting that even when acting within its "wind-up" powers, a trustee must still abide by the obligation of seeking the best possible result for the beneficiaries.[13]

CONCLUSION

It is critical for fiduciaries to exercise due diligence in assessing investment opportunities, monitoring the performance of investments, and regularly reviewing the composition of portfolios. Understanding these and other obligations is important to avoid exposure, ensure the protection of beneficiary interests, and maintain the integrity of the fiduciary relationship.

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[1] Uniform Prudent Investment Act ("UPIA") §2(a).

[2] *Id.*

[3] Id. at §3. *See e.g. O'Riley v. U.S. Bank, N.A.*, 412 S.W.3d 400 (Mo. Ct. App. W.D. 2013); *Dowsett v. Hawaiian Trust Co.*, 47 Haw. 577 (1964); *First Nat. Bank of Kansas City v. Hyde*, 363 S.W.2d 647 (Mo. 1962); *In re Mueller's Trust*, 28 Wis. 2d 26 (1965).

[4] In *Uzyel v. Kadisha*, 116 Cal. Rptr.3d 244 (Cal. App. 2 Dist. 2010), the court held the trustee had breached the duty to diversify when he invested one-third of the value of the trust in Qualcomm stock.

[5] *See In the Matter of a Trust by Hyde*, 44 A.D. 3d 1195 (2007).

[6] 135 S.Ct. 1823 (2015).

[7] *Id.* at 529.

[8] *Id.*

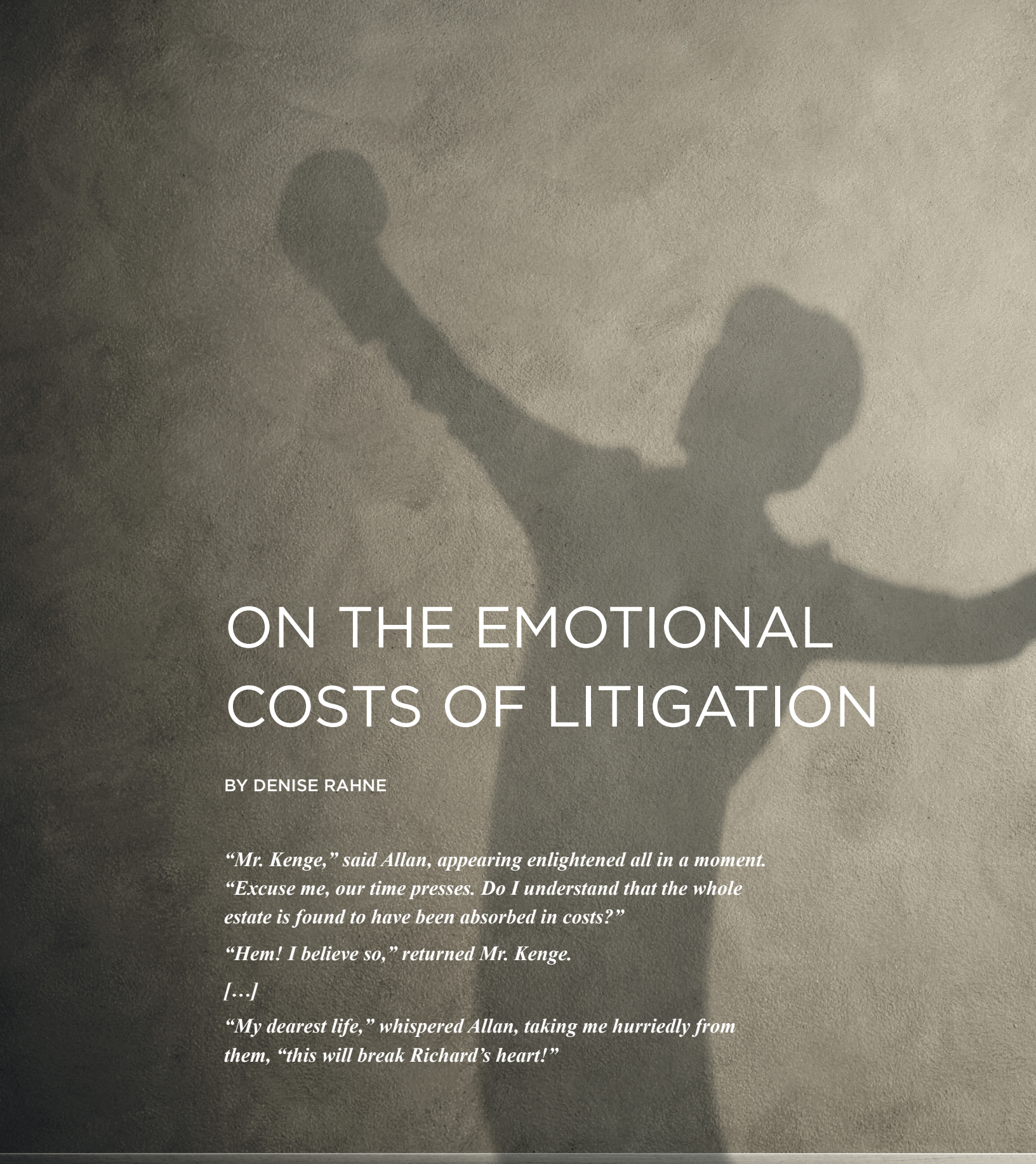
[9] 249 N.Y. 458 (1928).

