Sutton’s Law and Economics Applied to the Professional Fiduciary
Helping the Trustee Avoid Predatory Litigants

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I. INTRODUCTION

Regular grist for the media mill includes a periodic report on the coming intergenerational transfer of wealth from the World War II generation to the baby-boomers. Estimates as high as $10 trillion are commonly reported. The reporting on the 2001 machinations surrounding the “death tax” have only served to raise the profile of this intergenerational transfer as a field awash in money and filled with liability traps for the unwary professional.

One of the great anecdotes of the twentieth century tells us that when the media-savvy bank robber Willie Sutton was asked why he robbed banks, he replied, “Because, that’s where the money is.” The medical profession later adopted this anecdote as “Sutton’s Law,” a maxim directing one to look to the obvious first before seeking more complicated solutions. When applied to the world of litigation, this maxim tells the hopeful claimant to look to the obvious targets, “where the money is,” and a cause of action will follow.

The plaintiff’s bar is slowly awakening to the application of this maxim to the higher profile “pots of gold” represented by that $10 trillion intergenerational transfer of wealth. For a plaintiff’s bar trying to determine “where the money is” after finishing with the defense contracting, breast implant, and tobacco litigation of recent fame, the largest concentration of this $10 trillion wealth transfer seems to occur as a large proportion of it passes through the hands of professional trustees. When one combines this incentive with Justice Cardoza’s explanation that trustees must be held to a standard that is “[n]ot honesty alone, but the punctilio of an honor most sensitive,” the professional trustee will be considered a target of opportunity for litigation at a level not previously experienced.

A number of reference materials are available to professional trustees and their counsel to address specific problems once they have arisen. However, the professional trustee today also needs to focus on lowering its litigation profile before problems have been identified. Reams of published materials are available that address checklists of “dos and don’ts” as well as specific cautions and rules but their sheer volume make them unwieldy, difficult to remember or access, and impractical for daily use. Instead, the information-inundated trust professional of today needs to develop practical daily approaches to handling daily trust administration that result in serving the trust beneficiaries as well as minimizing the trustee’s exposure to unwarranted lawsuits in the future. The most effective model is to develop a systemic approach to trust administration that is flexible enough to apply to all trust administration actions and simple enough to be regularized to the point of becoming habit. The model suggested here is gleaned from examining hundreds of real situations with the benefit of the perspective of dozens of trust professionals.

II. EXPRESS LANES TO LITIGATION FOR THE FIDUCIARY

In attempting to construct a flexible and effective systemic approach to daily trust administration for the trust professional, one must start by considering how trustees find their way to the courtroom. While authorities abound with discussions of complex and exotic new potential liability traps for the trust professional, consistent with Sutton’s Law, we will eschew the exotic and start with the more mundane paths to litigation.

Most claims asserted against trustees seem to flow from one of the following “express lanes” to the...
A. Unauthorized Transactions: The initial reaction of most trust professionals to the unauthorized transaction express lane to the courtroom is “of course, that’s obvious; we don’t need to be warned against taking prohibited actions.” However, a derivation of Sutton's Law applies to this category with particular virulence; this type of mistake is so obvious that its avoidance is commonly taken for granted. But, any experienced trust professional will reveal scores of examples of unauthorized transactions when specifically questioned. The examples range from the simple to the more exotic.

A simple but recurring situation with many derivations can be illustrated as follows: A trust officer (“TO”) receives an existing trust file with papers all neatly arranged and secured in the file folder. The income beneficiary proposes that the trust purchase certain securities that are backed by real estate mortgages. TO examines the trust portfolio and notes that it had once held a few such securities but no longer holds any. TO is thorough and also examines the investment authority granted in the trust instrument. At the bottom of the fourth page, TO reads a provision authorizing the trust to invest in several categories that essentially cover the range of otherwise permissible investments. TO sees no applicable limitation and makes the investment. What TO failed to see was the statement at the top of the fifth page prohibiting investment in instruments secured by real estate mortgages because it was blocked by the two prong fastener holding the papers in the file.

Trust professionals initially chuckle at this real example but, upon reflection, each can recall similar examples where the instrument was never read, limitations placed in an unexpected portion of the instrument were not read, interlineations by the settlor were not consulted, or addenda were not examined. All were obvious in retrospect, but these oversights are consistently buried among the thousands of trust decisions made each and every day.

A more exotic type of situation occurs when the trust language is clear but the nature of the transaction is not immediately apparent. Consider the prior example except that TO reads the full instrument and is aware of the restriction. TO enters an unauthorized transaction anyway by purchasing shares in a common fund whose holdings violate the investment restriction. TO has unknowingly violated the investment restriction by not being familiar with the holdings of the common fund.

Another typical unauthorized transaction arises from facially ambiguous language in the trust instrument. For example, a 1950’s era trust instrument may authorize the trust to invest in “New York Curb Securities.” The “New York Curb” has not existed for decades and, in its absence, determining what qualifies as a “New York Curb Security” is a challenge. Commonly, TO recognizes that the phrase is, at best, ambiguous when applied to current markets. Nonetheless, TO blithely purchases NASDAQ stocks based on a guess at the modern translation of the standard and, more likely, because it seems consistent with the institution’s general investment strategy and some securities previously held by the trust. Not clearly understanding the language in the trust instrument, TO has entered an unauthorized transaction.

B. Ambiguous Language or Situation: Trust instruments rarely contain terms that are so express and inflexible that they relieve the trustee of exercising any judgment. Trust instruments rarely contain terms that are so express and inflexible that they relieve the trustee of exercising any judgment or discretion. Basic evaluations, interpretations and decisions under the instrument are the reason the settlor arranged to use a professional trustee in the first place. These are not the type of daily evaluations intended by the term “ambiguous.” Instead, this category describes the instance in which the trustee is faced with truly ambiguous language in a trust instrument or a situation that renders the language ambiguous.

