

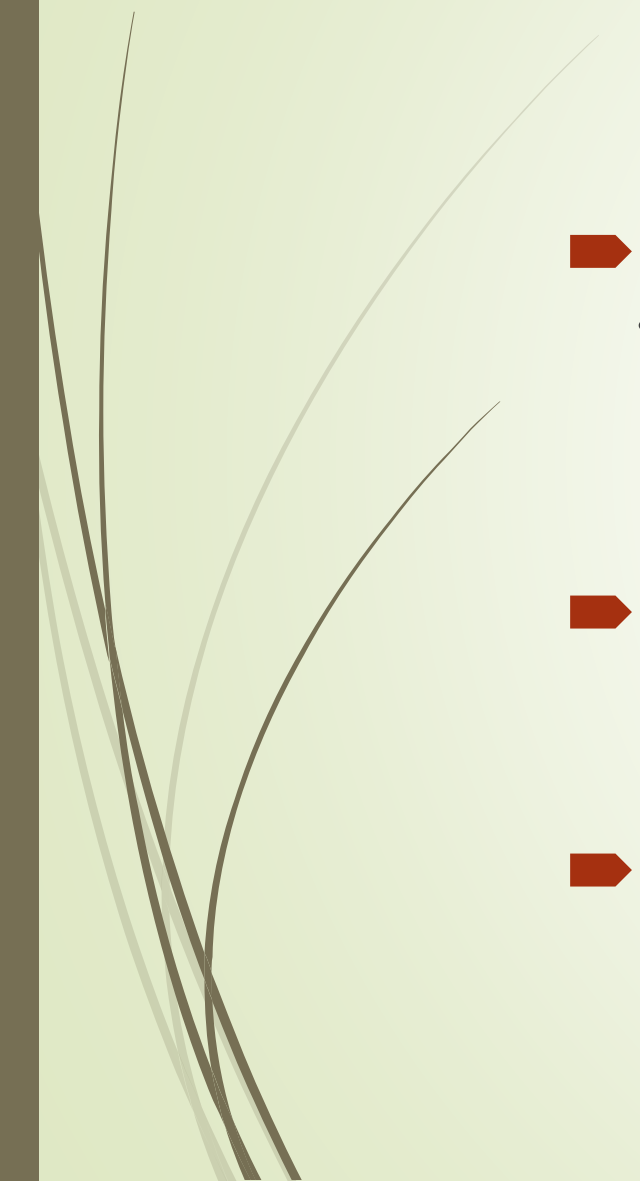


# Choice of Trustee

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

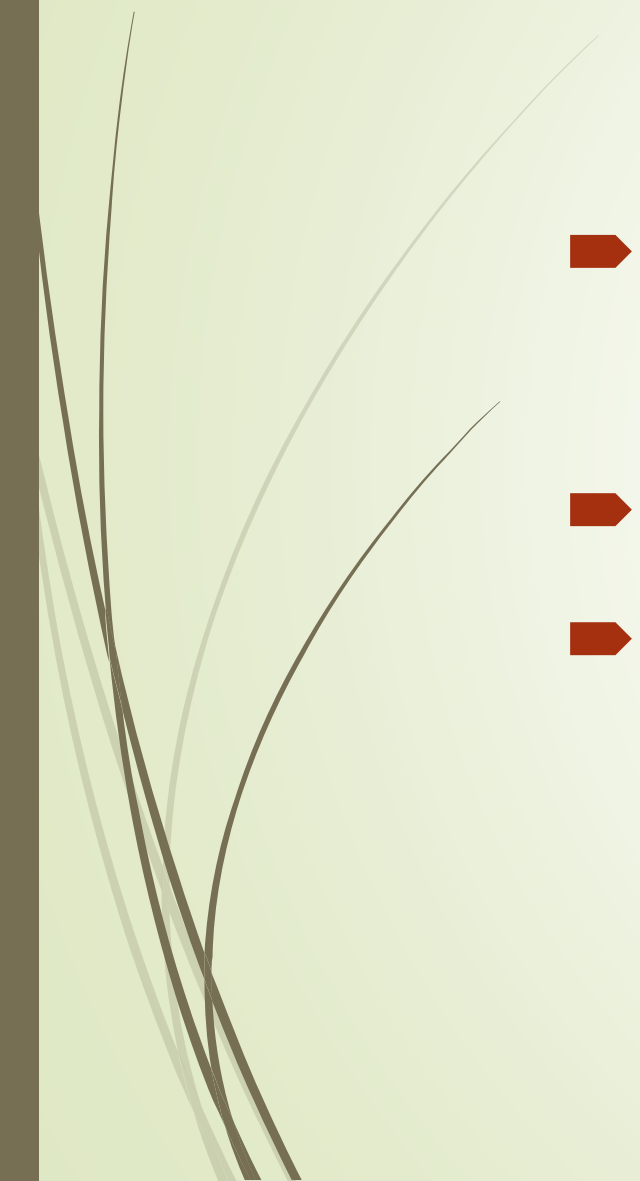


# Trustee Duties

- Duty to Administer the Trust according to its Terms
  - Duty to Act in Good Faith
  - Duty of Loyalty
- 



# More Fiduciary Duties

- The Duty of Impartiality
  - The Duty of Prudent Administration
  - Duty to Collect and Marshall Trust Assets  
(and keep those assets segregated and  
