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TOPIC: Suit Against Law Firm and Its Liability Insurance Company for Negligence in Drafting Life Insurance Trust Documents Dismissed Because It Was Time Barred

CITATION: French and Van Akkeren v. Attorney's Liability Assurance Society and Quarles & Brady, No. 2015AP758 (May 12, 2016, Ct. App. WI). For a related case involving the French family and Wachovia Bank as trustee of this trust, see French v. Wachovia Bank, Nat. Ass'n, 800 F.Supp.2d 975 (E.D.Wis.2011); French v. Wachovia Bank, N.A., 722 F.3d 1079 (7th Cir.2013).

SUMMARY: Jeanna French and Paula Van Akkeren, beneficiaries of a trust, filed this legal malpractice action against the law firm, Quarles & Brady, LLP and its malpractice insurance carrier. The suit alleged that the law firm and its attorney were negligent and breached their fiduciary duties in drafting certain trust documents that established an irrevocable life insurance trust for them and their siblings. This case was an appeal from the circuit court decision that dismissed the beneficiaries' claims on three grounds: (1) the claims were barred by the six-year statute of limitations; (2) the claims were barred by the doctrine of issue preclusion; and (3) the beneficiaries lacked standing.

The beneficiaries lost this appeal – mainly because the court found that the legal malpractice claims were "time barred" by a statute of limitations. This action was not filed until eight years after the beneficiaries had sufficient information that would give a reasonable person notice of injury and its cause, such that their legal malpractice claims accrued and the limitations period began to run.

RELEVANCE: This case is a reminder that a trust instrument can waive the general prohibition against a trustee's self-dealing and authorize a trustee to specifically engage in transactions that involve self-dealing. That is exactly what occurred in this case: The terms of the trust instrument gave the bank trustee broad discretion to invest trust property without regard to conflicts of interest, risk, lack of diversification, or unproductivity. This trust instrument language specifically overrode the common-law prohibition against self-dealing, and eliminated the prudent-investor rule codified under the Uniform Prudent Investor Act. A duty to administer the trust in good faith always remained, but there was no evidence that the bank trustee acted in bad faith. Note: such broad exoneration of a corporate trustee in a trust instrument is unusual and should be included only after a great deal of thought with respect to the implications of such a provision on the client's (and trust beneficiaries') expectations! Here, had there not been a conflicts of interest waiver in the trust instrument, there clearly would have been a breach of trust.

This case is a great primer with respect to a trustee's duties of loyalty and prudence but also contains some very practical take home lessons for life insurance advisors and financial planners.

- Beware of potentially troublesome clients - particularly those who are looking for "something for nothing" or who tend to be overly quarrelsome.

- Encourage all clients to ask questions early on in the relationship – and be sure to put your answers in writing and share them with all concerned. Communicate constantly and openly.

- Make the client aware of potential disadvantages as well as advantages of the overall arrangement you are proposing. Here, the insurance advisors discussed the advantages of the Section 1035 exchange of new policies for existing life insurance contracts and they also documented and disclosed in detail the downsides and disadvantages. In this case the drawback was the low cash values and relative inflexibility of the new life insurance contracts.

- The bank was smart enough to employ an outside disinterested party to evaluate the current life insurance protection and the feasibility and pros and cons of a life insurance replacement.

- The bank had advisors with specific expertise in evaluating life insurance products do an extensive analysis of the proposed replacement and documented those findings in a detailed memorandum.

- The bank, acting as the insurance broker as well as the trustee, here did not attempt to hide the fact that it would benefit significantly from the insurance exchange. In fact, it clearly and openly disclosed it.

- The bank acted according to a rational process which served the best interests of the trust's beneficiaries. The French trust had substantial non-insurance assets and would not likely ever need the policy cash values for the beneficiaries. The trust beneficiaries had substantial personal assets after the family business was sold. The new policies had superior rates of return at death and became an attractive investment in the trust's portfolio.

- Avoid conflicts of interest and self-dealing – even if the trust instrument seems to allow them. Remember, although the defendants won this case, they had to defend themselves.

- When a trustee does not have significant competency in evaluating the appropriateness of life insurance or making decisions with respect to it, it is essential that outside, independent, competent professionals be used to do so, perhaps by delegation of the trustee's investment powers, if available under local law or the trust instrument.

It's important to note that this case was not decided on the merits of the claim, but was dismissed because the statute of limitations had expired.

FACTS: James French's company built component parts for small engines and later sold this manufacturing business for over $200,000,000. As part of his estate plan, French created irrevocable trusts to benefit his four children upon his death. Kathleen Gray, an attorney working for Quarles & Brady, prepared trust documents for James, the beneficiaries' father, to establish two irrevocable life insurance trusts for the benefit of his children upon his death. The trust documents contain a clause under the

heading of Trustee "Powers and Duties" that states that the trustee shall have the power:

to deal with any trust hereunder without regard to conflicts of interest.

In December 2004, Wachovia became the trustee for the trust pertinent to this appeal. In March 2005, after months of evaluation and consultation with James and his lawyers, Wachovia presented James with a proposal for a "1035 Exchange" that provided that two life insurance policies in the trust would be exchanged for two "no-lapse life-insurance policies." The new policies would provide the same death benefit for significantly lower premiums.

The proponents of this switch highlighted both the pros and cons – the most important of which were:

> Pros: The trust would receive the same amount of death benefit for significantly less outlay and the no-lapse guarantee ensured that the contracts would pay the promised death benefit as long as the premiums were paid.
>
> Cons: The trust would lose the flexibility of coverage which accumulated cash value that could be recouped if the policies were surrendered before French's death.