One example is the investment restriction limiting
investments to “New York Curb Securities” described previously. Another type of ambiguous situation that trustees increasingly encounter results from the proliferation of trusts and their overlapping coverage. For example, an individual with a serious medical condition is the beneficiary of two or more “needs trusts.” Each trust directs its trustee that the beneficiary must look first to other available resources for payment of medical needs before receiving a distribution, the equivalent of an insurance policy’s “excess coverage” clause. This language has long been considered standard and sufficiently clear guidance for a trustee. However, when applied to the situation where two such instruments are involved, the trustees are faced with ambiguity as to how they should decide which trust should make what distributions for the beneficiary’s medical bills.

C. Unrealistic Beneficiary Expectations: Trust professionals have a great appreciation for the dangers of unrealistic beneficiary expectations and, to one degree or another, make efforts to manage those expectations. In the 1990’s, every trust professional received a call from a beneficiary at one point or another complaining that “the market is up 25% but my trust is only getting 5%, you’re costing me XXX dollars a month.” Unrealistic beneficiary expectations run a much broader gamut covering such issues as the role the trustee will play, the services the trustee will offer, the stated purpose and limitations of the trust (as opposed to what the beneficiary thought Uncle Harry would have wanted), and the charges that must be paid by the trust.

Managing beneficiary expectations boils down to a “high touch” approach to dealing with the beneficiary.

D. Discretionary Distributions: Handling requests for discretionary distributions is one of the bread and butter activities of the trust professional. Every exercise of discretion has the potential to be questioned and, if not properly handled, result in litigation. In truth, fiduciary law generally grants the trustee extensive insulation from liability for true exercises of discretion. Thus, as with unrealistic beneficiary expectations, the trigger for disputes can usually be found in the handling of the decision rather than the substance of the trustee’s actual exercise of discretion.

E. Investment Decisions: The potential for litigation based on applying hindsight to trust investment decisions is probably the highest profile pathway to the courthouse. Disgruntled beneficiaries who sue to second guess investment strategies or allege churning of accounts are recurring themes for discussion in any gathering of trust professionals. The cases certainly get filed and taken to trial but seem to be less prevalent than industry lore would lead us to believe. As with all segments of the investment related industry, these cases are a constant. The dramatic swings in the securities markets over the
The new twist on this area of liability is that the risks of litigation over investment decisions are increased by the trends of remote consolidation and economies of scale. While the beneficiaries may actually receive improved investment advice and services, these trends also make the trustee more prone to allegations of failing to tailor investments to the needs of the individual beneficiaries or circumstances of the trust. Centralized investment decision-making also increases the risk of violating unique investment restrictions placed in a given trust instrument.

The litigation danger of the growing dehumanization of the trustee-beneficiary relationship cannot be over emphasized. As noted, this has traditionally been an extremely "high touch" relationship and, thereby, provided significant opportunities to resolve complaints and problems before they escalate to litigation. That safeguard against resolving issues through expensive litigation is rapidly eroding. Recently, a beneficiary of a substantial trust sued to replace the corporate trustee solely because the beneficiary had received a form letter notice that the corporate trustee had decided to consolidate investment decisions to a committee physically located in another state. Maintaining a "high touch" and human relationship with the beneficiary likely could have prevented that dispute.

**F. Self-Dealing:** Self-dealing is another category that prompts trust professionals to say "obviously, trustees shouldn't do it." But, with traditional corporate trustees providing more and more investment services, the potential for the corporate trustee to have an inter-departmental conflict of interest in a given transaction, known or unknown, is ever increasing.

For example, how often does the corporate trustee use trust funds to purchase a "product" that happens to be sold by the corporate trustee? The complaining beneficiary will call this self-dealing. Did the trustee have a good reason to purchase its own products instead of some other course identified by the complaining beneficiary’s hindsight? Did the corporate trustee charge the trust a "load" for investment management in connection with the fund on top of the fee for investment management charged as part of the general trustee’s fees? While this argument saw little success when the corporate fiduciary offered little more than two or three “common trust funds” for investing, plaintiff’s attorneys are arguing it with greater optimism as trustees invest more and more in their own more varied "products."

Another risk of inadvertent self-dealing is created by the traditional confidentiality wall erected between the commercial and trust divisions of the corporate trustee. Corporate trustees may be on both sides of a given transaction in that the trust division may be selling a trust asset while the commercial division is involved with the purchaser. Where the corporate trustee is involved on both sides of a transaction, the transaction will be subject to scrutiny for self-dealing. Depending on the circumstances, a purely routine loan will not likely result in liability. However, any variation that results in some benefit to the corporate trustee has a high risk of later being seen as self-dealing.

In one decision, the California court determined that the commercial division’s issuance of a loan to a third-party to facilitate the purchase of real estate from the trust was self-dealing where the loan was secured by a deed of trust to the real property then being held in escrow as part of the sale transaction. The court found that the commercial division’s earning of $2,400 in interest on the loan secured by a trust asset was self-
dealing as a matter of law and the corporate trustee’s good faith was no defense.9 As modern financial institutions grow in the breadth of their geographic coverage and in the scope of their transactions, the risk of this type of “unintentional” self-dealing grows.

G. The Existing Mistake: A basic maxim among politicians, and apparently one that is proven nearly as often as it is ignored, is that the cover-up is worse than the original misstep. Despite the name, even a corporate trustee is ultimately human. The trust professional will make dozens of trust decisions on a daily basis. The law of averages alone dictates that even a brilliant and nearly perfect trust professional will make more than a dozen mistakes of varying significance in any given year. Once the mistake has been made and discovered, how it is handled can significantly increase or decrease the fiduciary’s liability risk.

For example, TO inherits an open trust account from another entity recently acquired through a merger. TO examines the trust’s accounting records and finds a repeated misallocation of a particular category of receipts between principal and income. TO has several options for proceeding:

- TO can ignore the mistake and continue the status quo allocation, hoping no one will notice;
- TO can quietly note the correct allocation for all future transactions and hope the beneficiaries do not notice the prior errors;
- TO can correct the allocation for all future transactions and write to the beneficiaries advising them that the state’s recent adoption of the new Uniform Principal and Income Act has resulted in a change in all future allocations of the receipts from certain of the trust’s assets;
- TO can review the file and develop a means of ensuring proper allocation in the future as well as re-adjusting the balance between principal and income to account for the past misallocation; or
- TO can examine the records, quantify the impact of the past errors, develop a proposal for addressing the mistake, and communicate with the beneficiaries about the mistake as well as TO’s proposed course of action.

