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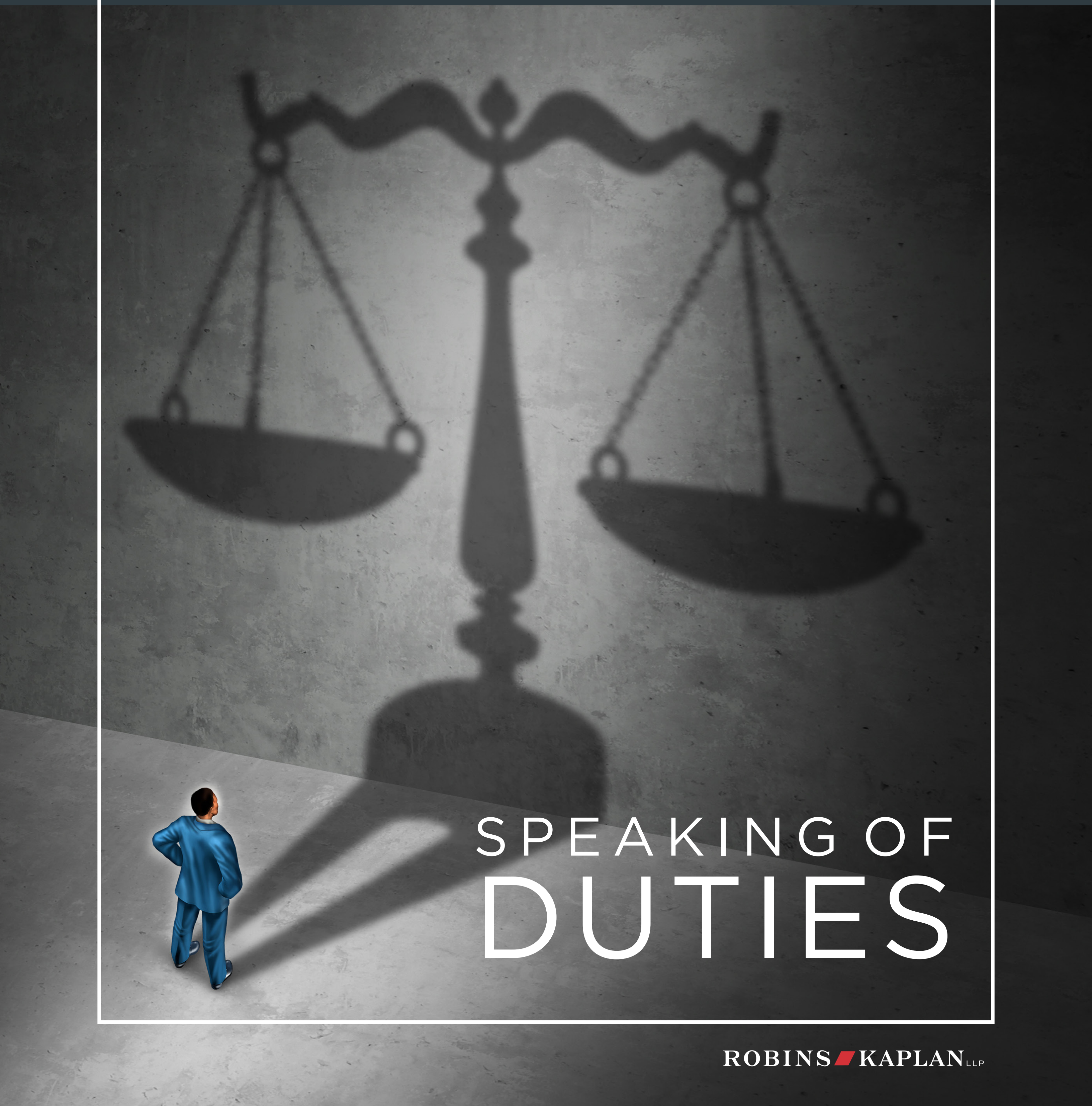
THE SPOTLIGHT

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



SPEAKING OF DUTIES

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 wealth 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 TPentelovitch@RobinsKaplan.com.

