Choice of Trustee:

Fiduciary Action and Reactions to Beneficiaries, Their Crises and Their Special Needs

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I. The Choice of Trustee

A. When creating a trust, most Settlors have important hopes and expectations. In most cases, their goals are to have a trust that runs smoothly, that solves the problem or issues that led them to create a trust rather than an outright distribution of assets, and that does not result in litigation. The courts, however, tell us a different story: many trusts are created with high expectations that unfortunately do not produce the results the grantor intended. In some instances, the problem lies in drafting errors, or choosing the wrong type of trust, but often, the choice of trustee, not the trust document, may have sown the seeds of discord and be the reason the trust was less than successful, or a downright disaster.

B. Beneficiary trustees or family trustees can be at special risk – they are likely the most common choice for many Settlors, but by their nature, a beneficiary trustee may have built-in conflicts of interest if there are other family beneficiaries, or their elevation over others may create tension and a revival of old family disputes. They are especially vulnerable in ways that more objective trustees are not.

II. Trustee Duties

A. **Duty to Administer the Trust According to its Terms** (Section 801 of the model Uniform Trust Code).

1. The first duty of any trustee is simple: read the trust and understand its terms and the purposes of the trust. The trustee should understand what the Settlor or Grantor was trying to accomplish in establishing the trust, and what the trustee's role should be in carrying out those wishes in light of the trust's purpose.

2. This duty is also reflected in the Restatement (Second) of Trusts in Sections 164-169 from 1959.

3. This duty is not waivable by the trust instrument – see UTC Section 105, Default and Mandatory Rules, item (2).

4. If there is a conflict between the written language of the trust and what the trustee believes is a material trust purpose, the UTC does allow the trustee (or a beneficiary) to petition the court to modify the trust terms or even terminate the trust if that is in furtherance of that material purpose (see UTC Section 412). Section 201 of the UTC permits a trustee to petition a court for instructions, another option in challenging circumstances.

B. **Duty to Administer the Trust in Good Faith**. (Section 801 of the UTC).

   1. Permeating the trustee's role throughout the term of service is the duty to always act in good faith. This duty is also not waivable under UTC Section 105 (2) and is reflected in the Restatement of Trusts.

   2. Good faith means the trustee undertakes the role placing avoiding conflicts of interest, ulterior motives, including taking sides re family disputes (even if the trustee is a family member) and generally acts in furtherance of the trust purposes, not a substitute agenda.

C. Duty of Loyalty. (Section 802 of the UTC).

   1. Related to the duty to act in good faith, the trustee must also administer the trust loyally, "and in the interests of the beneficiaries." This is one of the most fundamental duties of a trustee. Most of the issues regarding the duty of loyalty involve financial transactions, and the governing instrument may waive specific conflicts of interests that are likely to arise based on the choice of trustee.

   2. To fulfill this duty, the trustee must be careful not to place the trustee's interests or the interests of third parties above the interests of the beneficiaries.

   3. Some states (Connecticut) have modified the trustee's duty to act solely in the interest of the beneficiaries with a proviso that this duty is limited to actions that are also consistent with the settlor's intent to avoid a carte blanche, beneficiary forward approach to the interpretation of the trust, since a purpose of a trust may be to limit the access or interest of certain beneficiaries.

   4. Avoidance of conflict of interest is a corollary of this duty, including the not to use trust property for the trustee's personal benefit, even if

there is no direct loss to the trust, and avoid any personal gain. This can be a challenge to lay trustees, who may regard the standards of the marketplace (or less) as the appropriate standards of behavior, not those of fiduciary duty.

5. Transactions that violate this general duty may be voidable by trust beneficiaries.

6. Court approval in tricky cases is always an alternative for the trustee.

D. **Duty of Impartiality** (Section 803 of the UTC).

1. Related to the duty of loyalty, the duty of impartiality requires a trustee to act impartially if there is more than one beneficiary in investing, managing and distributing the trust property.

2. Impartial does not always mean equal – the trustee must look to the purposes and terms of the trust, which may provide different standards for distribution. But those standards must be administered impartially and consistently so as not to improperly favor one or more beneficiaries over others not consistent with the terms of the trust.

E. Duty of Prudent Administration (Section 804) and Standard of Care

1. A trustee must administer the trust with reasonable care, skill and caution.

2. Note that reasonable skill and care is not highly skilled; however, if a trustee should have special skills and was named in reliance on those skills, then Section 806 requires that those skills be utilized and that trustee will be held to a higher standard.

3. Recognizing that reasonable skill may not be sufficient for every situation, UTC Section 807 encourages delegation of duties and powers to others with greater expertise as long as the trustee is careful in selecting an agent, establishes the scope and term, and most importantly, **periodically monitors** the delegee agent's performance.

