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Fiduciary LITIGATION

Delegating investment duties: Decision applies traditional principles

Certainly every attorney who has counseled a fiduciary is or should be familiar with the provisions of the Prudent Investor Act, EPTL § 11-2.3.

Now, every attorney relying on that statute should consider (or reconsider) how it applies in light of the decision of the Monroe County Surrogate's Court in *Matter of Rivas*, index no. 2000 LT 00007/B, 2011 N.Y. Slip Op. 50008(U), at *1 (Sur. Ct., Monroe County Jan. 5, 2011, Calvaruso, J.), affd, index no. 346 CA 11-01966, 2011 N.Y. Slip Op. 01982, at *1 (Fourth Dept. March 16, 2012).

In *Matter of Rivas*, the court examined how EPTL § 11-2.3(c), which deals with the delegation of investment functions, should be applied to the trust at issue. But the court did not rely on the words of the statute alone in reaching its conclusion. Rather, the court based its decision on the traditional principles governing trusts: the language and structure of the trust agreement, fiduciary obligations, and fiduciary conduct versus claimed investment returns.

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Daily Record Columnist

Most important, the court concluded that in analyzing any trust agreement, a court must examine the overall intent and desire of the grantor as expressed in the entire document rather than a few specific sentences, no matter how direct those sentences may appear.

Helen Rivas (grantor) made a multimillion dollar gift to the University of Rochester in 1945 for the purpose of constructing the Helen Woodard (Rivas) Clinic, which is now known as the "R Wing." At the same time, she also created a trust of the same size, the income of which would be used to support the operation of the clinic.

At the time of the surrogate's decision, Bank of America served as the trustee, as the successor in interest to the original trustee. The trust agreement established an Investment Advisory Committee (IAC), which would be composed of three members. Two of the IAC's members were to be appointed by the university, and the remaining member would be appointed by the trustee.

The IAC was to "have sole and exclusive power and control over the investments making up this trust fund. …" This was undoubtedly a fairly unique arrangement by the standards of practice in 1945.

As anticipated by the grantor, the trustee and the IAC had worked together, without conflict, from 1945 to 2009 to keep the trust invested and managed. But in 2009, the IAC adopted a motion, by a 2 to 1 vote, directing the trustee to invest all of the trust assets in the Long Term Investment Pool (LTIP) managed by the university.

The trustee commenced a construction proceeding to determine whether the proposed investment was consistent with the grantor's intent as expressed by the provisions of the trust agreement. The university appeared in the proceeding and while agreeing that the intent of the grantor was paramount, the university maintained that the language of the trust agreement mandated that the IAC have the sole power to make investment decisions and the trustee must follow any direction by the IAC.

The surrogate disagreed. Although he noted that "a trustee is ordinarily under a duty to comply with the directions of an advisor," the surrogate, most significantly, also held that an "advisor, in turn, is conferred with the status of a co-trustee and fiduciary obligations attach."

After conferring the IAC with *de facto* trustee status, the surrogate went on to hold that the proposed delegation of the investment function to the University of Rochester must fail for a variety of reasons.

First, the surrogate noted that the investment in the LTIP would effectively remove the trustee and IAC from performing the roles intended by the grantor i.e. the management and investment of the trust. Second, the custody of the trust would be with the university's custodian bank, which had no fiduciary obligation to the trust. Third, the trust's assets would be managed by 85 investment managers overseen, not by any party to the trust agreement, but by a subcommittee of the university's trustees "who would have unfettered control and discretion as to the investment of the trust corpus." Finally, the court agreed with the

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Continued ...

trustee's concern that once the deposit was made to the LTIP, no fiduciary under the trust (i.e. the trustee or the IAC) would have any input as to asset allocation, selection of managers, retention or sale of any particular assets, etc.

The surrogate also noted that the trust assets would only comprise approximately 2 percent of the LTIP and that the investment objectives of the beneficiary of the trust, a specific department of the university, would not always align with the investment objectives of the overall university. The court obviously focused on the requirements of EPTL § 11-2.3(b)(3), which mandate that the trustee, or in this case a de facto trustee, take into account the specific requirements of the specific beneficiary in fashioning the investment strategy for the trust.

To that end, the surrogate noted that a cardinal rule of construction that a grantor's intent "must be collected from the whole [a]greement taken in its entirety, in view of all the facts and circumstances under which the provisions of the [a]greement were framed, not in detached portions alone," and held that the two paragraphs in the trust agreement that gave the IAC "sole" investment authority must be read in conjunction with the entire trust agreement to ascertain the grantor's, and thus the trust's, intent.

Perhaps the final "nail in the coffin" for the proposed investment in the LTIP was due to the very reason that the proposed action was taken in the first place. The trust agreement stated that the trustee was to appoint one member of the IAC and the university was to appoint two.

The only requirement imposed by the grantor was that the members reside "in or near the City of Rochester." The trustee had named an employee of the bank who worked in the trust investment arena. The university had appointed two of its employees.

EPTL § 11-2.3(c) requires that a fiduciary who delegates investment function must "periodically review the delegee's exercise of the delegated function and compliance with the scope and terms of the delegation." The surrogate noted that there could be situations where the loyalties of the IAC members who were employees of the university may be in conflict as they had certain obligations as IAC members and other obligations as university employees.

The court noted that having been "conferred fiduciary status," those members owe a duty of "undivided and undiluted loyalty" to the beneficiary, and that "[t]his rule is sensitive and inflexible," citing *Meinhard v. Salmon*, 249 N.Y. 458 (1928) and *Milea v. Hugunin*, 24 Misc. 3d 1211A (Sur. Ct., Onondaga County 2009).

Finally, on this point, the surrogate quoted the Court of Appeals: "The fundamental rules [are] undivided loyalty to a trust [and] … a trustee shall not *place itself i*n a position where its interest *may* be in conflict with its duty," *In re Title Guar. & Trust Co.*, 291 N.Y. 376 at 404 (1943) (emphasis in original).

The surrogate's decision is significant given that many universities have sought to convince trustees of trusts for their benefit to invest trust assets into portfolios managed by the university itself (see 2003 TNT 248-20, LTR 2003352017), maintaining that superior investment returns and lower costs of management of investments mandate such a course.

Interestingly, the surrogate's decision did not specifically address investment returns or costs, perhaps signaling a victory for the long established rule that a fiduciary will be judged by course of conduct, not by returns.

It has been noted, in at least one professional journal, that the courts are holding fiduciaries, even though you may be surprised by who the courts find to be a fiduciary, to their promises made in the trust agreement and their fiduciary obligations imposed by applicable law.

Moral to the story: Keep the trust's interests, with due consideration of the plan of the grantor, above all else.

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