not commingled)
- 

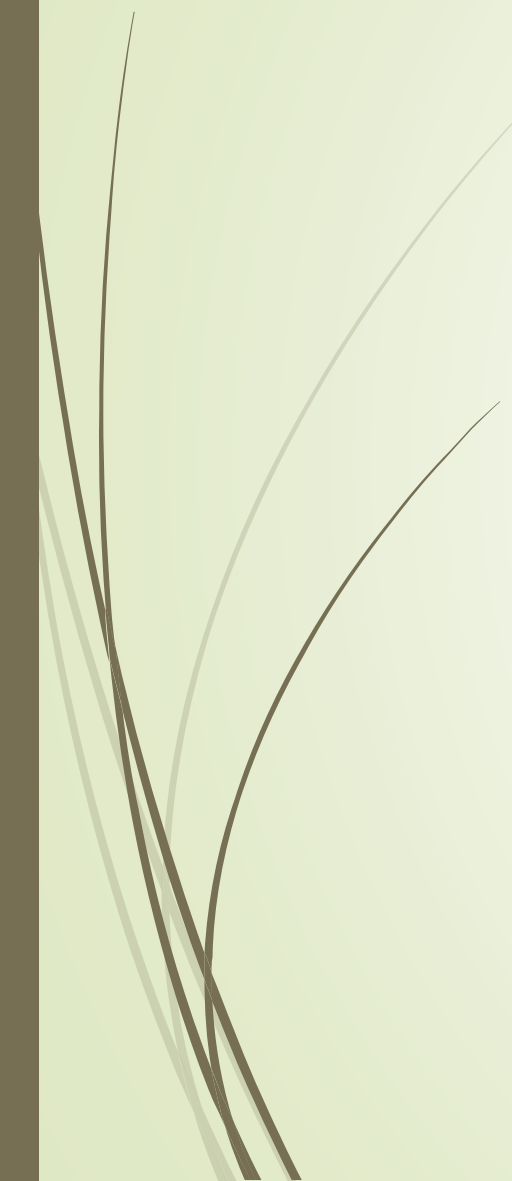


## Last but not least

- The Duty to Keep Beneficiaries Reasonably Informed
  - Both a burden to the trustee
  - And a benefit
  - Determining which beneficiaries to inform, and how much information to provide can be a challenge



# Types of trustees

- Corporate
  - Professional
  - Family
  - Hybrid
  - Directed trustees – each with limited duties and liabilities
- 