4. The standard of review of a trustee's performance is waivable to some extent in the trust instrument, but not below a certain minimum floor. Specifically, UTC Section 1008, which is a mandatory provision in most versions of the Code, does not permit

a Settlor to indemnify or exculpate a trustee who acts in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries.

5. Sample language to lower the standard of care (or increase the standard for breach of trust) typically reads: "the trustee shall only be liable for willful misconduct or gross negligence," for example.

    (a) "Some persons may be hesitant to serve as Trustee hereunder because of a concern about potential liability. Therefore, with respect to any trust created hereunder no Trustee shall incur any liability by reason of any error of judgment, mistake of law, or action of any kind taken or omitted to be taken in connection with the administration of any trust created hereunder if in good faith reasonably believed by such Trustee to be in accordance with the provisions and intent hereof, except for matters involving such Trustee's willful misconduct or gross negligence proved by clear and convincing evidence."

    (b) Language indemnifying the trustee for expenses of defense may also be included.

    (c) Exculpatory language inserted if the trustee abuses a fiduciary or confidential relationship in order to obtain that exculpation may be held invalid; the burden is on the fiduciary to prove fairness and adequate disclosure.

F. **Duty to Collect or Marshall Trust Assets** and to keep trust assets segregated.

1. A trustee has a duty to inventory and collect trust assets and to bring them under the trustee's control. This also means not commingling the assets with the trustee's own personal funds.

2. In addition to inventorying the assets, a trustee may be wise to engage an independent appraiser to evaluate the assets in the trust. This can enable the trustee to determine how best to manage them in light of the trust terms and purposes.

3. If there are problem assets, a trustee may wish to ask the relevant court for instructions on how best to handle the assets.

G. **Duty to Keep Beneficiaries Informed** (Uniform Trust Code Section 813)

1. In general, a trustee has a duty to keep qualified beneficiaries of a trust reasonably informed about both the administration of the trust and of material facts necessary to protect their interests in the trust.

2. In addition, the trustee has a duty under the UTC to respond promptly to the request of any beneficiary, qualified or not, for more information related to the management of the trust, subject to the limits of reasonableness. This may include a request to be sent the entire trust document, not just the portions "relevant" to that beneficiary..

3. This duty regarding notice and reporting has been one of the more controversial aspects of the Uniform Trust Code. This provision is mandatory in some states, regardless of the terms of the trust instrument, and waivable or modifiable in others – the Uniform Law Commission has acknowledged that states may want to choose whether and to what extent this requirement can be waived and a valid trust still be maintained. Some states have chosen to allow waiver and others have not; others have appointed a designated representative who can be authorized to receive notice on behalf of young or problem beneficiaries and to enforce the trust on their behalf..

4. This fiduciary duty to communicate reasonably is often one of the more difficult ones for trustees to perform. Problems may range for benign neglect due to a high turnover of trust officers and/or a too small trust; to emotionally laden communication issues due to sibling hostility, jealousy or other factors.

III. Types of Trustees

A. There are broadly three categories of trustees that Settlors or Grantors may choose from in deciding who will be responsible for carrying out their wishes.

B. The **corporate trustee** – that is, a trust company with fiduciary powers, licensed under the laws of a particular state, or a nationally chartered trust company licensed under federal law to do business in all states.

(1) Corporate trustees are often reluctant to manage real property in trust, but may, either by utilizing an LLC or other device to hold the real

estate, or after view, in appropriate cases, considering it investment property.

(2) Some corporate trustees as a matter of policy will not serve as trustee of specialized trusts, such as first or third party special needs trusts.

(3) A family office can be a hybrid of a corporate or professional trustee, composed of independent professionals but dedicated to the specific needs of one (or more) families.

C. **The family trustee** – a trustee who is also a close family member of the trust Settlor, such as a spouse, child or other close family relation. The trustee in this case is often a beneficiary of the trust (trustee/beneficiary).

D. **A professional** serving as a trustee – may be an accountant, an attorney or other individual with substantial experience and understanding in trust and tax law to carry out the Settlor's directives.

E. **The hybrid** - a combination of a family trustee/beneficiary serving as co-trustee with a corporate or professional trustee.

F. **Directed trustees** – a more recent development, and generally beyond the scope of this discussion. A directed trustee arrangement allows the Settlor to divide the responsibility of trusteeship among more than one person, allowing one type of trustee to direct another, for example, a Settlor may choose an administrative trustee to take advantage of the laws of the State of Delaware, but prefer an investment advisor trustee who is resident in Missouri who directs the administrative trustee regarding investments. The directed trustee is not under an obligation in most circumstances to monitor or question the orders of the directing trustee, and has limited fiduciary duty as a result. The directing trustee takes on the corresponding fiduciary duty regarding the investments.