– Denise S. Rahne and Steven K. Orloff

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INSIDE THIS ISSUE

ARE ALL FIDUCIARIES CREATED EQUAL?

BY ERICA RAMSEY

Acquiring a "fiduciary" title comes with special obligations. But while all fiduciaries share a high-level similarity—a duty to someone else—the duties of a fiduciary can vary widely from one context to another. Some of the most common fiduciary—and surprising nonfiduciary—relationships are summarized below:

LAWYERS

An attorney-client relationship involves a range of duties designed to safeguard the client's interests. For example, attorneys must disclose any conflicts of interest, must focus on the client's best interests, and must maintain strict confidentiality with their client's information. Additionally, lawyers are obligated to use reasonable care when representing a client, which encompasses issues such as keeping the client informed and adequately understanding substantive legal concepts. In addition to fulfilling these general fiduciary duties, lawyers are governed by specific rules of professional conduct. Although the rules vary slightly by jurisdiction, the legal profession is one of the more highly regulated fiduciary relationships, and a failure by a lawyer to abide by applicable standards can result in a claim for legal malpractice or an ethics complaint to a bar disciplinary authority.

TRUSTEES & PERSONAL REPRESENTATIVES

When a person undertakes the responsibility to administer another's estate, they assume the duty to manage the assets appropriately and impartially. A trustee, whether corporate or individual, will have duties and obligations largely defined by the trust instrument, which can also insulate the trustee for liability in certain circumstances. The specific responsibilities of a trustee, and the potential liability for failing to meet those responsibilities, can vary greatly. At a fundamental level, though, trustees owe beneficiaries a duty to act in good faith and according to the trust's terms. They generally cannot, for example, use estate assets for themselves or others who do not have a legal entitlement to the estate.

Personal representatives generally have a duty to administer the estate as an ordinary prudent person would, which typically includes opening the estate, preserving assets, preparing an inventory, paying expenses, and pursuing claims that an ordinarily prudent person would pursue.

DIRECTORS OF CORPORATIONS

Directors have a duty to maximize corporation and shareholder interests and to examine all related information critically. In addition to mandating that directors focus on the bottom line, some states explicitly permit directors to consider constituencies external, but related, to the business, such as community interests, customer interests, and environmental interests. Directors also must disclose any personal interests that might interfere with their ability to run their companies. Because businesses can face uncertainty and risks, directors generally will not be liable for making business decisions, so long as they were reasonably informed and acted in good faith.

REAL ESTATE AGENTS

Real estate agents owe clients full disclosure of any conflicts of interest or concerns that affect the value of the property. While real estate agents can represent both the buyer and the seller in a transaction, many states require each client's informed written consent to do so.

FINANCIAL ADVISORS

There is a complex set of rules regarding when, whether, and to what degree financial advisors are fiduciaries. In other words, not all financial advisors must act in the best interest of their clients. For example, financial advisors who work for brokerages generally are not fiduciaries and are instead held to a nonfiduciary legal standard known as "suitability," meaning that the advisor must provide advice and guidance suitable for the client's particular situation. Thus, a nonfiduciary can recommend products that generally fit the client's needs, even if those products include higher fees or a bigger commission for the advisor.

In contrast, fiduciary financial advisors by law must act in the best interest of the client. Like nonfiduciary advisors, fiduciary advisors must consider a client's overall financial situation when making recommendations, but fiduciaries must also consider the most economical solutions and overall performance, which can include fee and commission structures. Both registered investment advisors and certified financial planners, generally, are fiduciaries. In any situation, it behooves both the advisor and the client to discuss their roles to avoid confusion regarding expectations and legal obligations.

BANKERS

Absent special circumstances, banks and bankers do not owe customers a fiduciary duty. In some circumstances, though, a special relationship could create a fiduciary duty, such as:

- A special relationship involving trust and confidence.
- Superiority and influence over the customer.
- The customer's detrimental reliance on the bank's superior knowledge.
- A disparity in business knowledge and invited confidence.