Which of these options, or any of the other options creativity can develop, TO takes will substantially impact the corporate trustee’s liability risk for the future.

III. KNOW YOUR A-C-D’S

The categories identified are derived from a review of literally hundreds of genuine situations faced by trustees and reported in cases which were then evaluated with frontline trust professionals, analyzed with various trust lawyers, and discussed with probate court judges. Roughly ninety percent of these case studies fall within the categories identified with the remaining qualifying as more exotic.

In seeking to distill these categories and hundreds of scenarios into a systemic approach to trust administration that will minimize the corporate trustee’s risk of litigation and liability, one applies Sutton’s Law. In so doing, one quickly realizes that the same basic tactics for risk avoidance could have succeeded in case after case. In fact, these same risk avoidance opportunities appear to have existed as commonly in the exotic scenarios as they did in the more mundane situations. The simple tactics best suited to exploiting these risk avoidance opportunities can be summed up in three simple steps: Analyze, Communicate, and Document, the A-C-D’s of lowering a trust professional’s litigation profile. Consistent with Sutton’s Law, they seem painfully obvious tactics, but tactics that are nonetheless effective and appear to be routinely ignored.

A. ANALYZE

Each and every decision made with respect to a trust should be made only after careful analysis. This advice is more easily given than fully appreciated and followed. Even a brief review of troubled trust accounts reveals
that far too many actions, investments, distributions, and transactions simply evolve rather than result from considered analysis.

As a trust professional gains experience, the number of decisions to be made mounts rapidly and many decisions start to seem "routine." The trust professional makes mundane, daily decisions more by instinct and reaction than true analysis. The step-by-step, methodical analytical approach taken by the new, unsure trust professional quickly fades as confidence builds. The analysis becomes more passive and instinctual; increasingly, maintenance of the status quo seems to be the result of most "decisions." Even decisions that depart from the status quo seem to be based on vaguer and vaguer reasoning. Usually though, decisions seem to be driven more by deference to prior practices or comments of others than the trust professional's own evaluation of a given situation. As time passes, requests from a beneficiary receive less evaluation and the trust tends simply to grant the request or grant it with a slight reduction that is intended to demonstrate fiscal responsibility but has little other foundation. By these paths does the corporate trustee quickly find the courthouse.

The trust professional should imagine the quintessential four-year-old child that seems unable to utter any word besides "why?" No matter what the explanation, the child persists in asking "why?" Trust professionals who imagine this persistently inquisitive child at their elbows when they make trust decisions will be well served. Any trust professional that cannot answer "why" a decision is being made is on the fastest of all roads to the courthouse. Moreover, if the answer to the question is because "that's the way it was done last time," "because that is what we’re doing with all the trusts," "because the investment committee thinks derivatives are going to take off," "that’s what the settlor did," "that’s what the beneficiary wanted," or "it seems reasonable to me;" then no genuine analysis has been undertaken.

A thoughtful analysis that can be proven to have been conducted and explained is the corporate trustee’s most powerful defense.

The trust professional must genuinely evaluate the factors that are present and applicable to the trust at issue. The trust professional must consider the goals of the trust that are impacted by the decision being considered, the options available, and how each impacts the purposes of the individual trust. Does the trust itself have provisions that set standards for the decision? This seems to be one of the most often neglected steps in the analysis by trust professionals accustomed to making what they think are routine decisions based on general principles of equity. If the trust instrument does not state an applicable standard to guide the specific decision, what are the standards for making the decision? Has the trust professional identified all of the available options? For example, if a beneficiary proposes one course of action that is a change from the status quo, has the trust officer considered the reason for the proposed change? Is the trust officer merely choosing between the suggestion and the status quo or has the trust officer considered whether other options are available and evaluated them?

A thoughtful analysis that can be proven to have been conducted and explained is the corporate trustee’s most powerful defense in the event of litigation. A corporate trustee in New York presented one of the most forceful demonstrations of this point in the late 1970’s. The trustee managed four trusts with a substantial portion of their investments in only three stocks. Upon undertaking management of the trusts’ assets, the trustee continued to hold these three stocks. The stocks began to plummet, but still the trustee held them. The trustee held the stocks without change for three years while their market value declined from $940,000 to $93,000 and the beneficiaries finally sued for mismanagement.

On first blush, this sounds like a very tough case for the trustee. The trustee appears to have abdicated its responsibility and taken no action to preserve the trust assets or diversify their investments over an extended period of time and in the face of clear warnings.
However, at trial, the trustee was able to prove that its apparent inaction in holding the stocks was the result of a continuing, careful, and thorough analysis. The trustee was able to prove that it conducted over 40 careful analyses of the individual holdings of the trusts during the three-year period in question. The analyses drew on several sources of information and expertise. Ultimately, the court was convinced that

The Trustee’s retention decisions were the result of careful and informed deliberations; the fact that in retrospect they may have been wrong or unwise is no ground for surcharge.10

As the judge’s comments suggest, the lesson in this case is that a reasoned analysis is given great deference, even if it turns out to have been wrong. The analysis need not be elaborate or time consuming, but it must be genuine and it must be followed by the Communicate and Document steps. The greatest challenge once a dispute has arisen regarding trust administration is to explain why a particular course of action was taken. More importantly, a jury must be convinced of the thoroughness and reasonableness of that analysis years or decades later through the obscuration of hindsight. This task is all but impossible if the original analysis has been lost to time because it was neither communicated nor documented.11

The trust professional must also remain mindful of the various tools available in conducting its analysis of a given issue. Most corporate trustees have specialists in various areas available for consultation. For investment decisions, a variety of committees or specific experts are available. Publications exist on most topics that can provide guidance on issues from the trustee’s responsibilities to the best method for liquidating aircraft leasehold interests. Inside or outside counsel can be available and should be consulted for legal advice. In many circumstances, the beneficiaries are also valuable sources of information for a given analysis. Moreover, most corporate trust departments also have a regular meeting or other means of presenting a particular issue to a select committee or the entire department for input. A

trust professional should not hesitate to consult any or all of these sources in pursuing an analysis of a given question.