G. **Issues to consider in choice of trustee**:

(1) skill and competence;
(2) knowledge of family dynamics;
(3) objectivity;
(4) investment acumen;
(5) knowledge of a specific field or unique issue (closely held business, management of a special needs or supplemental needs trust);
(6) cost – compensation or volunteer;
(7) potential conflicts of interest;
(8) personality or compatibility with beneficiaries,

(9) diligence- will the work actually get done, the records kept, the tax returns filed; and
(10) permanence – is the trust long term and is there a need for continuity in a particular trust. .

H. Please note that **some of these factors directly conflict with each other**: a high degree of skill and professional competence is typically in conflict with low cost; an intimate knowledge of family dynamics usually comes at the price of objectivity and with potential conflicts of interest; low cost often comes at the expense of diligence and knowledge; etc. On the other hand, we are all familiar with cases where a trustee's alleged competence, especially in the area of investments or relations with beneficiaries, did not produce the expected results. Choosing the right trustee for a trust is often the most difficult and critical part of the process.

IV. When Is the Choice of Trustee a Material Purpose?

A. Don't want them beneficiaries getting their hands on my assets. A Nebraska court examined the question of whether the particular choice of trustee was a material purpose of the trust. Like many states, Nebraska's Uniform Trust Code allows a court to remove a trustee if removal is requested by all beneficiaries AND is not inconsistent with a material purpose of the trust.

1. *In re Trust Created by Jack Fenske v. Elkhorn Valley Bank & Trust, Trustee,* 303 Neb. 430 (Neb. 2019), the family members of Mr. Penske after his death were unhappy with the **bank** that their uncle had chosen to manage his trust. The trust provided for income to his great nieces, Jennifer and Laura, but invasion of principal only for his great nieces' educational expenses. The great nieces wanted to appoint one of their husband's, an attorney, as successor trustee and ultimately to terminate the trust.

2. Accordingly, the great nieces petitioned the court to modify the trust based on a substantial change in circumstances and to remove the bank as trustee. The trust had in fact paid substantial amounts for the great nieces' educations, and the trustee's fees now were almost equivalent to the trust income.

3. However, the testimony of the drafting attorney was pivotal in the court's decision to keep the bank on and decline to modify the trust. The attorney testified that Mr. Fenske wanted a trustee "to keep it together as long as it could possibly be kept together" and "the one

thing that I think [Fenske] was really trying to get away from was to have any of his relatives in charge of his assets."

4. On that basis, the court found the choice of trustee to be a material purpose of the trust, and that no substantial change in circumstances had occurred.

B. A good job comes to an end. The opposite result was reached in a Georgia case, *Glass v. Faircloth*, 354 Ga. App. 326 (Ga. App. 2020). In that case, the decedent had established an inter vivos generation-skipping transfer tax trust back in 2020, the Glass Dynasty Trust, and appointed **two officers in the closely held business as trustee, together with one family co-trustee**. A dispute arose over the independent trustee's compensation. The beneficiaries sought removal of the independent trustees, an injunction preventing the payment of their reasonable fees going forward, and then filed a motion to modify the trust pursuant to the Georgia Uniform Trust Code.

1. The court found no reason to enter an injunction as both the independent trustees and their law firms appeared solvent, and there were no allegations of wrong doing or danger to the trust.

2. However, the court did permit modification of the trust based on consent of the beneficiaries and the modifications not being inconsistent with a material purpose of the trust. The material issue of the trust again was the primary deciding factor, and in this case, nothing about the modification changed the process or eligibility for distributions established in the original trust, the purpose remained the same. Further, the modification statute did not contain a burden to show good cause or involve proof of trustee misconduct.

3. The modification of the trust approved by the court permitted the beneficiaries to remove and replace trustees by a majority vote of the most senior generation of descendants, which they promptly did.

V. Theory versus Practice – Competence

A. A Trustee's first duty is that of competence – knowing what the terms of the trust are, what the assets are, and being able to carry out the trust terms relative to the property conveyed to it. Sounds basic, but sometimes it is not so easy for some trustees.

B. A **family trustee finds out that there is no trust corpus**. In H*oman, Trustee v. Estate of Homan*, 121 N, E. 3d 1104 (Ind. App. 2019), it was not clear to the trustee whether or not the primary asset of the trust belonged to the trust or not.

1. Indiana law allows property to be transferred to a trust by declaration – and in 2013, Robert Homan seemed to do just that by declaring in his trust instrument that "the GRANTOR hereby transfers to himself as TRUSTEE the property listed on the attached Schedule marked A and incorporated herein." The Grantor's nephew, John, was named successor trustee.

2. The trust contained specific instructions on the management of the farm, specifically referring to the various parcels, tillable acreage and farm income. However, Schedule A was blank, and there was no deed from the Grantor to the trust..

