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WEALTH MATTERS

The Flaw in Warren Buffett's Estate Plan

Mr. Buffett has instructed his executors to not sell any shares of his firm, Berkshire Hathaway. But these types of directives typically result in lawsuits.

By Paul Sullivan

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Warren E. Buffett's annual letter to shareholders is always parsed for investing wisdom from the Oracle of Omaha.

And for good reason: His success at investing is well known. He points out in this year's letter, which was released last weekend, that Berkshire Hathaway has gained 2,744,062 percent since 1965, compared with a mere 19,784 percent gain for the S&P 500. On an annualized basis, Mr. Buffett has returned twice as much as the stock index.

All that success has made him a very rich man, and this year, at age 89, he added a few lines that had little to do with Cherry Coke or See's Candies. He addressed what happens to his vast wealth when his time is up.

On Page 11 of the letter, Mr. Buffett discusses how he and his lieutenant, Charlie Munger, 96, have positioned executives at Berkshire Hathaway to carry on after they die. That's prudent planning.

The part that caught some advisers' attention was this line: "Today, my will specifically directs its executors — as well as the trustees who will succeed them in administering my estate after the will is closed — not to sell *any* Berkshire shares."

Mr. Buffett added, "My will also absolves both the executors and the trustees from liability for maintaining what obviously will be an extreme concentration of assets."

He said 99 percent of his wealth — estimated at nearly $90 billion — was in Berkshire holdings.

If this sounds like a straightforward plan, then you are not well versed in the myriad lawsuits that such provisions have prompted in the past. No one complains when concentrated positions rise, but they often sue when they fall.

"It's difficult to guess what his estate plan is with three paragraphs of a letter," said Sharon L. Klein, president of family wealth for the Eastern United States at Wilmington Trust. "But when people leave these directions to their fiduciaries, do they understand the full extent of their duties and the fiduciary liability?"

With a cadre of highly trained and well-paid advisers, Mr. Buffett presumably understands the liability and has put structures in place to make future corporate and individual trustees comfortable. But not everyone putting directions like his into a trust has the wherewithal and advice to grasp what that guidance means.

Generally, trustees are expected to diversify the assets of a trust. When that has not happened and the value of the trust has fallen substantially, beneficiaries and state attorneys general (on behalf of charities) have sued the trustees.

One of the better known cases involving restrictive provisions is the Dumont case from 2004, which involved a concentration of Kodak stock in a trust that was held for nearly 50 years while the stock's value declined substantially.

In the case, the trustee was charged with failing to review the investments and not informing the beneficiaries that the value was falling. The lawyers showed that the trustee had not performed the regular due diligence of a fiduciary.

The trustee, in turn, argued that Charles Dumont, who created the trust in the 1950s and funded it with Kodak stock, was explicit in his desire that the trust not sell the stock. Mr. Dumont used language similar to Mr. Buffett's: "Neither my executors nor my said trustee shall dispose of such stock for the purpose of diversification of investment and neither they nor it shall be held liable for any diminution in the value of such stock."

A New York Surrogate's Court ruled in favor of the plaintiffs and charged the trustee $21 million. That judgment was overturned on appeal, but the Dumont case is still discussed among the risks that trustees face in not properly performing their fiduciary duty.

"Heavy concentrations of a single stock in a trust is an invitation to fiduciary liability," said Peter S. Gordon, founding partner of the Gordon, Fournaris & Mammarella law firm in Delaware.

The situation is made worse, he said, when trustees become complacent. After all, how much work could it be to monitor a single stock?

Mr. Buffett wrote in the letter that keeping such a concentrated position of stock was not in accordance with prudent trust management and could open up trustees to litigation from beneficiaries who received less money than they expected. Berkshire Hathaway's stock could conceivably tumble in the 12 to 15 years he expects it will take to distribute his billions to charity.

This acknowledgment might seem enough to absolve the trustees, but such directives have not always protected trustees from litigation over the management of the assets. Once a trust is funded, those trustees are managing and distributing that money for an entity that is separate from Mr. Buffett or any other person who created the trust. They are responsible to the beneficiaries, be they charities or individuals, who are expecting to get distributions that do not decrease.

"Whenever there's money involved, people are likely to sue," Ms. Klein said. "With individuals, there's no more where that came from. And attorneys general are vigilant overseers of charitable funds. The best advice is: Be vigilant about performing your fiduciary duty."

If the person setting up the trust is determined to make it restrictive, advisers recommend setting up a directed trust, which splits up the roles of trustees and gives some the right to direct actions of others. These trusts have existed for a century in Delaware, and other states have adopted them more recently, including Nebraska, where Mr. Buffett lives.

"When you look at directed trusts, it's very clear under the statute that, with what you can give to the adviser, they'll be off the hook," said John D. Dadakis, a partner at Holland & Knight. "In a jurisdiction like Delaware, you

can say, 'Hey, this was the guy who created Berkshire Hathaway.' Unless you saw malfeasance at the company level, can you really say he was wrong about what he did?"

There are ways to undo what people have written into their trust documents, but they generally involve going to court for guidance. But sometimes, the documents are not as tied up as they seem.

"It may be rigid on its face, but there could be flexible provisions written in," said Kevin Matz, a partner at Stroock & Stroock & Lavan. One strategy is decanting, in which the assets of an existing trust are poured into a new one. Another is looking for provisions that allow the assets to be distributed to other beneficiaries, who can then put them in their own trusts.

Not surprisingly, Mr. Buffett is bullish on the prospects of Berkshire Hathaway even after he and Mr. Munger are gone. But this is a blind spot that business creators often have: Past performance does not dictate future returns.

Berkshire Hathaway is not making a product, the way Kodak made film before the world went digital. It is making decisions about how to allocate capital into various companies, a process that requires its own expertise.

Mr. Buffett has done spectacularly well over the past six decades making investment decisions, but it is not unreasonable to wonder if his successors can do the same. This is one area where Mr. Buffett's lead should probably not be followed.

For someone leaving money in trust to heirs, writing a letter with some guidance is fine, but commanding trustees to do a series of things when the world could change even a few years from now is ruling from the grave.

"The only thing we know when we draft a document is that everything is going to change," said Anita S. Rosenbloom, a partner at Stroock & Stroock & Lavan. "You want to draft a document that has certain flexibility to it. You want to give people the ability to look at things over time."

Mr. Gordon said he discouraged clients who want to put restrictive language in trust documents. "I plead with them not to do it," he said. "Give them guidance, a letter of wishes, say, 'This is what I hope happens.' But don't put restrictions on the trust."