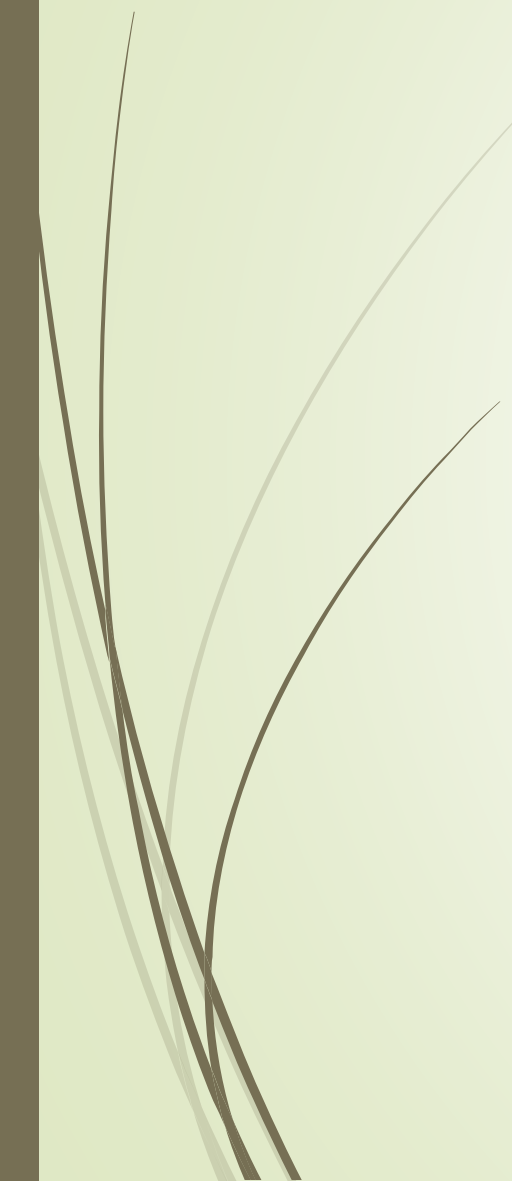


Some factors in the choice of trustee directly conflict with others


- Skill
- Objectivity
- Knowledge of family dynamics
- Lack of conflict of interest
- Low cost
- Knowledge of special circumstances



The choice of trustee may be a material purpose in a trust

- A court may imply this from facts and circumstances
  - A court may find this fact from witness testimony, including from the scrivener
  - If the choice of trustee is material, it may be best to state this in the trust instrument
- 





Beneficiaries may put trustees' fees and costs over all other considerations

- ➡ *Glass v. Faircloth*, GA 2020
- ➡ Non-family trustees selected for special knowledge of a business, pitted against second generation family who wanted control and lower fees
- ➡ Trust modification was the weapon - not inconsistent with a material purpose





Competence – low cost may be low standards and poor results

- *Homan v. Estate of Homan* – a lay trustee may be put in an unfair position
- *Virgil and Agnes Morningstar Trusts, Ind.* 2019, a family trustee who knew the business and reflected the norms of the trust settlors – an unfortunate result



# Family Trustees and Predictable Conflicts of Interest

- Lambley v. Diehl, Trustees, et al, MO 2020
- Three siblings at war
- Sometimes the choice of the responsible child may be a disservice
- Price of family division, disharmony and litigation



## The Second Spouse as Trustee, or Tales of the Wicked Step Mother

- *In the Matter of the Raggio Family Trust*, Nev. 2020
- Father creates marital trust remainder to wife's children, by-pass trust remainder to his children, names her as trustee
- What could possibly go wrong?




Yet another wicked stepmother (does anyone learn?)

- *In the Matter of the Testamentary Trust for Dale F. King, OR 2018*
- Choice of law – Oregon court, Nevada law, Minnesota powers and scrivener
- Loans by stepmother to her son and others
- Removal, replacement, damages



# Communication and the Duty to Keep Co-Trustee Informed

- *In the Matter of T.R. Potter, Jr. Exempt Trust*, MO 2019
- A neutral trustee became co-trustee with a corporate trustee; dispute over income distributions versus growing corpus
- Poor communication, removal



## Sibling rivalry: sister as trustee for her brother, *in terrorem* and a history lesson

- The good sister and the black sheep brother
- Waiver of the trustee's duty to inform and report in the instrument versus other duties to report
- Declaratory judgment sought whether this is a contest under trust's no-contest clause – lower court- yes; Supreme Court - no






## A brief detour - history of “in terrorem” clauses – designed to strike terror

- 13<sup>th</sup> century B.C. – Mesopotamia – the contestator of a will could be cast out of the family, losing its protection. “Set his cloak upon the doorbolt” and “depart into the street”
- English common law -10<sup>th</sup> and 11<sup>th</sup> century wills – rather than forfeiture, admonitions of doom: “torments of hell” “Day of Judgment”





## History of in terrorem, continued detour

- American common law – equitable election – choose to take under a “flawed will” or seek an abrogation and take nothing
  - Virginia common law – balance societal benefits of deterring bitter family disputes that will contests frequently engender versus equity abhors a forfeiture
- 



## Back to sibling rivalry and the trustee with possibly no duty to inform

- Virginia court expressed concern that trusts may last a long time, and the rising use of forfeiture clauses clashes with beneficiaries seeking oversight of trusts
- General principle: one who seeks guidance from a court in interpreting a will is not considered to “contest” will; same with trusts