3. On Mr. Homan's death in 2016, his brother, Paul Homan, was appointed personal representative in his 2009 will and took control of the decedent's farm and began to manage it. The **nephew, acting as trustee**, brought an action to confirm his title as trustee.

4. The court found that the declaration of trust in the preamble of the document, and even the particular articles of the trust dealing with the purported trust real estate were all ineffective to constitute a conveyance to the trust. Had Schedule A been prepared, the result may have been different. Had a more professional trustee been chosen, the error in the declaration of trust might have been spotted at the outset.

C. **A family trustee gets in over her head.** In another recent case from Indiana, *In the Matter of the Living Trust Agreement of Virgil C. Morningstar and Agnes B. Morningstar*, 136 N.E. 3d 1139 (Ind. App. 2019), a **family trustee**, Teresa B. Morningstar and initially co-trustee with Agnes and Virgil, works with Virgil after the death of Agnes to manage the trust's main asset – about one fourteen rental homes in "the bad part of Fort Wayne, Indiana." After Virgil's death, Teresa is tasked with winding up the trust and selling the rental properties. The problems?

1. There are twenty-one trust beneficiaries.

2. The properties were distressed – valued at about \$10,000 to \$15,000 per rental home – and in a poor location, needing substantial repairs.

3. Teresa never obtained an appraisal of the properties, arguing that the costs of appraisals would be too high and just reduce the beneficiaries' distributions. She also did not make a list of each property and what

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repairs it in fact needed. She received one offer to purchase, without marketing the properties widely, and immediately became vested in it.

4. Further, Teresa was generous with her own expenses, paying herself a monthly management stipend (even for several months after they are sold) and a finders' fee for her work in arranging a bulk sale to one buyer, although she is not a realtor.

5. Although Teresa was represented by the attorney who drafted the trust for Agnes and Virgil, and who tried to defend the bulk bargain sale, one beneficiary objected in writing, based on valuation prior to the time of the sale. That objection was overruled by the trustee and her counsel, and the beneficiary them pursued an action for accounting and surcharge for breach of trust

6. In this instance, while Teresa may have been the choice of Virgil and Agnes, representing their values and business morals, the business norms of the low end rental marketplace did not serve her well as a fiduciary. A more knowledgeable beneficiary was able to prevail. Teresa was removed after the sale and her share of the trust was charged to pay the costs of the surcharge.

VI. Theory versus Practice – Family Trustees and Conflicts of Interest

A. Probably the most common choice of trustee is one's family member, based on trust, a shared knowledge of family values and goals, and the hope that they will work for little or no fee. But that can put the family trustee at personal risk, and in many families, bring out feelings of competition, jealousy or special entitlement that were kept in abeyance while the parents were alive.

B. **Three sibling fight**. An example from Missouri involves three siblings, a son and two daughters, *Lambley v. Diehl, Trustees* et al, 603 S.W. 3d 346 (Mo. App. W.D. 2020). Mr. and Mrs. Diehl owned a farm, livestock and equipment which were the primary assets of their two trusts. The land was divided between their two revocable living trusts, the Phyllis Trust and the Raymond Trust, during their lifetimes. Both trusts named each other followed by their son, Kim, as the successor trustees. Phyllis died first, followed some years later by Raymond. During Raymond's "overlife,"as he became older and less able to farm, Kim did a great deal of "custom farm work" on the Phyllis Trust to help manage and maintain the Phyllis properties and to provide Raymond with an income from those farm assets, including advancing funds, using his own farm equipment and doing extensive farm management and labor.

.Raymond acknowledged his son's efforts and promised to pay his son at a future date, when they would figure it out. On Raymond's death, Kim's sisters, who were to inherit a specific sum plus an equal share of non-farm property, brought suit for an accounting, breach of fiduciary duty and related issues relating to the two trusts.

1. Kim was likely a better farmer and son than a businessman or sole trustee. Neither he nor his father kept a separate bank account for the Phyllis Trust, and there was no written agreement between he and his father regarding the custom farm services he provided, which his sisters claimed should be gratuitous.

2. Kim brought a counter claim for unjust enrichment as well as q*uantum meruit*, but these claims ran into the legal presumption that services provided by family members to a trust or its beneficiaries were rendered gratuitously, notwithstanding the local custom that farm work often was done based on oral agreements to be worked out later among community members who knew and trusted each other.

3. Ultimately, the two sisters were not successful in their attempt to remove their brother as trustee or some of their other claims, but the matter was remanded to the trial court for further proceedings re the trustee's claim based in q*uantum meruit*.