While these duties may seem common for many banks and their customers, the standard is high, and there is little precedent for banks or bankers to be categorized as fiduciaries.

"Fiduciary" is a blanket term that can describe many different relationships. Although they may share some features in common, each fiduciary's obligations will depend in large part on the relationship between the parties and the context of the relationship.

CONTEXT MATTERS: FIDUCIARIES AND THE RULE AGAINST SELF-DEALING

BY BRENDAN JOHNSON AND TIM BILLION

Fiduciary duties can arise out of many different relationships. Aside from defining the terms of the fiduciary's responsibilities, the nature of that relationship can provide important policy context in the event of a dispute. The rule against self-dealing is one example of how policy considerations can change the outcome of a case.

In *Smith Angus Ranch, Inc. v. Hurst,*[1] the South Dakota Supreme Court discussed the differences in the fiduciary duties owed by a corporate officer to a closely held company and its shareholders, and the fiduciary duties owed by a person acting as a power of attorney.

Dee Smith was the sole shareholder, director, and officer of Smith Angus Ranch. Travis Hurst began working for the Smiths in 1994. Travis was eventually added as a signatory to the ranch's checking account and made purchases on that account. When Dee began to experience health issues in 2013, she added Travis as a director and officer of the ranch, although the changes in title roles did not meaningfully alter the operation of the ranch.

While serving as a director and officer, Travis wrote checks from the ranch's account to, among other things, purchase a vehicle for his son, a vehicle for himself, and other supplies for a different ranch that Travis himself owned. According to Travis, Dee had authorized the self-dealing transactions. Dee also transferred land, vehicles, and cattle to Travis.

When Dee passed away in 2015, her will passed her shares in the ranch to her sons. It also forgave the outstanding amounts that Travis owed Dee for the ranch land. Dee's sons, the new owners of the ranch, filed suit against Travis, alleging, among other claims, that he breached his fiduciary duties to the ranch by engaging in self-dealing transactions and usurping corporate opportunities.

As a general rule, fiduciaries may not engage in self-dealing and may not prioritize their own personal interests at the expense of their obligations The primary issue on appeal before the South Dakota Supreme Court was a rule, most recently stated in *Stoebner v. Huether*,[2] that no extrinsic oral evidence may be introduced to raise a factual issue as to whether an attorney-in-fact was authorized to self-deal under a power of attorney. In other words, a person acting under a power of attorney (who is a fiduciary) cannot give things to himself or herself and later claim that the principal said it was OK.

In distinguishing between a fiduciary acting under a power of attorney and a fiduciary who is a corporate officer, the court focused on the vulnerability of a principal who is represented by a person acting under a power of attorney: the vulnerability that merits a heightened protection against self-dealing by the fiduciary.[3] By contrast, state statute does not require a corporate fiduciary to obtain written authorization to avoid liability for self-dealing—a legislative recognition that the risk of abuse by a corporate fiduciary is lower than the risk of abuse by a fiduciary acting under a power of attorney.

In the *Smith Angus Ranch* case, because Travis was acting as a corporate director and officer, he was not subject to the bright-line rule against the introduction of extrinsic oral evidence authorizing self-dealing, and the South Dakota Supreme Court remanded for further consideration.

If you are a fiduciary, whether in a corporate context or a power-of-attorney or trust context, policy considerations can impact your exposure to a potential claim for breach of fiduciary duty. If you have questions on how to protect yourself and limit exposure to future claims, contact a member of our Wealth Planning and Disputes Group.

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1 2021 S.D. 40.

2 2019 S.D. 58, ¶ 23, 935 N.W.2d 262, 268

3 *Smith Angus Ranch*, 2021 S.D. 40, ¶ 22 (noting that the "rule arises from the acute vulnerability of POAs to self-dealing" and is "adopted in order to avoid fraud and abuse" (internal quotations and citations omitted)).