When the result of the analysis is that the trustee’s duty is unclear or the trust instrument is unclear, the most powerful analytical tool available to the trustee is the court system. All jurisdictions should have some means by which a trustee can present a question regarding trust administration or instrument interpretation to a court and seek instructions. A typical statute allows a trustee broad latitude to present almost any question of trust administration to a court for decision.12 While this tool could easily be abused and should not be used by a trustee as an attempt to abdicate its responsibilities,13 in practice, trustees appear to be overly reluctant to use it in an appropriate circumstance.14 The specific standards will vary by jurisdiction, but generally, if the trust instrument is ambiguous or if the trustee’s duty and power is unclear, a petition for instructions is likely to be appropriate.

The ultimate result of any analysis must be a conclusion and specific course of planned action. The conclusion may be that the securities held are inappropriate because they are not sufficiently diversified. That conclusion must be followed by a plan of action such as a plan for changing investments to achieve appropriate diversification and the goals of the trust. As illustrated above, the conclusion may also be that no change in investment need take place and the plan of action may simply be to reevaluate the assets on a given date or at the time of a given event. Regardless, the analysis must reach a conclusion and must result in a plan of proceeding with concrete steps and a clear time table.

The final step of the analysis is to ensure that the plan of action is carried into effect. One of those excessively generous gifts too often given to a plaintiff’s attorney is a clear record of an analysis that concluded a particular action was required but never taken.

B. COMMUNICATE

The relationship between the trust professional and the trust beneficiary is ultimately an inter-personal relationship, no matter how impersonal the form of
communication may be. Like all inter-personal relationships, the bedrock of a successful relationship is good communication and the surest path to a rocky relationship is poor communication. The best and least expensive means of preventing a beneficiary's concern or dissatisfaction over an issue from escalating into heated litigation is not the world's most skilled trust attorney on retainer, it is a strong personal relationship with the beneficiary. As noted previously, a beneficiary that feels a connection to his or her trustee will be much more likely to discuss a concern or complaint and try to resolve it with the trustee than to engage an attorney to file litigation. Strong communication with the beneficiary is the key to building such a relationship.

Additionally, the trust professional that communicates freely about the decisions she has to make, the options presented, the reasoning for her decisions, the services she will provide, the fees she will charge, the actions she has taken, the actions she is taking, and the actions she will take is much more likely to establish those strong bonds with the beneficiary. If the beneficiary has complaints about a given decision, an established practice of regular communications with the beneficiary is much more likely to result in the complaint being aired and evaluated early. The beneficiary just may have a valid point or merely needs a better explanation of the planned course of action. Regardless, the earlier the trustee is aware of the beneficiary's complaint, the better. Better the trustee learn of the beneficiary’s complaint when action can still be taken to address it rather than sit idly by awaiting an easy hindsight challenge with twenty years of accrued damages. For example, when California and Colorado enacted their versions of the 1997 Uniform Principal and Income Act, they included a notice shield provision. Under these statutes, a trustee may give notice of a contemplated action or inaction under the Act and beneficiaries are required to assert complaints in a relatively short period of time or be barred from later objection. More significantly, the notice shield is not limited to vested, possessory beneficiaries that receive actual notice as are most statutes of limitations. Instead, these notice shields purport to insulate the trustee from liability to "any current or future beneficiary" so long as the notice requirements of the statute are fulfilled.

Finally, the communication step is not limited to beneficiary communications. The trustee must also communicate with co-trustees or other members of the trustee’s own team. If the trust professional’s analysis determined that a given action must take place and the assistance or approval of some other party or team member is required, the trust professional had better communicate those needs.

C. DOCUMENT

In the event of a dispute, the documentation step is often the single most important step. Unfortunately, it is also the step most commonly neglected. The documentation step really serves as a form of communicating with future recipients of the trust file. The most thoughtful analysis of a given trust situation is of limited value if it is unknown to the subsequent trust professional with responsibility for the trust in the future when the complaint arises.
This communication through documentation has always been one of the keys to successfully defending the trustee in the event of litigation. The documentation permits the trustee to communicate to the court examining events of past years what happened and why. Traditionally, the individual trust professional knew what happened and why and only faced the challenge of explaining it to the court through live testimony supported by file documentation. However, the documentation in the file is increasingly important to the preservation of a corporate trustee’s institutional knowledge. With long-lived trusts and multi-stage trusts that span the careers of several trust officers, the increasing frequency of corporate reorganizations that shuffle trust personnel and files, merger and acquisition activity among corporate trustees, and the increased mobility of employees, the file materials are now often the only source of information a corporate trustee has regarding the trust and the corporate trustee’s own actions.

The documentation step must communicate two critical pieces of information to future file reviewers, first, what happened and, second, why. As noted, the file record is increasingly the only source of information about the events relating to the trust that occurred. Many trust disputes involve substantial questions of what happened and when, e.g., what assets were held, what transactions occurred, what distributions were requested, what information was provided to the trustee, what notices were given to the beneficiaries, what direction was actually given by the settlor outside the original instrument, when the settlor passed away, what heirs exist and when. If litigation erupts over what actually happened, contemporaneous documentation of events is generally considered the most persuasive evidence available, even stronger than live testimony from that increasingly rare animal, a still available trust officer with firsthand knowledge.

One of the greater surprises in this field is how frequently a corporate trustee has no knowledge or record of the assets actually held by a trust at a given time or the transactions made involving trust assets. Unquestionably, corporate trustees make some form of record of assets and transactions. However, the trust file itself often does not contain asset and transaction records. Instead, master asset, investment, and transaction records are kept elsewhere in paper or electronic form, often times these records are not organized by trust and are not self-explanatory. The danger is that most corporate trustees manage to track and preserve the formal paper file for an individual trust, but records, particularly electronic records, not included in that file are often lost or become inaccessible. One can easily understand that two or three mergers that reshuffle the trust department and a few additional changes of computer systems quickly render historical electronic records virtually inaccessible.