4. While it makes sense that Kim's parents would name him, the responsible farmer, as trustee for an estate that primarily involved farm and agricultural assets, the appointment as sole trustee over his sisters may not have done him any favors. Had an independent co-trustee been appointed to handle the finances, make sure contracts were put in place, and financial accounts and communication done more professionally, the situation may not have resulted in the family division and animosity that resulted.

C. **The problem of the step-mother trustee**. Another instance where a family fiduciary may not have been the best idea based on conflict of interest is *In the Matter of the William Raggio Family Trust, Dale Checket Raggio individually and as Trustee of the Marital and Credit Share Trust*s, 136 Nev. Op. 21 (Nev. 2020), in which Mr. King created a will with two trusts, a marital trust and a credit shelter trust. Both trusts were for the benefit of his second wife during her life, and on her death, the marital trust passed to the children of his first marriage and the credit shelter trust passed to descendants of the second wife. And yes, he named the second wife as sole trustee of both trusts. **What could possibly go wrong**?

1. The marital trust directed the trustee to pay as much of the principal of the Trust as the Trustee, in the Trustee's discretion, shall deem necessary for the proper support, care and maintenance of the beneficiary" and so the wife, as Trustee, distributed principal from the marital trust trust for her support: - and did not take principal from the credit shelter trust for the same purpose. The decedent's daughters petitioned to remove the wife, and ask for discovery relating to the credit shelter trust, on the basis that the wife, as trustee, needed to consider her other assets before making principal distributions for support.

2. The court's decision was based in part on a Nevada statute that provides that unless otherwise provided in the instrument, trustees are not required to consider a beneficiary's assets or resources in determining whether to make a distribution of trust assets, NRS 163.4175. The trust terns did not otherwise provide, so the remaindermen did not prevail.

3. Query whether the decedent or his drafting counsel thought through the likely tension and disharmony this type of estate plan would inevitably create.

D. **And another (wicked) stepmother case**. In Oregon, again we see a second wife as sole trustee of a trust for the benefit of herself and children of the first marriage (does no one learn?). In this case, the result was not so favorable to the wife. I*n the Matter of the Testamentary Trust of Dale F. King*, 295 Or. 176, (Or. App, 2018), the second wife was removed for various breaches of trust and replaced by a corporate trustee; the question became whether her share, subject to spendthrift limitations, was available for damages to the remaindermen.

    1. This matter presents an interesting choice of laws: a trust governed by Nevada law, where the testator resided at the time, drafted by a Minnesota attorney who incorporated the Minnesota statutory powers, not Nevada's, and subsequently interpreted by an Oregon court.

    2. The allegations of breach of trust involved loans the stepmother trustee made to her own son by a prior marriage

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and to another entity in which she had a personal interest; the likelihood of repayment on these loans was in serious question. Nevada law, but not Minnesota or Oregon, specifically prohibited these types of loans by a trustee. There were other allegations of misconduct as well.

3. The court removed the wife and appointed a corporate trustee. The trustee then requested instructions as to whether the trust's spendthrift clause protected the wife's share from attachment. The court directed that based on equitable powers to compel redress of a breach of trust, as detailed in both the Second and Third Restatements of Trusts, the wife, as trustee beneficiary, could have her interest in the trust charged against by the other beneficiaries to secure their claims, notwithstanding the trust's spendthrift provisions.

VII. Communication among Trustees and Beneficiaries – the Duty to Keep Informed

A. Even when a Settlor seems to have considered the choice of trustees well, lack of communication between or among the trustees, or between the trustees and the beneficiaries, as well as the cost of those professional trustees, can create dissension. Several cases illustrate the tensions that can arise.

B. **Trustees must review and communicate**. In the Missouri case, *In the Matter of T.R. Potter, Jr. Exempt Trust f/b/o John M. Potter*, 593 S.W. 3d 556 (M0. App. E.D. 2019), the Settlor chose a corporate trustee plus an individual trustee, to manage an inter vivos GST exempt trust established in 1988.

1. The trust was divided into two shares, one for each of the Settlor's children. As time went by, an individual who appears to be unrelated to the family became the individual co-trustee, and he disagreed with the corporate trustee on making income distributions to the current trust beneficiary, in order to continue growing the trust for future generations.

2. There was a lack of communication, however, with the corporate trustee, and eventually the beneficiary petitioned for his removal and surcharge. Because the corporate trustee had in fact been making the disputed income distributions for several years before the co-trustee appeared to notice, the end result was his eventual removal but not surcharge – his interpretation of the trust was not unreasonable, but the court found his inattention and lack of communication with the corporate co-trustee a factor.