UPDATE ON DOL FIDUCIARY RULE

BY MICHAEL D. REIF

The long saga that is the United States Department of Labor's "Fiduciary Rule" has officially entered its second decade. When first proposed in 2010, the rule was, broadly, an effort to provide clarity and greater protections for clients of the financial services industry by imposing a statutory federal standard for a broad swath of advisors and firms. In particular, it set out new definitions for when financial advisers were considered to be giving investment advice and when they were acting as a "fiduciary" for Employee Retirement Income Security Act of 1974 (ERISA) purposes. The rule held investment advice to the highest standard—the fiduciary standard—and required advisers to act in the absolute best interest of their clients rather than the current "suitability standard," which required only that advisers suggest investments "suitable" to client needs. This initial DOL proposal appeared in October 2010, with little to no advance warning or political stage-setting, and was met with hundreds of official public comments—most of them critical. The blowback led the DOL to abandon the proposal in September 2011.

President Obama and his Department of Labor revived the concept of the fiduciary rule in April of 2015. The subsequent rulemaking process included thousands of pages of commentary, petitions, and days of hearings that ultimately resulted in the April 2016 final rule, which bore an effective date of June 9, 2017, and envisioned a phase-in period through January 1, 2018. The new rule expanded ERISA's definition of an "investment advice fiduciary," and it automatically characterized all financial professionals working with retirement plans or giving retirement planning advice as fiduciaries—a status that bound them legally and ethically to a heightened standard. This approach differed from the original rule in two important ways. First, it embodied a "functional approach" to defining investment advice rather than characterizing advice as subject to the rule simply because it was offered by a registered investment advisor (RIA). Second, it loosened the advice requirements, eliminating the needs-focused tailoring and mandating only that the investment advice be directed to the plan, beneficiary, or participant.

Despite the years-long roll-out, enactment of the final rule prompted impacted institutions to prepare for the realities of the rule. Many lobbied against it even as they spent time and money preparing for its ultimate implementation. Even after it was final, the rule continued to be the subject of debate, analysis, scrutiny, and angst, prompting legislative proposals to revoke or rewrite the statutory definition and related exemptions and to delay the rule's implementation altogether.

The regulatory landscape shifted dramatically, however, with the election of Donald Trump in 2016. Just weeks after taking office, President Trump issued an executive order instructing the Department of Labor review the rule. New Labor Secretary Alexander Acosta soon officially delayed implementing the rule in spring and summer 2017, directed his department to accept additional public comment on it, and eventually pushed back full implementation to July 1, 2019.

While facing this hostility from within the very department that had issued it, the rule was also the subject to multiple external challenges, including a variety of lawsuits that focused on its fundamental legitimacy. Eventually, in March 2018, the Fifth Circuit Court of Appeals vacated the rule altogether in a 2-1 decision that found the rule "unreasonabl[e]" and determined that the DOL had engaged in "an arbitrary and capricious exercise of administrative power" when it enacted the rule in 2016.

Amid the uncertainty created by the 5th Circuit's ruling, the DOL enacted a temporary enforcement policy that remained in effect until the summer of 2020, when the department released what could be fairly seen as a compromise position. That 2020 guidance formally reinstated the investment advice fiduciary definition in effect since 1975 but added new interpretations that extended its reach regarding retirement accounts—specifically for rollover scenarios—and also proposed a new exemption for conflicted investment advice and principal transactions. In December of 2020, toward the end of the Trump administration, the Department of Labor officially adopted this third effort, and the incoming Biden administration allowed it to become official on February 16, 2021. The still-temporary enforcement policy is scheduled to sunset on December 20, 2021, though the DOL—known for its at-times late action—could still extend the life of the compromise measure even as it debates the prospect of a new rule that hews more closely to the 2016 standard.

MEET OUR ISSUE EDITOR:

DENISE RAHNE

Denise Rahne is co-chair of the Wealth Planning, Administration, and 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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