A recent example involved allegations of investments that violated the trust instrument’s restrictions made in the late 1970’s. The trust department at issue had been through five mergers in the interim. As is often the case, the paper file for the trust had been carefully preserved and passed down from trust officer to trust officer. However, the file itself had only sporadic records of the assets held by the trust. Since the early 1970’s, the institution had relied on computer generated account statements sent to the income beneficiary. These statements were generated from a master database containing information for all accounts. The whereabouts of the 1970’s databases were completely unknown. Even if the data had been located, whether it could still be accessed was also unknown. Understandably, the institution had focused on converting to new systems rather than preserving historical information from old systems. No paper or electronic copies of the statements sent had been kept because those documents had been issued from a separate department and, of course, the underlying information was all considered to be available from the computer databases.

Moreover, the limited copies of account statements that did survive indicated only that a certain portion of the trust’s investments consisted of shares in “Common Trust Fund B.” The trust file had no record of what made up Common Trust Fund B, a significant issue in the case.
At the time, that information had been considered well known, reflected among the extensive information in the databases, reflected somewhere in one of the institution’s prospectuses, and surely buried somewhere among the wealth of information in the records of other departments. Thus, it did not seem necessary to include it in the file for the trust. Unfortunately, the only file materials available to the trustee’s team two and one-half decades later was the carefully preserved paper trust file. Other records that reflected the contents of the common trust fund may have existed, but they were not accessible by any identifiable means. As noted, the electronic data had long vanished. What limited paper files still existed were not indexed to a degree of specificity that would allow any meaningful search. The basic question of what assets were held by the trust and when was nearly unanswerable. Defending a trustee’s actions can be difficult enough when they are actually known, but the task becomes all but impossible when the trustee does not even know what its actions actually were.

To the extent possible, the file for a specific trust should be self-contained.

In the event of a complaint from a beneficiary, why an action was taken is often as important as knowing what action was taken. If TO has conducted the perfect and complete analysis of a given situation, that analysis is of limited value if it is not preserved for future reference in the file. As noted, statistical chance alone dictates that a fair number of well reasoned decisions, particularly investment decisions, will turn out to be “wrong” in light of future developments. The challenge is that the future file examiner (whether a court or a future trust officer responding to an inquiry) sees the action that resulted from an analysis through hindsight. The well documented file allows the future reviewer to see the decision from the perspective of the actual decision-maker at the time and understand why that decision was made.

An excellent example of the persuasive ability of a file that puts the reviewer in the shoes of the decision-maker can be found in the case of In re Estate of Niessen. The case involved another hindsight attack on a trustee’s investment strategy. The trustee was accused of failing to fulfill its fiduciary obligation to manage the assets of the trust when it simply held large blocks of stock without apparent activity through a substantial decline in value. The corporate trustee was able to present evidence from its file to convince the court that its decisions to retain the stock at issue were the result of extensive analyses conducted as part of a regular process and in pursuit of an overall investment strategy carefully constructed to achieve the goals of the specific trust instrument. In the face of such evidence of thorough analysis, the court found no liability even if one considered the trustee to have made a “mistake or error in judgment in the retention of any securities.”

Some large institutions can be vulnerable to the fear of a “smoking gun” that leads some personnel to avoid documenting a file or manipulative documentation. Media reports and popular culture feed these fears by the manner in which they treat high-profile litigation. The anti-corporate point of view is regularly expressed with the corporate evildoer on the verge of getting away with unspeakable acts except for the hero or heroine finding the smoking gun document that brings them to justice. The “plague of lawsuits” point of view is presented by stories of perfectly honorable companies being brought down in litigation by one engineer’s report expressing unreasonable concerns about a product’s safety. The isolated report is then blown out of proportion as a “smoking gun” thereby forcing a legitimate corporate citizen to close its doors.

While parties may debate the wisdom of avoiding documentation in certain industries, the issue is not even open to debate for the professional fiduciary. In fact, an inclination to avoid documentation is exceedingly dangerous for a professional fiduciary. Simply put, thorough and accurate documentation is one of the professional trustee’s best friends for two reasons. First, a trustee operating within its authority and discretion is given great deference in the event of litigation. Consequently, the vast majority of the trustee’s decisions will be upheld but only if they can be adequately explained from the perspective of the decision-maker.
Thorough and accurate documentation will permit this explanation.

Second, the trustee holds a relatively unique position among American businesses because the trustee’s ultimate duty is not to its own financial interests but to comply with the settlor’s intent and provide for the settlor’s beneficiaries. Moreover, the great deference granted to a trustee properly exercising its discretion within its authority seems to all but evaporate if the trustee exceeds its authority and discretion or ventures into areas of self-dealing. Thus, when a trustee has made an error, its own best interests are served by identifying and correcting that error as early as possible.

Clear documentation in a trust file facilitates future trust personnel in identifying and evaluating potential "mistakes." The corporate trustee is best served by finding and resolving genuine errors as quickly as possible, and certainly prior to expensive litigation. The trustee’s relatively minor mistakes are also more vulnerable to the passage of time than other industries. Most businesses can take some comfort when a given number of years have passed since a particular action with no claims having been asserted. The trustee, however, manages trusts that may span several generations and many decades with relatively few time bars to prevent a newly vesting beneficiary from challenging decisions made at the outset. Consequently, a small dollar mistake may lay quietly below the surface for many years with damages compounding annually before it is challenged in litigation. A relatively modest four figure mistake can easily require a five to six figure solution as well as a five to six figure litigation bill.

Thus, a responsible trustee seeks to identify genuine errors and quantify them as early as possible. This task is substantially enabled by accurate and thorough documentation in the trust file.

The legitimate corollary to the “smoking gun” concern directs that the documentation be accurate and thorough. Incomplete, ambiguous, or misleading documentation can become a false “smoking gun” and be worse than no documentation. In a recent case, a newly vested remainder beneficiary challenged a fifteen-year-old distribution of $25,000 as improper and unauthorized under the trust instrument. The trust professional involved was no longer with the institution which left only the file entries to determine what had happened. An accounting entry confirmed the date of the distribution but did not identify the recipient or the reasoning. A handwritten note reflected that shortly after the distribution was made, an income beneficiary called the trust officer. The notation said only "our distribution was wrong." The complaining remainder beneficiary filed litigation and argued that the notation was an admission by the trustee of wrongdoing.