C. **Sibling rivalry with a stick:** *in terrorem* as a weapon. In *Charles Hunter, Jr. v. Eleanor Hunter Trustee,* 838 S.E. 2d 721 (Va. 2020), a Virginia court had to interpret the difficult issue of a trust divided into shares for each child, with one child trustee over her own trust and over the trust for her brother. The trust contained both an *in terrorem* clause plus a waiver of the trustee's duty to inform and report under the Virginia version of the Uniform Trust Code. The sister as trustee refused to give her brother as beneficiary basic information about the trust, including why it had dropped markedly in value over the course of six years.

> 1. While much of the details of the case involved a decision of whether the *in terrorem* clause applied to the interpretation of the trust terms, surely the choice of trustee, with one sibling dominant over her brother, with the duty to communicate waived in the trust, played a role as well..
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> 2. The court noted that *in terrorem* clauses have a long history, back as far as the thirteenth century B.C. in Mesopotamia, where they were used to remove a disgruntled family member from the protection of his family, through medieval times, when they were threats of terror, not loss of money, "admonitions of doom" warning the contester of the "torment of hell" and the "Day of Judgment" among other spiritual threats. Now while their public purpose is to deter bitter family disputes that will contests frequently engender, the penalty is merely financial, but can be severe.
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> 3. The court also acknowledged the distinction in these clauses between will contests, with a short time horizon, and trusts, with a much longer life span, and perhaps an even greater duty to supervise: "The rising use of expansive trust forfeiture clauses is problematic because by disinheriting beneficiaries who seek oversight of this fiduciary relationship, the clauses threaten to forfeit trusts altogether," citing Deborah S. Gordon, *Forfeiting Trust*, 56 Wm. & Mary L. Rev. 455, 474 (2015), footnotes omitted. *Supra* at 725.
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> 3. Regardless, the law does not like a forfeiture and such clauses are to be strictly construed, the court observed. Because the brother having carefully pled in the alternative for the court not to go forward with the construction suit if the *in terrorem* clause would be invoked, the court concluded that the request for construction or interpretation of the trust instrument did not give rise to the threatened loss of benefit and the case was remanded for interpretation of whether the waiver included a waiver of common law trustee duties of trust oversight and keeping the beneficiary informed, in addition to the formal trust code reporting requirements that were waived.
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> 4. One can imagine the thought processes involved in the selection of trustee, since the son had previously borrowed money from his parents and likely did not repay them, since the trust indicated those sums were to be deducted from his share. This must have given rise to the appointment of the "responsible" daughter as trustee, but the waiver of the trust code's duty to inform and report,

and the likely sibling resentment and rivalry the whole situation created, may be an example of taking things a step too far.

VIII. The Specter of Divorce and the Choice of Trustee

A. Divorce can be a significant challenge for a trust, and many trusts for children are created for just that purpose – to try to insulate and protect inheritances from subsequent divorce. Further, some states are more aggressive than others about allowing inclusion of trust assets as marital assets. Drafting can make a difference – but drafting for divorce and drafting for qualified retirement plans or other typical estate challenges may be quite different and in opposition (one can involve sole benefit, see-through trusts, while the other involves as many beneficiaries and as much discretion as possible – e.g. *Pfannenstiehl v. Pfannenstiehl*, 475 Mass. 105 (2015) And while a Settlor can choose what state he or she resides in, and what law applies to the trust, the Settlor usually does not choose where his or her children reside or the law for their subsequent divorces, which is based on their domicile. But a trustee can choose how to respond to a beneficiary's divorce or the court orders in its aftermath, and those choices may make a significant difference in outcome. There are some well-known divorce cases in which the choice of trustee may have made a difference.

B. **The trustees' gambit: a family and independent trustee go to immense lengths and risk**. In the well-known case *Michael J. Ferri, Trustee v. Powell-Ferri*, 476 Mass. 651 (2017), and its companion cases, *Michael J. Ferri*, *Trustee v. Powell-Ferri*, 317 Conn. 223 (2015); *Michael J. Ferri, Trustee v. Powell-Ferri*, 326 Conn. 438 (2017 and finally, *Powell-Ferri v. Paul Ferri*, 326 Conn. 457 (2017). These **four Supreme Court** cases all involve a substantial Massachusetts trust (value approximately $60 to $70 million at the time of the dissolution) created in 1983 for the sole benefit of the Settlor's son, Paul, when he was eighteen years old. Paul married about 12 years later, and fifteen years after that, in 2010, his wife filed for divorce. At that time, the trustees of Paul's trust were his brother, Michael, and an independent trustee. Paul's 1983 trust gave him the right to request withdrawals, gradually increasing from 25% at age 35 to 75% at the time of the divorce. In 2011, while the divorce was pending, the trustees decanted the Massachusetts trust, notwithstanding the 75% withdrawal right, into a new lifetime spendthrift trust.