[10] 213 Cal.App.2d 729 (1963).

[11] 578 F.Supp. 1518 (2009).

[12] 242 Cal.App.4th 185 (2015).

[13] *Id.* at 201.



ON THE EMOTIONAL COSTS OF LITIGATION

BY DENISE RAHNE

"Mr. Kenge," said Allan, appearing enlightened all in a moment. "Excuse me, our time presses. Do I understand that the whole estate is found to have been absorbed in costs?"

"Hem! I believe so," returned Mr. Kenge.

[…]

"My dearest life," whispered Allan, taking me hurriedly from them, "this will break Richard's heart!"

Anyone familiar with Charles Dicken's *Bleak House* will recall the gloomy dénouement regarding the eternally litigated Jarndyce and Jarndyce case and the sudden reckoning that the cost of the fight had, like the snake eating its own tail, negated the reason for the fight.

While lawyers will often counsel clients facing or navigating litigation about the emotional toll that the litigation inflicts on the parties, in practical reality, those same emotions can bring high economic costs. Particularly with disputes among former business partners or family members, such costs are not only difficult to quantify, but they also present challenging topics for clients and potential clients in the early throes of a dispute. The early stages are, however, the best time to frame the role that emotion may play for a client or potential client. Toward that end, a discussion agenda should include the following:

1. JUSTIFIABLE EMOTIONS DO NOT NECESSARILY CORRESPOND WITH ILLEGALITY.

Even in highly sympathetic situations, the adage "there ought to be a law" remains an unanswered call for many people who harbor grievances with a former partner, business associate, or family member. This discussion is perhaps the first and most important between a potential client and lawyer before embarking on a process that looks cathartic at the start but that assuredly will not remain in that vein beyond the early stages of the fight. The earlier that an honest assessment of what part of a potential client's plight are ethical, moral, human, or consumer, as opposed to grounded in statutory or common law, the better the emotional and real prospects for the potential client. This early, honest conversation can be the most valuable service a lawyer provides.

2. DEFINE A WIN.

If the conversation survives an honest discussion regarding the nature of a potential client's grievance, an equally important topic is discussing the nature of potential outcomes. Even the most sophisticated of potential clients can feel so strongly about their experience that they will yearn for validation from a fact-finder who will adjudge them the winner. What lawyers know but sometimes do not discuss early enough is the challenging duality that, though few cases go to trial, if parties are not settlement minded, it can be exceedingly difficult to step off the trial treadmill. An early discussion of satisfactory outcomes, alternatives, and flexible paths that leave open such alternatives is key early in the attorney-client relationship.

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3. EMOTIONS ABHOR A BUDGET.

We cannot predict the future, but we know with near certainty that parties will be even more motivated to seek a psychological upper hand in emotionally charged cases. In cases involving family and former business associates, that means parties know one another and have, consciously or unconsciously, amassed a bank of knowledge for pushing one another's buttons. If one is not strategic, this can become a very expensive game of psychological warfare. Picking one's battles (because they are not free) is a plan best made very early, so you can revisit it when a client's instinct to "win every battle at all cost" is neither economical nor strategic.

4. THE RIGHT SERVICES FROM THE RIGHT PROFESSIONAL.

One of the most delicate but invaluable conversations with clients is informing them of limits to your professional services and the need for other support and professionals. This is all the truer with emotionally charged matters where the line between the client's need for advice and their emotional state can become blurred inadvertently. In disputes involving business interests and family, financial and tax planning will likely be required, and if not attended to early can restrict options for resolution or present unforeseen consequences for the client. A client's physical and mental health is equally or more important than other aspects of the dispute, and the stress of litigation can adversely impact both. Specific to the client's mental well-being, it is understandably easy for the legal counseling role played appropriately by a lawyer to bleed into acting as a support person, a role for which the lawyer isn't properly trained. This situation disadvantages both client and attorney when the client requires and deserves a different level and type of support than the lawyer is qualified to provide. An early conversation about having the appropriate professionals in place, including counselors, benefits both client and lawyer.

5. THE PRICE OF PEACE.

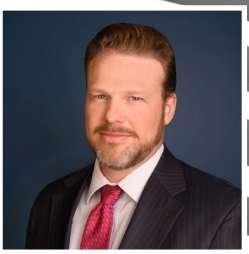
Resolution can be surprisingly difficult in cases involving high emotion. Balanced against the potential to shed a large burden are perceptions of justice, fairness, and right and wrong. Faced with a dispute with personal dimensions involving family or a business, the practical benefits of controlling your own destiny by settling out of court can be difficult to appreciate when the dispute is in full wind-up mode. But most cases do and should resolve through some form of settlement, and talking about it as early as possible, if not at the point of retention, can benefit both the lawyer and the client, and save costs.