With no other information available, the corporate trustee was hard-pressed to mount a defense until the retired trust officer that had made the note was located in another state. He explained that the note merely recorded the statement of the beneficiary and that, at the time, he had conducted a thorough evaluation and determined the distribution was proper.

Unfortunately, the documentation he left for future reference did not provide any of this information and was sufficiently ambiguous that, even with his testimony, a resolution of the dispute favorable to the corporate trustee cost tens of thousands of dollars in legal bills and incalculable lost value in resources that were diverted to resolving the dispute. Most of this could have been avoided had the trust professional’s evaluation of the beneficiary’s concern been accurately and thoroughly documented. Had the actual trust officer not been located or not been able to recall the incident, or not been able to convince a court of his explanation, the corporate trustee would surely have been liable for a mistake that never actually happened.

Again, thorough and accurate documentation is among a trustee’s best allies. Certainly, expecting a three page file memorandum for every twenty second telephone call with a beneficiary is impractical. However, for every action or decision taken, some basic documentation of the action/decision and the reasons for it should be in the primary file.
IV. APPLY YOUR A-C-D’S

This simple, three-step process of Analyze, Communicate and Document is intended as a guide to trust duties that will minimize the trustee’s likelihood of becoming involved in a dispute and maximize the trustee’s ability to explain its actions in the event of a dispute. It is designed to be simple and flexible enough so that the trust professional can incorporate it as part of his or her daily routine, such that it becomes second nature. Your A-C-D’s should be part of practically every aspect of your trust duties.

For example, if the trust professional is fortunate enough to be involved in the incipient stages of creating a trust, the A-C-D approach is invaluable. A trustee that learns that it is being considered to act as trustee under an instrument being prepared should, to the extent possible, request a copy of the draft instrument. While not always possible, the trustee may save itself substantial difficulty in the future by carefully analyzing the instrument while it is still a draft. Drafting attorneys simply do not have the experience of having to “live with” a given instrument over time that a professional trustee has. This perspective allows the professional trustee to identify impractical provisions, ambiguous, or inconsistent working provisions in the instrument that may otherwise be overlooked.

Consequently, when possible, the trustee should obtain an early copy of the trust instrument and perform a thorough analysis to determine whether the instrument is sufficient for the trustee’s needs. The trustee should then communicate any difficulties in the design of the trust instrument that it finds. As with any communication, the trustee should begin attempting to manage the expectations of the interested parties by explaining what duties the trustee understands it is to perform under the agreement, what duties it will not perform, and how it will charge for its services.

These communications themselves should be written and designed to document exactly what evaluation the trustee performed. Part of the documentation step should be to make clear the limitations of the trustee’s review of the draft instrument. The trustee should document in its communication to the settlor that it did not undertake to provide estate planning advice. This early analysis and communication, reflected by clear file documentation, will substantially decrease the likelihood of future misunderstandings as to the role of the trustee. It should also help focus the settlor on providing the trustee with express directions on those areas of importance to him or her. “The trustee says she will consider basic food, shelter, and health needs in making discretionary distributions. So, if I want Frank to be given money to buy a sports car on his sixteenth birthday, I better put it in the trust agreement.”

More commonly, a trust officer’s first contact with a trust is after the instrument has been executed and the trust has gone into effect. The trust officer is introduced to the trust either when it is being activated or when it is already active and is being passed along by another trust officer. In either situation, the trust officer should remember his/her A-C-D’s and apply them from the outset.

First, analyze the contents of the trust file. Is it complete, are the essential documents present, does it include relevant contact information, does it identify the assets, what file notes are present, and what issues do they raise?

Second, analyze the trust instrument. Is it complete, are there any amendments, is it executed, is there any indication of subsequent documents issued by the settlor, is it registered, is the document intelligible, what are the duties of the trustee, are they complete and intelligible, what are the powers granted the trustee, are they sufficient to accomplish the duties imposed on the trustee, what benefits are to be funded by the trust, what guidance or restrictions on asset management are provided, are there particular accounting directions, are the beneficiaries sufficiently identified, are the standards for making distributions adequately stated, are there reporting requirements, is there a co-trustee or identified...
Third, the trust officer should examine the assets and conduct an analysis to determine if they comply with the investment standards established in the trust. This analysis should be conducted regardless of whether the trust is being established or has been administered by the same corporate trustee for many years. In the first instance, the trust assets will commonly need to be adjusted. The second instance too commonly falls victim to a passive acquiescence to the institutional status quo. By this means, simple mistakes grow dramatically over the years into ridiculously expensive problems. After analyzing the assets for compliance with the trust’s investment standards, the appropriateness of the assets should also be analyzed from the perspective of whether the investment strategy is fulfilling the purposes of the trust and whether it adequately accounts for market conditions. Next, the assets should be analyzed for compliance with the trustee’s own investment standards. One of the easier plaintiff’s cases, and surprisingly common, is presented when the corporate trustee has departed from its own investment standards without good and clearly documented reasons.24

Next, the trust officer should analyze prior transactions. A successor trustee is not generally liable for the breaches of duty made by its predecessor.25 However, the successor may be liable if it permits a continuing breach of duty to occur or fails to require the predecessor trustee to redress its breaches of duty.26 Moreover, a successor trust officer at a given corporate trustee is not a “successor trustee.” Thus, the same corporate trustee remains in place and remains liable for its errors, discovered or not, regardless of which prior employee made the error. Consequently, any change of trustee or trust personnel should serve as a trigger to conduct at least a limited review of prior transactions so that, at a minimum, the new trustee or trust officer can understand how the trust came to its current situation. In the event any errors are discovered in this review, action should be taken to address them.

After any and all issues have been analyzed, the trust officer should develop a plan of action for the trust. The plan may be as simple as continuing the status quo or it may require actions from other departments, a complete readjustment of the investments, ranging up to court proceedings to address a potential problem or ambiguous provision of the trust instrument. Regardless of the nature of the plan, the analysis must result in some form of concrete plan of proceeding.