    1. The first Supreme Court case in 2015 involved a declaratory judgment of whether or not the defendant husband had breached his duty to preserve marital assets by allowing the decanting and by failing to remove assets from the trust. Because the decanting was done by a third party, the trustees, the Connecticut Supreme Court found that the husband had no duty to take affirmative steps to recover marital assets

from a third party without a finding of dissipation. (Prior to this decision, but after the decanting, the independent trustee had resigned).

2. **Can they even do that**? The second cases were the Connecticut court's attempt to determine if, under Massachusetts law, the decanting was even legally permissible. The Connecticut Supreme Court certified three questions regarding Massachusetts law to the Massachusetts Supreme Judicial Court: The three questions were, was it permissible under Massachusetts law for the trustees of the 1983 trust to decant substantially all of its assets to a new 2011 trust? If no, should 75% or 110% be returned to the 1983 trust? Finally, is an affidavit from the still living settlor admissible to establish trust purpose for the 1983 trust?

3. The Massachusetts court, to the astonishment of most in the trust world, held that because the 1983 trust gave the trustee's broad powers and authority to take any steps and do any acts which the trustee might deem necessary in connection with the management and disposition of the trust it could decant, notwithstanding the withdrawal rights of the beneficiary. Because these powers were expansive, including the power to segregate assets for later payment to the trust beneficiary so long as the beneficiary was living, the withdrawal did not affect the trustee's right to protect. Further, the trustees' broad powers continued even after trust termination until final distribution, and they could continue to act pursuant to those powers provided under the trust instrument. And the court did consider the rather self-serving affidavit of the Settlor that the trust purpose was to protect the interest of his son whenever it might be at risk.

4. Because of the risk involved in this trust, it is unlikely that a corporate trustee would undertake such a gambit to protect a divorcing beneficiary. The risk included potential adverse tax consequences, involvement in a potential fraudulent conveyance, breach of duty and I am sure others. But the gambit was successful; the Connecticut court respected the new decanted trust. But it did saddle the trust beneficiary with a very high alimony award as a result.

C. **A corporate trustee comes through.** An heiress, Cleopatra Cameron, inherited substantial funds from her father as part of her share of a GST Exempt, Non-Exempt and a Gift Trust for her benefit. All three of these trusts were discretionary spendthrift trust and prohibited the trustee from making payments to her creditors. Cleopatra married Christopher Pallanck and together the couple had two children. Christopher filed for divorce in 2009 and was granted sole custody of the children as well as temporary child support and alimony. Because the father was working only part-time and the mother was receiving $40,000 per month from the trusts, the court ordered a child support obligation of $8863 per month using a feature of California trust law to require the trust to directly fund Cleopatra's child support obligation. Initially, no payments were made.

1. California law allows a court to overcome the trustee's discretion under narrow circumstances when there is an enforceable child support judgment that the trustee refuses to satisfy. As part of its means of enforcing a child support judgment, notwithstanding the spendthrift nature of a trust, the court can order the trustee to satisfy past and ongoing child support obligations directly from the trust.

2. Wells Fargo was the trustee and objected on the basis that the court had no authority to order direct payments to accreditor from a spendthrift trust; ultimately, however, it complied with the court order.

3. Both Wells Fargo and Cleopatra subsequently resigned their positions as Trustee and BNY Mellon was appointed successor trustee

4. A final judgment of divorce was entered in 2010; the father retained sole custody of the children, and the trustee continued to pay the child support order from the trust as per California law.

5. In 2012, Cleopatra exercised .her authority under the trust to change situs, and moved the situs of the trust to South Dakota. BNY Mellon resigned as sole trustee and was replaced by Citicorp Trust of South Dakota. Citicorp Trust resigned shortly thereafter and was replaced by Bankers Trust Company of South Dakota. The trust petitioned the South Dakota court for approval of the situs change and amendment of the trusts, both of which were approved. The trusts continued to pay the child support obligation.

6. In 2016, yet another corporate trustee was appointed, Trident Trust Company, Inc; and Empire Trust was appointed the Trust Protector. Empire Trust questioned the direct payments of child support from the trusts in light of South Dakota law and the trusts' rapidly depleting assets. Trident then ended child support payments to the father.

7. In response to a declaratory judgment regarding the construction of the trusts, the South Dakota court considered whether the California court order was entitled to full faith and credit in South Dakota. It concluded that the full faith and credit clause does not mean that states must

adopt the practices of other states regarding the time, manner and mechanisms for enforcing judgments. "Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the evenhanded control of forum law, *Baker by Thomas v. Gen. Motors Corp*., 5222 U.S.222, 235 (1998); see also Restatement (Second) of Conflict of Laws, §99 (1971). *Supra* at 250. "The local law of the forum determines the methods by which a judgment of another state is enforced."