## Final resolution – black sheep saved

- Alternative pleading saves our black sheep brother
- Court does not rule on underlying issue, but remands and separates declaratory judgment action from forfeiture clause
- Consider the wisdom of naming sister as sole trustee and waiving duty to inform and report



## Protections from Divorce and Choice of Trustee – how far to go

- *Ferri v. Powell-Ferri* – four Supreme Court cases, three in Conn., one in Mass. 2015-2017
- Famous trust – beneficiary allowed to withdraw from 25% at age 35 to 75% at the time of divorce



Trustee decants the trust after rights to withdraw have matured

- Initial trustees – brother and an independent trustee
- While divorce pending, the trustees decanted the entire trust into a new, lifetime spendthrift trust
- The independent trustee resigns, leaving the family member as sole trustee



## Ferri Powell #1 and #2

- Ferri-Powell #1 – husband did not violate his duty to preserve marital assets because the decanting was done by a third party, not by him
- Ferri-Powell #2 – Conn. Supreme certifies questions of law to Mass. court – can trust assets subject to withdrawal be decanted





## Ferri-Powell # 3

- Mass. Supreme Judicial Court says yes – trustee can decant assets – trust gave trustees broad powers to manage trust, including power to segregate assets for later payment to beneficiary, trustee had duty to protect assets, decanting permissible






## Ferri-Powell #4

- The Conn. Supreme Court respected the Mass. court's interpretation: the gambit worked; the new trust prevailed, but watch out for alimony
- Only a family member trustee would likely be willing to undertake that level of risk; note that the independent trustee resigned early in this process



## Divorce # 2 - the Cleopatra case, child support and corporate trustees

- A wealthy heiress living in California inherited substantial assets through 3 trusts for her benefit; all had corporate trustees
- Her husband was granted custody of their 2 children and granted child support based on her income of \$40,000 per month from the trusts




## California law re child support payments from trusts

- California law allowed its court to order direct payment of child support from the trust to the father; Wells Fargo and Cleopatra as co-trustees initially objected, but then complied
- BNY Mellon took over as successor trustee as both Cleopatra and Wells Fargo resign



# Change of situs, change of result

- The beneficiary had the right to change the trust situs, and did so, to South Dakota
- BNY Mellon resigned, Citicorp Trust of SD was appointed, resigned, then Bankers Trust of SD was appointed. The trust continued to pay the child support.
- Bankers Trust resigned; Trident Trust was appointed



# Corporate Trust Protector saves the day

- Empire Trust was appointed Trust Protector and questioned the payment of child support from the trust under South Dakota law, now the law of the trust
- Declaratory judgment: full faith and credit clause does not apply to enforcement of judgments in foreign states – forum law prevails



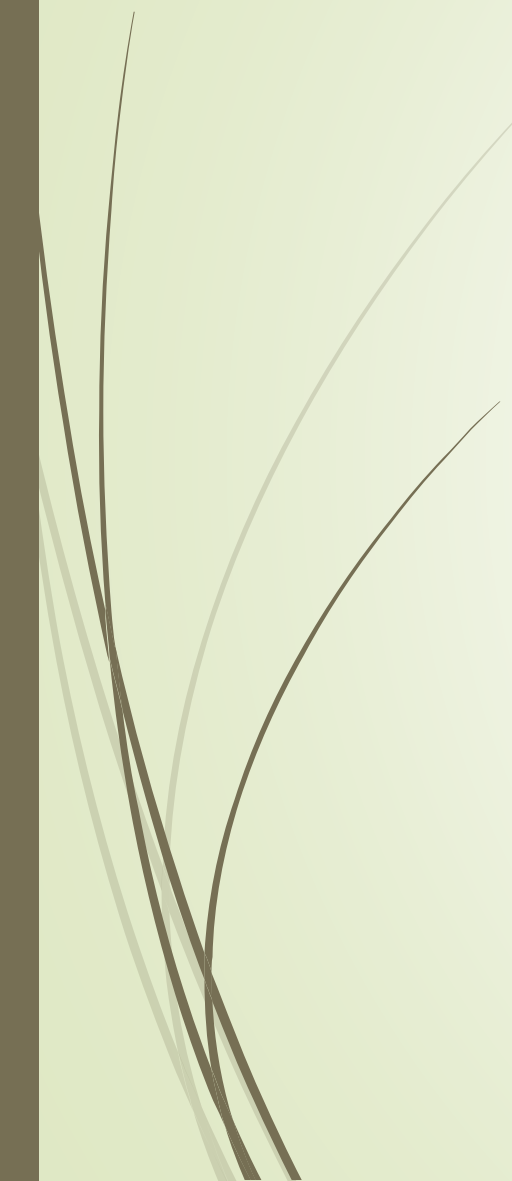
## Forum state law controls method by which judgment of Cal. is enforced

