

Important Victory for Wisconsin's Trustees and Professional Fiduciaries

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The Seventh Circuit Court of Appeals recently affirmed a trustee's victory on summary judgment, including an award of its attorneys' fees, in *Brian French, et al. v. Wachovia Bank N.A.*, Case No. 06-cv-00869-RTR. Godfrey & Kahn, S.C., who represented the prevailing trustee, believes the case to be a noteworthy one for banks, trust companies, investment managers and other professionals offering fiduciary services -- particularly those administering trusts in Wisconsin.

The Case

In 2004, successful entrepreneur Jim French moved his two irrevocable trusts worth almost \$30 million to Wachovia as trustee. One irrevocable trust held two whole life insurance policies, each with a \$5 million face value death benefit.

After months of analysis and discussions with Jim and his attorneys, Wachovia initiated a 1035 exchange, trading the two volatile, expensive, and cash-value rich policies for two no-lapse guarantee policies that were stable and inexpensive, but which had negligible cash values. Wachovia used Wachovia Insurance Services (WIS) to research and execute the exchange, resulting in more than \$500,000 in commission from the insurance company. French knew of the affiliate's involvement and of its receipt of a commission, but he did not sign a conflict waiver.

After the exchange, French and his children -- the beneficiaries under the trusts -- complained. They claimed that the new policies were inferior based on their limited and diminishing cash values and that WIS's commission constituted self-dealing by the trustee.

The Litigation

In 2006, the beneficiaries filed suit claiming breach of fiduciary duty. They claimed the bank acted with a conflict of interest while saddling the trust with two inferior insurance policies with poor and diminishing cash values. The beneficiaries sought disgorgement of the commission and payment for damages to the trust calculated at over \$7 million.

Wachovia defended its actions as authorized, first by the terms of the trust, and second by the beneficiaries themselves -- who acted and spoke through their father, the settlor. Wachovia also defended the transaction as prudent, and its actuarial expert opined that the exchange created over \$600,000 in value to the trust.

Both parties moved for summary judgment. The district court granted the bank's motion, agreeing that the terms of the trust waived all conflicts of interest, thereby eliminating the strict prohibition on self-dealing in favor of a good faith standard. It also found the 1035 exchange prudent under Wisconsin's Prudent Investor Act. Finally, because Wachovia was common law, the court awarded the bank attorneys' fees of almost \$700,000. The beneficiaries appealed both rulings. The appellate court affirmed the district court's decisions, reiterating the district court's analysis on both the merits and award of attorneys' fees.

The Lessons

This six-year litigation holds many important lessons for trustees and other professional fiduciaries.

There is no such thing as "boilerplate." The courts' key holding was that the trust instrument authorized self-dealing. It provided that the trustee had the power "to continue as trustee and to deal with any trust hereunder without regard to conflicts of interest...." Many estate planning lawyers might dismiss this language as a mere boilerplate provision, lacking any real meaning. Indeed, the Frenches attempted to render the provision meaningless with several strained interpretations rejected by the courts.

The district court held that "it is hard to imagine how the authorization to self-deal could be described more clearly." The appellate court agreed, finding the language "quite clear." As a result, the trust provision acted as an express waiver of the strict prohibition against self-dealing, and thereby it subjected Wachovia's investment decision to a lower, good faith standard.

Document the investment decision. The biggest obstacle for Wachovia was the sheer magnitude of WIS's commission. However, the bank's documentation of its processes and of the lengthy collaboration with French and his attorneys helped neutralize the commission's negative impact on the case. A thorough email memo outlined the pros and cons of the exchange. Months of analysis by French's attorney culminated in a favorable memo to French and the bank. Also, French signed an application for the replacement policies and had attempted to negotiate a rebate of the commission that he knew WIS was going to get.

This documentation was critical to the courts' determination that Wachovia had satisfied its obligation of good faith. Moreover, had the case proceeded to trial, much of this information would have been assisted in the bank's additional defenses of consent and ratification.

Prevailing trustees can bite back. The district and appellate courts' opinions clarified a longstanding but obscure aspect of Wisconsin's common law -- that prevailing trustees can get their attorneys' fees and costs. Moreover, the case provides precedent for recovery of fees from the beneficiaries, personally, rather than from the trust corpus. While any award of fees itself may be fact specific, trustees should take comfort in a clear decision reaffirming their ability to recover fees and the resulting hoped-for deterrent effect on frivolous claims brought by beneficiaries.

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