8. South Dakota law, on the other hand, does not have such a means of enforcing child support by direct payments from a spendthrift trust. In fact, the court observed, "it is not authorized and is, in fact, expressly prohibited." "The [South Dakota] Legislature has emphatically rejected even the specter of an argument that would allow a child support creditor to reach trust funds protected by a spendthrift provision." The court observed that the Legislature had specifically rejected the position of the Restatement (Third) of Trusts and *"…does not intend the courts to consult the Restatement (Third) Law of Trusts...§59….with respect to subject matters addressed by the provisions of §§ 55-1-24 to 55-1-43, inclusive."*`. Italics in original, *Supra* at 251. The court did affirm Cleopatra's child support liability, but left it to others to enforce.

9. Note that it took three different trust companies plus a trust protector four years in the face of diminishing funds before the discrepancy between South Dakota and California child support mechanisms was noted.

…**IX. Special Needs Trusts, Medicaid and Trust Purpose**

A. A beneficiary with special needs may require a trustee with specialized knowledge, or the ability and willingness to seek out that knowledge. That knowledge will involve both the particular disability or challenge that the beneficiary has, and a knowledge of any benefit programs, private or governmental that are being used to support the beneficiary, or should be resources to support and enrich the beneficiary's life. Alternatively, the trustee should be smart enough to know who to consult, and accept the advice of others who are knowledgeable in that particular field of disability and governmental and private resources available. Trustees who maintain trust business as usual may find themselves in some difficulty.

B. **Investing is not the sole measure of a trust.** *In the Matter of the Accounting by JP Morgan Chase and H.J.P. Co-Trustees v. Marie H., Grantor*, 956 N.Y.S.2d 856 (Sur. Court, New York County; 2012), the New York Surrogate's Court surcharged a corporate fiduciary JP Morgan Chase and an attorney co-trustee, for properly managing trust investments but failing to use those funds for the benefit of the trust's sole beneficiary.

C. The trust was created by Marie H., who died in 2005, having adopted two children, one of whom, Mark, was severely disabled, vulnerable and institutionalized. The trust instrument for Mark, like many for disabled individuals, gave the Trustees absolute discretion in making distributions for Mark from income and principal, and as typical for a person with special needs, directed the Trustee to consider the availability of governmental or private assistance programs and endeavor to maximize such benefits. The trust also directed the trustees to pay to "any facility where the beneficiary may be residing in, and/or to any organization where he may be a client or a participant in any program(s) sponsored by them, as the Trustee shall determine, for the general uses of such facility and/or organization.

D. The commissions paid to the Trustees during the accounting period were $34,914.61 to the corporate trustee and $17,622.53 to the attorney, plus additional sums to his firm for legal fees. The trust income during the five year accounting period was $248,881.35, none of which was distributed. In contrast, the amounts paid to a care manager for Mark were only $3525, the only money paid out for the benefit of Mark over a span of five years.

E. The attorney trustee admitted that he had not seen Mark since Mark was six years old, and never visited him at the residential treatment facility where he lived to ascertain his condition or his needs, nor had he inquired of the staff about any unmet needs.

F. The corporate trustee's excuse for inaction "was its lack of institutional capacity to ascertain or meet the needs of this severely disabled, institutionalized young man."

G. The court concluded that "it was not sufficient for the trustees merely to prudently invest the trust corpus and to safeguard its assets. The trustees here were affirmatively charged with applying trust assets to Mark's benefit and given the discretionary power to apply additional income to Mark's service providers. Both case law and basic principles of trust administration and fiduciary obligation require the trustees to take appropriate steps to keep abreast of Mark's condition, needs, and quality of life, and to utilize trust assets for his actual benefit." *Id.*, at 867-868.

H. The court held that the failure of the trustees to fulfill their fiduciary obligation to Mark should result in a denial or reduction of their commissions for the period of their inaction.

I. **A better ending.** Fortunately, as a result of the intervention by the court and the g-a-l, the trustees did hire a case manager and did spend substantial sums on Mark, including upgrading his residence, getting him furniture, a computer, taking him on a vacation and facilitating visits with his brother. He made substantial progress, but only after the **trustees were made to leave their comfortable offices** and take steps to visit him, hire experts and truly look at Mark as a person with rights to benefit from the trust his mother established for him.

X. Conclusion.

In fiduciary matters, the wrong choice of trustee can lead to family disharmony, the severing of family relations or ties, and ultimately, loss of trust assets through poor decision making and lawsuits. And an inspired choice of trustee can make all of the difference when a trust or its beneficiaries face a personal crisis, whether it be business or personal. Sometimes careful drafting of the instrument, giving limited discretion to a family member trustee with obvious conflicts of interests, and making the role more mechanical, can solve the problem. But there are enough cases that appear in our case law, and others that are making their way into the courts now, that demonstrate how important that trustee choice can be.,