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TRUSTEE DISCRETION AND THE COURT

The Court of Appeals of the State of Washington, Division II, recently reviewed a case involving a trustee's discretion regarding investment strategy. *In re: Mark Anthony Fowler Special Needs Trust* (No. 39729-2-II, February 8, 2011, unpublished opinion)

In 2000, Mark Anthony Fowler suffered brain damage at a church function; he was 13 years old when the injury occurred. His parents established the Mark Anthony Fowler Special Needs Trust and funded it with settlement proceeds from the resulting lawsuit. The trust agreement appointed Wells Fargo, N.A., as trustee. The corpus of the trust was approximately \$940,000 and an annuity. The superior court approved the trust agreement on September 5, 2001; at that time Mark's life expectancy was 57.85 years. The trust agreement stated that the trust "is to be conserved and maintained for the special needs of [Fowler] throughout his lifetime." The trust agreement also stated that the trustee's exercise of discretion "shall be conclusive and binding on all persons." As trustee, Wells Fargo maintained the trust's assets in 60% equity investments and 40% fixed income investments, a "balanced investment approach."

The superior court approved Wells Fargo's annual accountings and its trustee's fees each year from 2002 to 2007. Annual disbursements during this period ranged from approximately \$38,000 to \$90,000. Wells Fargo's fee was 1.3% of the trust's market value, calculated on a monthly basis.

Wells Fargo filed its seventh accounting on December 16, 2008. The trust's value for the accounting period from October 1, 2007, to September 30, 2008, showed that the trust's market value dropped from \$1,065,934 to \$870,790, a loss of 12.12%. The trust's assets were invested 65.56% in equities (stocks), 31.43% in fixed income accounts (bonds), and 3.012% in cash equivalents. The trust's stocks outperformed the S&P 500 index, and the cash equivalents outperformed the 91-day Treasury bill yield, but the bonds underperformed the Lehman Brothers Intermediate

Government/Credit A+ index. The trial court, at the original accounting hearing on January 30, 2009, observed that the trust's ending value was "not a happy figure." Wells Fargo reported at a February 27, 2009, hearing that the trust's market value had dropped to \$738,000 at the end of January. The trial court expressed concern about the trust's asset allocation, and stated that "you [the trustee] need to move everything into FDIC-insured accounts with diversified institutions. That needs to get done at this point."

At a subsequent hearing, Wells Fargo's investment manager for the trust explained its asset allocation decisions to the court. He explained that the investment objective had always been "a balance between current income and long-term capital appreciation." He stated that "[A] reallocation of the investments to a portfolio of only 'insured' investments would be a short sighted and imprudent move . . . [that] would short circuit the investment plan currently in place and would realize or 'lock in' the losses at perhaps the worst possible time.... It would essentially eliminate any chance for the account to recover the losses of the prior accounting period. And, most importantly, it would also result in an un-diversified portfolio, breaching our duty to the Beneficiary." The manager performed a depletion analysis that predicted that if the trust consisted of only FDIC-insure CDs, it would be fully depleted by 2019, five years earlier than the current portfolio. The trial court continued to question the trust's allocation at the next two hearings, and appointed a guardian ad litem (GAL) to determine "(1) whether the Trustee complied with the prudent investor rule; (2) whether funds should be invested in insured deposits; and (3) whether the Trustee fees should be approved." The GAL submitted a written report on June 18, 2009, and concluded that Wells Fargo had complied with the prudent investor rule, and that it had properly applied the "total asset management" approach to investing the trust assets, as required by Washington law. The GAL stated, "[T]he 'prudent investment rule' does not require trustees to act to avoid all risk, but simply to be prudent in that risk allocation." The GAL further observed that about 50% of the trust's total assets (including the present value of the annuity) were in the more secured portion of the portfolio, and that the portfolio "was appropriate for the current 'special circumstances'" of the economic events of the preceding year. The GAL also recommended payment of the trustee's fees, which were consistent with its fee schedule at the time the trust was established. The trial court entered an order approving the accounting, but also entered a second order directing that "the trustee shall present the court with a plan to transfer a portion of the assets to insured deposits and showing fees and costs of such a plan to the trust" at a future hearing. Wells Fargo appealed both orders, and the Court of Appeals granted Wells Fargo's motion to stay the second order pending appeal.

The issue before the Court of Appeals was "whether the trial court had authority to order the trustee to reallocate the trust's investments where the trust agreement required the trustee to submit accountings to the court 'for review and approval,' but where the trial court did not find that the trustee breached any fiduciary duty and where no evidence supported a finding of breach." The Court of Appeals said that the trial court lacked such authority because "[w]hen a trust gives the trustee discretion to carry out the trust's objectives, a court may not control the trustee's exercise of its discretion absent an abuse of the trustee's discretion." The Court of Appeals said that "the trial court did not make a finding that Wells Fargo violated the prudent investor rule. Nor did the trial court determine that Wells Fargo breached its fiduciary duties to Fowler." The Court of Appeals stated that the trial court ordered the

reallocation because the trust assets lost over 13% of its market value from October 2007 to September 2008, the trust did not include insured deposits, and that the trust held 60% of its assets in equities. The Court of Appeals said that the trust's value declined during a steep decline in the stock market, but that the trust's stocks still outperformed the S&P 500 by almost 2.5%. The Court of Appeals agreed with the GAL's conclusion that "the trust's losses resulted from market volatility rather than Wells Fargo's selection of inferior assets." The Court of Appeals said that the dispositive question was "whether Wells Fargo abused its discretionary powers as trustee by allocating the trust's assets as it did." The Court of Appeals concluded that although the trial court implied a "yes" answer, "judicial intervention is not warranted merely because the court would have differently exercised the discretion." The Court of Appeals determined that Wells Fargo properly exercised its discretion during the accounting period in question "because it adequately considered economic conditions, the trust's duration, and Fowler's long-term needs in order to make investment decisions." The Court of Appeals recognized that the trial court's concerns were understandable, but that did not give the trial court the authority to order a reallocation plan in the absence of a breach of fiduciary duties or abuse of discretion on the part of the trustee. The Court of Appeals vacated both of the trial court's orders and remanded the matter to the trial court for the award of appropriate trustee's fees.

The attorneys at Oast & Hook can assist clients with their estate, financial, insurance, long-term care, veterans' benefits and special needs planning issues.

Ask Allie

O&H: Allie, now that spring is approaching, people may want to start traveling with their pets. Please tell us about pet travel agents.

Allie: Sure! Pet travel agents can arrange every aspect for your pet to ensure that your pet makes it to the destination safely and stress-free. This may involve arrangements for boarding, transportation by ground or air, required health documentation and pre-trip veterinary treatments. Pet Airways, located in Delray Beach, Florida, is a pet travel agency (www.petairways.com). Jeni Redmond, owner of petsfly.com, a division of The Pet Chauffeur, says "The trend of using pet travel agents started over three decades ago." The rules for transporting pets get more stringent every year, so many people feel more comfortable working with an expert. Additionally, more and more companies are paying for pet relocation for their employees. Many pet travel agents are members of the Independent Pet and Animal Transportation Association International (IPATA), whose members adhere to a strict code of ethics. What a great idea! Time to look out the front door and see if my friend the skunk has made a return appearance. See you next week!

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