The trust officer must then communicate. If the trust is being initiated or a new phase in the trust is being initiated, seize the opportunity to manage the expectations of the beneficiaries. The trust officer should communicate with them the role of the trustee under the trust instrument, the general standards for distributions, the investment plan and current performance if available, and the anticipated expenses for the trust. If the trust officer is faced with a simple transfer of personnel, the individual situation dictates the nature of the communication but, at a bare minimum, the beneficiaries should be advised of the new trust officer’s name and contact information and be invited to raise any questions or objections. The trust officer should always keep in mind that underlying goals of any communications with beneficiaries are to manage expectations and identify any objections they may have as early as possible for resolution.

Human nature is to shy away from inviting criticism. However, the trustee’s goal should always be to “lean into the punch” and get complaints out in the open as early as possible for handling and resolution one way or another.

Similar communications should be sent to any co-trustee or advisor or otherwise interested party. To the extent the analysis has resulted in a determination that other personnel need to take some action, the trust officer must communicate with those departments or personnel to instigate those actions. The trust officer must then maintain those communications until those tasks are completed.

Next, the trust officer must document each step of the process. The trust officer should document the analysis itself, the findings of the analysis, the
anticipated plan of proceeding as well as its reasons, the various communications launched and any responses, minutes of any internal meetings held to address issues presented by the trust, file memorandum on key points of analysis or decisions, and the accomplishment or revisions of the plan of proceeding should also be clearly documented. Again, one of the easier cases for the plaintiff to pursue is presented when the file reflects a determination that certain acts needed to be taken but were never accomplished.

This basic three step approach should be applied to all actions undertaken and decisions made with respect to a trust. It should be applied to a request from a beneficiary, to investment decisions, to distribution decisions, to consolidations, and to periodic reviews. If followed, it will put the corporate trustee in a good position to avoid disputes, resolve issues before they blossom into expensive problems, and, in the event of litigation, place the corporate trustee in the best position to defend itself.

V. SOME SPECIFIC WORDS OF ADVICE FROM THE TRENCHES

A list of specific items of advice or mistakes to avoid is always destined to be misplaced and forgotten. Consequently, such lists can never provide the trust officer with the degree of day-to-day guidance as can a simple, systemic approach that is flexible enough to address most situations and implemented to the point of becoming habit. However, the advice "checklist" can provide helpful illustrations of a point. The following is a list of "words of advice" collected from dozens of interviews with trust professionals of every type. In reviewing the list, note that each could be considered a corollary or subpart of knowing and following one's A-C-D’s.

A. Read and Re-read the Instrument
Read the instrument first, read the instrument throughout and read the instrument last. This was by far the most commonly repeated suggestion from trust professionals of every type. It is usually stated with the emphasis born of frustration with the commonality of errors experienced that could have been avoided by simply reading the instrument.

The understood but too often neglected risk of not reading the instrument is ever growing. While recent years have seen an explosion of "trust mills" that churn out hundreds of boilerplate form trust instruments, many segments have also seen an increasing customization of trust instruments, each with its own unique peccadilloes. Most trust professionals appreciate the need to consult the trust instrument for distribution or investment standards. However, trusts are increasingly customized in other areas as well. A reaction to some of the dramatic changes being effected by the 1997 Uniform Principal and Income Act is that some estate planners are creating custom principal and income allocation standards in each trust instrument. This new trend in customizing what have been more traditional and uniform administration can create a nightmare for the corporate trustee handling large numbers of trust accounts.

B. Specialized Assets and Transactions Require Specialized Help
When specialized situations are presented, the trust officer should not hesitate to obtain specialized advice or assistance. Is the trust officer truly qualified to liquidate the privately held water company held by the trust? Of course, the trust professional must keep in mind that the trustee may not delegate its duties to the specialized consultant. The trustee can merely take the consultant’s advice into consideration in making its own decision, a decision for which the trustee remains responsible.27

C. Assure the Beneficiaries
Many beneficiary concerns can be allayed simply by reassuring the beneficiary that someone is actively monitoring the trust, the assets, and the distributions. Their expressed concerns are often driven by a fundamental fear of being lost among the accounts processed by a faceless bureaucracy. A simple reassurance that they have not been lost in the shuffle will accomplish a great deal and provide very inexpensive risk avoidance.
D. Avoid Institutional Focus
Corporate trustees each have their own personality, point of view, culture, and means of proceeding. The trust officer should be aware of these biases and evaluate whether they are appropriate for the trust account at issue. The trust department may always use Company X to liquidate hard assets, but does Company X really have the experience and contacts to sell the mink farm held by this trust?

E. Follow the Trustee’s Own Guidelines/Policies
As noted previously, one of the plaintiffs bar’s favorite types of cases involved a trustee that has taken action contrary to its own policies. The trustee can and should depart from general guidelines or policies when appropriate, but only after careful analysis and thorough documentation of the reasons for doing so.

F. Document
One of the more frustrating situations for a corporate trustee is the file that simply contains no information on the matter at issue. In the event of a dispute, the corporate trustee is effectively immobilized in the absence of documentation.

G. Disclose Errors Early
Setting aside the powers of compounding, history is replete with examples where the cover-up was worse than the mistake being concealed. Find errors early, disclose them early, and resolve them early.

H. Speak in Plain Language
Most beneficiaries are “lay people” and are unlikely to be either informed or impressed by explanations in unfamiliar language. The purpose of communications is to communicate with the recipient. Obtuse language or jargon do not accomplish this task. This caution applies to all forms of communication, including those too often indecipherable computer generated form account statements.

I. Get Consents
When an action is taken, communicate it to identifiable beneficiaries and obtain their consents whenever possible. Consents will not relieve the trustee of liability in all circumstances, but they are always a powerful tool in seeking to resolve a complaint raised by the party that consented.18

J. Follow the Instrument’s Requirements
This is an obvious corollary to the advice to read the instrument.

K. Schedule Regular Trust Reviews
The trust professional should not rely on external events to trigger reviews of a trust. A regular schedule of periodic, targeted and comprehensive reviews of a trust should be scheduled and acted upon.

L. Know the UPIA
The Uniform Principal and Income Act provides standards for allocating receipts from assets to either principal or income. This allocation decision has a substantial impact on most trusts requiring a balance between payments to an income beneficiary and management of assets for a residuary or principal beneficiary. Several states have adopted the 1997 version of the Uniform Principal and Income Act which effects several significant changes from the old law. Trust professionals should be well aware of the law applicable to a given trust and follow its dictates.