The advisors opted for the no-lapse coverage because:

(1) it was not likely that early surrender would be necessary or desirable,

(2) the trust had significant assets and was well diversified,

(3) the trust made no distributions during French's lifetime,

(4) the beneficiaries were already very wealthy,

(5) the loss of flexibility was relatively unimportant to the overall goals of the trust, and

(6) the major objective of life insurance in the trust's investment mix was to receive the death benefit.

This transaction yielded a hefty but industry-standard commission for Wachovia's insurance-brokerage affiliate.

On April 7, 2005, Wachovia asked James and his children to sign a waiver of conflict of interest, because the broker for the proposed 1035 exchange was an affiliate of Wachovia and would earn a commission on the transaction. James refused to sign the waiver and instructed his children to do the same.

On May 18, 2005, Wachovia withdrew its request for a signed waiver of conflict of interest, and informed attorney Gray: "[O]ur legal counsel has determined that after reviewing the facts and circumstances in this case, Wachovia will not require the signing of any waivers by the beneficiaries of the French Trust."

By May 20, 2005, the exchange was completed and an initial commission of $512,000 was paid to Wachovia's affiliate. Wachovia's affiliate continued to receive two percent of the annual insurance premiums every year until 2014, bringing the total commission amount to $548,000.

In November 2005, James and his children retained new counsel and demanded that Wachovia reverse the transaction. Wachovia refused.

In July 2006, the children filed an action against Wachovia for breach of fiduciary duty, alleging that the trust documents prohibit self-dealing and conflicts of interest absent express written waiver, and that Wachovia completed the exchange without obtaining such a waiver.

In July 2011, the federal district court in that action granted summary judgment in favor of Wachovia. It held that the trust documents unambiguously authorized Wachovia to engage in self-dealing, and awarded Wachovia attorney's fees and costs.

In July 2014, the beneficiaries filed this legal malpractice action against the law firm's insurance carrier. The beneficiaries amended the complaint in August 2014 and added the law firm as a defendant. Their amended complaint alleges that the law firm and attorney Gray "were negligent, and breached the fiduciary duties they owed James French and the beneficiaries of the Trust, in drafting the trust instruments to permit the trustee ... to effectuate transfers in trust assets despite having conflicts of interest, and despite self-dealing, without first informing James French and/or the beneficiaries that such conduct was permitted under the Trust documents in securing their consent to such terms." The beneficiaries sought as damages the attorney's fees

they paid their own counsel in the federal litigation, the attorney's fees the federal court in that litigation ordered them to pay to reimburse Wachovia, and the alleged lost value of the trust.

In October 2014, the law firm filed a motion to dismiss asserting among other defenses that the claims were barred by the statute of limitations. The circuit court granted the motion to dismiss, and the beneficiaries appealed and lost.

The dispositive issue on appeal is whether the beneficiaries' legal malpractice claims were barred by the statute of limitations. "A threshold question when reviewing a complaint is whether the complaint has been timely filed, because an otherwise sufficient claim will be dismissed if that claim is time barred."

Wisconsin law provides – for malpractice claims - a six-year statute of limitations. To prevail in an action for legal malpractice, a plaintiff must prove four elements: (1) a professional - client relationship existed; (2) the defendant committed acts or omissions constituting negligence; (3) the professional's negligence caused the plaintiff injury; and (4) the nature and extent of injury.

The parties' dispute concerns the latter two elements, specifically, when did the beneficiaries obtain information that would give a reasonable person notice of their injury and its cause? The law firm argued the beneficiaries' malpractice claims accrued no later than November 2005, after: (1) the 1035 Exchange had occurred without James' and the children's waiver of conflict of interest; (2) the commission had been paid to Wachovia's affiliate; (3) the children had discharged the law firm as their attorneys; (4) the children had retained replacement counsel who demanded that Wachovia reverse the exchange; and (5) Wachovia had refused to do so. Because the claim accrued no later than November 2005, and the beneficiaries did not file this malpractice action until more than eight years later in July 2014, the court ruled the claims were time barred.

According to the court:

> By November 2005, the information available to the beneficiaries would have triggered a reasonable person to look at the trust documents. Clearly, by April 2005, the beneficiaries knew that there was potentially a conflict of interest issue if the 1035 Exchange went through because Wachovia specifically asked them to sign a conflicts waiver. On May 18, 2005, Wachovia withdrew its request and gave the reason that upon review by its "legal counsel" of the

facts and circumstances, it would "not require the signing of any waivers by the beneficiaries of the French Trust." By May 20, 2005, the 1035 Exchange went through, and the commission was paid to Wachovia's affiliate. If the information up until this point was not enough to signal to the beneficiaries to look at the trust documents and see whether this transaction involving conflicts of interest was authorized, then the beneficiaries certainly would have had sufficient information by November 2005, when the beneficiaries hired new counsel and demanded that Wachovia reverse the transaction, and Wachovia refused. At that point, a reasonable person would have wondered whether the reason for Wachovia's refusal was because the trust could reasonably be read as authorizing Wachovia to refuse. In other words, the plain language of the trust documents provided the beneficiaries with notice of their injury, namely receiving trust documents that authorize self-dealing, and a probable cause to their injury, namely the law firm's allegedly negligent drafting of the trust documents.

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