Disputes with emotional aspects are destined to have a longer arc than even standard litigation. For that reason, early and frank conversation about their real and potentially costly dynamics can help lawyers and their clients make informed decisions about engaging in litigation in the first place—and how to navigate it if they decide to do so.

Picking one's battles (because they are not free) is a plan best made very early, so you can revisit it when a client's instinct to "win every battle at all cost" is neither economical nor strategic.

LESSONS FROM THE TRIAL TRENCHES:

HOW TO AVOID LARGE ADVERSE VERDICTS



The Spotlight had a chance to sit down with Robins Kaplan trial attorney Mike Collyard after his historic and latest trial result—the largest verdict in the State of Minnesota—to glean some practical advice on how companies and those in positions of trust can avoid massive (or even moderate) liability that Mike's adversaries have endured.

THE SPOTLIGHT: Mike, some of your cases involve scenarios where there is not one evil mastermind to blame, but rather a series of repeated failings by a number of people that add up to serious liabilities. Can you explain some of those scenarios and how that could happen?

COLLYARD: When we are the plaintiff suing another company, we always want to make the corporate defendant the bad guy (not its individual employees). Juries will punish companies for doing bad (or stupid) things, but human nature is to be more forgiving of an individual or two who did something wrong or fell short of a standard. And jurors might be able to relate to those individuals when they tell their story on the stand. So we try to take the individual failings as a whole and make them part of a systematic business problem that we can blame the company for. That gives you a far better shot at a bigger damages pool when you tell your plaintiff-side story to a jury who is generally less sympathetic to corporations.

THE SPOTLIGHT: Based on what you've learned in those cases, how would you advise your clients and others to mitigate the risks of those scenarios occurring on their watch?

COLLYARD: In defending a case, it's just the opposite. We often use the individual employees to be the company's face. Use a sympathetic employee who jurors can relate to who can tell the company's story. This gives the company a persona that the jurors

can connect with and not want to punish. Also, make sure your employees are following good guidelines and policies. If employees are doing that, it gives you a better chance of telling a story about how the company always chose to do the right thing and the individuals were doing exactly what they were told. Jurors can easily relate to that type of story and defense.

THE SPOTLIGHT: You've also been able to capitalize on missteps of your adversaries during the litigation process. Can you describe how companies can make their situation worse and what they should do to avoid that fate?

COLLYARD: There are easily three parts to this: a court part, a jury part, and a discovery part. First, always maintain credibility with the court. We often decide early on to not fight certain things and to only fight things we win. So every time we speak, we win. That creates credibility with the court, and the court knows we're right every time we speak. The court knows when you're being reasonable and will appreciate it. That will pay off throughout the case when it comes time for the court to make hard decisions.

Second, create credibility with jurors through your witnesses. Teach your witnesses how to properly give testimony during depositions and at trial. Teach them to not say things like "I don't recall" after an objection. Instead, teach them a factual story to tell, and, if the question calls for something they don't exactly remember, have them say something like "I knew that before, but I can't think of it sitting here right now without having my computer." That keeps the door open for them to fix that testimony later and maintains credibility so they can't be impeached. They look like they're being helpful and not hiding something from the jury.

Third, don't be your worst enemy in discovery. There are so many ways to get in the way of yourself during discovery. The biggest example is document preservation and production. Preserve documents and produce documents. Don't be afraid of producing documents. As a plaintiff, you can make so much out of a defendant not preserving or producing documents. Have the big picture in mind no matter which side of the case you're on, and don't get too greedy where you get caught withholding things because you just don't want to produce them. We like to go in with a "we have nothing to hide" approach if possible and really only fight on the most sensitive issues. Taking the opposite approach can be very detrimental. In my most recent trial, we were able to obtain an adverse-inference instruction due to the other side's destruction of evidence and repeated misrepresentations about it to the court. That played right into our narrative about the defendant being the bad guy and gave us a tremendous advantage at trial.

THE SPOTLIGHT: You've handled cases where trust and duty can play a key role in your trial themes. Explain why that can be effective and what companies can do to increase their chances of having those themes work in their favor?

COLLYARD: Choices and taking responsibility are always good themes on both sides of the "v," depending how you spin it. So we like to position ourselves to be able to say our client chose to do the right thing and our client takes responsibility, while the bad guys chose to do the wrong thing and refuse to take responsibility. You say it like "you could have done this, but you chose not to." So help yourself out by creating a culture that not only has good policies and procedures but supports your people in sticking to them. That can give you a solid foundation to incorporate these themes throughout your trial story, and these are both themes that sell easily.

MEET OUR ISSUE EDITOR:

DENISE RAHNE

Denise Rahne is co-chair of the Wealth Planning, Administration, and Fiduciary Disputes Practice Group. Her practice focuses on disputes involving estates, trusts, fiduciaries, shareholders, and closely-held corporations. On those matters, she serves corporate and individual clients facing a wide variety of active and potential litigation. A skilled trial lawyer, Denise leads and collaborates on large and mid-size legal teams and has significant experience in traditional and alternative-dispute forums. She can be reached at **DRahne@RobinsKaplan.com**.

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