M. Follow Through
Once a trustee determines that a given course of action is required, the trustee must actually follow through and take the required action.

VI. CONCLUSION

Trust professionals spend their careers “where the money is” and make tempting targets for predatory litigants because of the broad scope of fiduciary liability. Considering the broad scope of potential liability and the inevitability of errors in judgment, a conscientious trust professional should strive to adopt a method of making daily trust administration decisions that will maximize the quality of the services delivered, minimize the risk of mistakes, encourage the beneficiary to express its concerns or complaints to the trustee, and provide the trustee with its strongest defense in the event a complaint escalates to litigation. Each of these goals is served by a systematic pursuit of analysis,
communication, and documentation with respect to trust administration activities. Thus, a trust professional who remembers and uses its A-C-D’s will be well served and will minimize its litigation profile.

FOOTNOTES

1David Prince is a trial and appellate attorney, his practice focuses on resolving fiduciary disputes. Mr. Prince represents a number of national corporate fiduciaries and beneficiaries. In preparing these materials, Mr. Prince drew on his experiences as well as input from innumerable contributors in the ranks of professional trust officers.

See, e.g., Nedd, Sibling Rivalry Moves To The Courts-Disputes Among Siblings About Aging Parents’ Care Are On The Rise, Legal Inteligencer, January 21, 2000, at S1 (“Some estimates have put the amount of money in question at $10 trillion, which would make it the largest inter-generational transfer of wealth ever”); Marino, Passing the Bucks: Baby Boomers Stand To Inherit Trillions Journal Record, Oct. 1, 1993 (“Economists estimate $8 trillion in collective net wealth will transfer from one generation to the next over the coming 20 years, the largest movement of inherited wealth in the nation’s history”).

2W. Sutton, Where the Money Was: The Memoirs of a Bank Robber 120 (1976). The great irony is that a reporter invented the quote; Mr. Sutton never actually said it. Id.


5Compare In re Hyde Trust, 458 N.W.2d 802, 804-05 (S.D. 1990) (trustee violated trust instrument that authorized prudent investments by investing in commodities which could not be considered a prudent investment).

7See III A. Scott and W. Fratcher, Scott on Trusts § 187 (4th ed. 1988) (hereinafter “Scott on Trusts”) (“so long as [the trustee] acts not only in good faith and from proper motives, but also within the bounds of a reasonable judgment, the court will not interfere”). See, e.g., Hurtig v. Gabrielson, 525 N.W.2d 612, 614 (Minn. App. 1995) (court upheld trustee’s decision to reduce beneficiary’s share of distribution by amount of prior debt owed to trust as within trustee’s discretion even though debt had been extinguished as a matter of law through bankruptcy).

8See, e.g., In re Lerch’s Estate, 399 Pa. 59, 58-69, 159 A.2d 506, 511-12 (1960) (trustee whose commercial department extended periodic loans to company with financial difficulties did not act improperly where no funds from trust were lent, no usual terms for loans were noted, trust had held stock in company since creation, and company had been indebted to trustee’s commercial department at inception of trust as well)


11Ironically, the trustee in Stark had less than perfect documentation of its “more than forty” analyses. See id. at 681. However, the corporate trustee had the now unusual situation of having the two trust officers who handled the trusts throughout the relevant period available to testify. Their detailed testimony along with other available evidence and documentation was sufficient to overcome the lack of complete documentation. See id.


13See generally Wilmington Trust Co. v. Haskell, 282 A.2d 636, 639 (Del. Ch. 1971) (though instructions on questions submitted may aid the trustee and the beneficiaries, the court cannot provide advisory opinions).
14See generally Robertson v. Central Jersey Bank & Trust Co., 47 F.3d 1268, 1274 n. 6 (3rd Cir. 1995) (in noting that a trustee has a duty to act in the interest of the trust, sometimes even in contrast to the terms of the trust instrument, court noted, "[i]f it be in doubt in a situation then it behooves [the trustee] to seek instructions from the courts as to its course of action," quoting Liberty Title & Trust Co. v. Plews, 142 N. J. Eq. 493, 60 A.2d 630, 648 (1948), rev’d on other grounds, 6 N.J. 28, 77 A.2d 219 (1950)).

15See, e.g., Cal. Probate Code § 16460 (West 2001) (prohibiting beneficiary from asserting claim more than three years after the trustee has provided a report or accounting that makes adequate disclosure of the existence of the claim).

16See Scott on Trusts at § 219.4.


18Id. at Cal. Probate Code § 16337(f); Colo. Rev. Stat. § 15-1-405(6).

19In re Estate of Niessen, 489 Pa. 135, 141, 413 A.2d 1050, 1053 (1980).

20A typical statement of the applicable standard can be found in In re Trusts Created By Hormel, 504 N.W.2d 505, 512 (Minn. Ct. App. 1993) ("When a matter is entrusted to the trustee’s discretion, a court generally should not intervene unless that discretion has been abused."). See generally Scott on Trusts at § 187 (discussing scope of liability relating to exercise of power within scope of discretion and authority). And see note 7, supra.

21A typical phrasing of the trustee’s ultimate obligation states “the trustee’s primary duty is to carry out the settlor’s intent.” Austin v. U.S. Bank of Washington, 73 Wash. App. 293, 304, 896 P.2d 404, 410 (1994).

22In fact, a trustee may have an obligation under its duty of “vigilance” to alert the settlor to identifiable impediments to the settlor’s intent. In re McCoy, 142 Wis. 2d 750, 757, 419 N.W.2d 301, 305 (Wis. Ct. App. 1987).

23The trustee’s review alone may give rise to certain duties to the settlor. See id.


25See Scott on Trusts at § 223 (discussing liability of successor trustees).

26Id. at §§ 223.1-223.3.

27See, e.g., Krug v. Krug, 838 S.W.2d 197, 203 (Tenn. Ct. App. 1992) (“a trustee may only take professional advice into consideration as to the management of the trust; it is his duty to exercise his own judgment in the light of the information and advice which he receives", emphasis in original).

28See Scott on Trusts at § 216 (discussing requirements for and scope of protection afforded by consents of beneficiary to trustee action).
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