- Under S.D. law, direct payments from a spendthrift trust for child support are prohibited; Restatement 3 to be disregarded
- Child support liability remains, but not enforceable against the trust
- Contrast number of corporate trustees and number of years, diminishing assets, with the performance of the trustee in Ferri-Powell





# Choice of Trustee in Special Needs Trusts

- Whether third party or first party, supplemental or payback, special needs trusts require special knowledge and skills to administer well
  - Family members may be the first choice for trustee, but conflicts of interest and the knowledge required are high barriers for performance
- 





## Options for Special Needs Trustees: charities and pooled trusts

- Many states have developed pooled trusts and non-profit or charitable organizations to run these trusts
- To be cost-effective for volunteer run groups, trusts are standardized, costs are pre-set
- Groups develop knowledge of programs and support services in their area – can be good choice for many

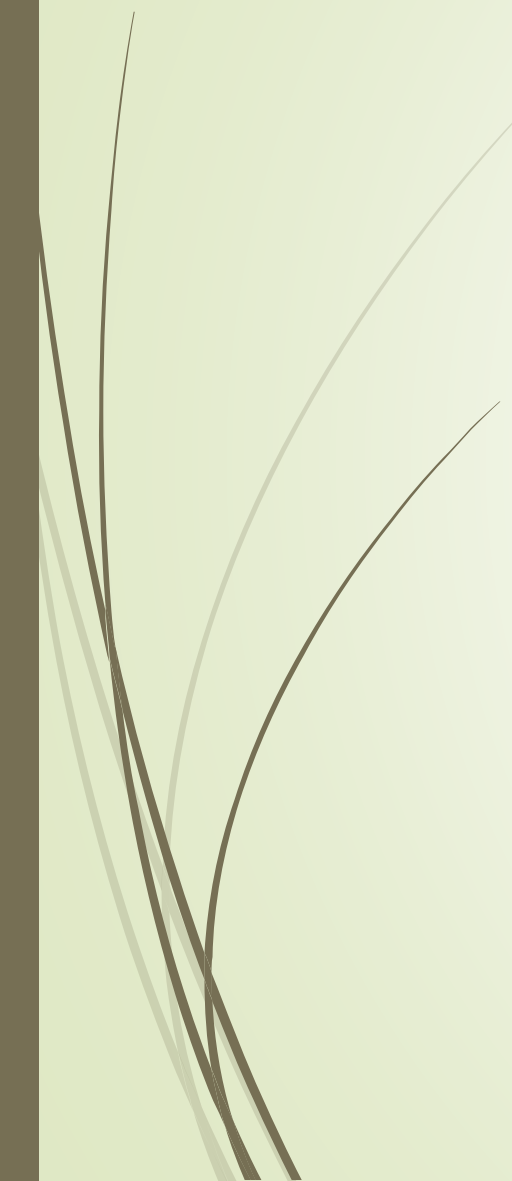


## Personalized trustees for special needs trusts: family members

- Particularly for large personal injury awards, family members may be better as co-trustees, not sole trustees
- Lack of knowledge of choosing asset manager, allocations, budgeting, trust income tax, fiduciary duty, conflicts re distributions, self-interest are traps for the unwary




## Family members as co-trustees can be valuable

- Family members can assist corporate trustees, who may know investments but may be helpless in the face of special needs, benefit programs, and knowledge of the beneficiary's particular disability
  - They can ensure the beneficiary and his or her needs are not overlooked
- 



A warning for corporate trustees – and  
a reason they are reluctant to serve`

- In 2012, the corporate trust world was shaken by the case *In the Matter of the Accounting by JP Morgan Chase and H.J.P., Co-Trustees v. Marie H. Grantor*, NY Surrogate's Court
- Before her death, Marie H. established a trust for her adopted, disabled son, and funded it generously



## The issue - inaction

- The trust gave the trustees absolute discretion to provide for Marie's son, Mark, while allowing them to consider the government benefit programs he received. It was supplemental in intent.
- In 5 years, the trust generated substantial income; the trustees received substantial commissions, and Mark received \$3525



# The surcharge

- The court concluded that it was not sufficient for trustees to prudently invest the trust corpus; they were affirmatively charged with providing for Mark, and they failed to do so
- Their commissions were reduced or denied during their period of inaction






# The good news

- The trustees, who had never even visited Mark during the pendency of the trust, hired a case manager to recommend a series of benefits for him
- The program was implemented and Mark thrived – his housing was upgraded, he got a computer, assistive devices, additional therapy, new furniture, vacations and was able to have visits with his brother






# The take away

- Unfortunately, many corporate trustees responded predictably by refusing to accept trusteeships of special needs trusts
  - Others, including smaller trust companies, have stepped up and created systems for assisting disabled beneficiaries, including consulting with local experts, care managers and service providers
- 




# Choice of trustee

- The drawback is that these additional services can come with extra costs
  - A family co-trustee, if appropriate, can be an alternative source of information on the special needs beneficiary, and be more cost effective
- 





## Some guidance as advisors

- As attorneys and advisors, we have a special role in advising our clients regarding their choice of trustee, and tactfully directing or re-focusing their choices to a more appropriate selection for their circumstances
  - Sometimes there is no good choice
- 




# Drafting may help but is no substitute

- If there is no good choice, or the clients are reluctant, then careful drafting can help
  - The choice of trustee can be a material purpose of the trust
  - A trustee with inherent conflicts (second spouse, sibling) can be given limited discretion and strong oversight
- 

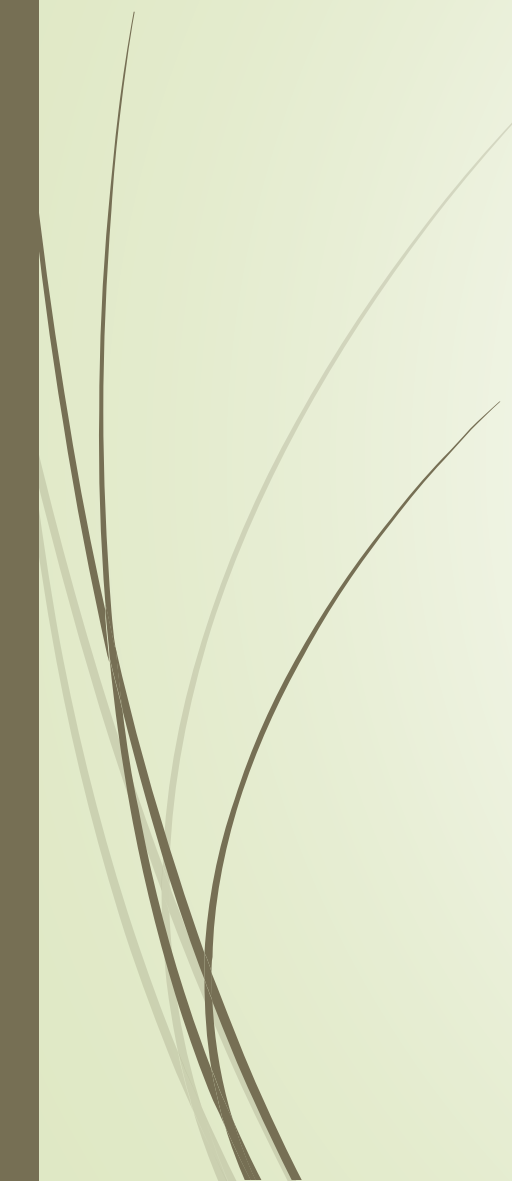


## For family member trustees - tools to minimize resentment and objections

- A reduced standard of liability (gross negligence or willful misconduct)
- Expanded notice and reporting OR
- No notice – a designated notice representative if permitted in your state (someone to receive notice and act in good faith for the problem beneficiary, likely held to a fiduciary standard)



## Trust modification, situs change, decanting or merger

- Another tool to consider is trust modification, situs change or decanting
  - To avoid a modification or other change contrary to grantor intent, consider stating one or more material purposes of the trust
- 





# Conclusion

- A poorly drafted trust can succeed with a good trustee
  - The best drafted trust cannot overcome a negligent or dishonest trustee
- 