

GETTING AHEAD OF FAMILY FEUDS AND EMERGENCY SITUATIONS: TRUSTEES' FIDUCIARY DUTIES

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FACT PATTERN A: Pressured to Make Trust Distribution

Specialbank, N.A., is the corporate trustee of a trust for the Harvey family, which holds assets valued at over \$10 million. Although the family matriarch's brother was best known as the host of the well-known game show, Family Feud, the matriarch of this family made a fortune investing in her brother's clothing company. The matriarch is both the sole current beneficiary of the trust and a co-trustee. Specialbank, as the "independent trustee," has the power to make distribution decisions in its sole and absolute discretion. The matriarch has the power to remove and replace the corporate trustee for any reason. When the matriarch passes away, the trusts will continue for the benefit of the matriarch's descendants.

The matriarch has also hired Specialbank to invest \$20 million of her personal assets, and the matriarch has advised Specialbank that she intends to name it as trustee of the perpetual trusts to be created under her will when she passes away.

The matriarch wants Specialbank, as trustee, to distribute millions of dollars to her from the trust for the purposes of helping her new business endeavors, which have hit some hard times. She does not want her descendants (who are also successor beneficiaries) to know about the distributions. The matriarch has strongly implied that if Specialbank does not make the requested distributions, she will withdraw her personal assets from Specialbank, name a different corporate trustee of the trusts under her will and remove Specialbank as trustee of the existing trust. What should Specialbank do?

Top Five Answers on the Board:

1. Go to Court!

Petition for the court to approve the distribution.

2. Family Agreement!

Agree to distribute, provided that the beneficiaries (including the matriarch's descendants) execute a nonjudicial settlement agreement approving the distributions.

3. Man Up — Use Your Discretion!

Exercise your discretion and agree to the distribution without a release or court approval, accepting the inherent risk of future litigation.

4. Indemnify!

Agree to distribute, provided that the matriarch releases and indemnifies Specialbank for any liability it may incur with respect to the distribution; including any possible surcharge and the costs of defending the distribution.

5. You're Out!

Introduce other options, such as a secured loan, a nonjudicial settlement agreement by which the trust distribution terms are modified, etc., in conjunction with declining to make the distribution—and take the risk that Specialbank will lose the business.

FACT PATTERN B: Evolving Roles in Trust Relationships

John Smith, a California resident and longtime client of your institution, has been serving with CalTrust, a California trust company, as trustee of the Smith California Irrevocable Trust, valued at \$75 million, created by John's mother. CalTrust is a California Trust Company that has served as a co-trustee with family members for over three generations. The current beneficiaries of this trust are John's three children who reside in New Jersey, New York and Florida (John is not a current beneficiary of the trust). The document was reviewed and it was determined that there are no restrictions on migrating the trust to another state. John Smith has the power based on the trust terms to resign, remove trustees, replace trustees and add trustees - and continues to have the power to remove and replace trustees for life, even if he is not a trustee. After the annual review with the accountant, attorney and trust team, it was determined that if John were to resign as co-trustee, the trust situs were to be moved to Delaware and DelTrust, a Delaware trust company, were to serve as trustee, the trust would be able to save substantial state income tax on realized capital gains retained in the trust, as long as there is no California source income.

After considering this for a year, John decides that he should resign as trustee, DelTrust will replace him and serve as the sole trustee and the situs of the trust will be moved to Delaware. Before John resigned, he, the client team, the attorney, accountant and DelTrust's relationship team were clear in defining DelTrust's role as sole trustee. However, almost immediately after the change of trusteeship and the move to Delaware, John starts complaining that he is not included in decisions regarding investments and discretionary distributions – even when he continues to say that it is time to turn over the reins to DelTrust. He feels that because this is “his money” he should have the right to have a say even though he is no longer a trustee.

John becomes very disgruntled and starts threatening to remove and replace DelTrust if the team is not responsive to his input and directions.

This is an important new relationship. How do you balance the John Smith relationship while maintaining your obligations to administer this trust properly?

Top Five Answers on the Board:

1. Sweet Talk Him!

Have a meeting with the John and his trusted advisors (attorney, accountant and the trust team) to review the evolution of the trust relationship, reminding him of previous meetings, prior discussions, etc., and review his new role. If he complains, remind him that it is important to preserve the tax benefits from the recent changes, but that if he prefers he could again become a co-trustee, however, this will undo the state income tax benefits gained in connection with his resignation and the change of situs.

2. Change It Up!

Determine if John would be happier if a member of his family (for instance, one of his children) is named as a co-trustee or investment direction advisor (but ensuring that the family member's domicile does not cause the trust to experience any adverse state fiduciary income consequences).

3. R-E-S-P-E-C-T!

Given that John and his family are good clients, document all conversations and continue to obtain John's approval for all transactions and discretionary distributions going forward, as if he were still a trustee.

4. Keep Your Friends Close . . .

Schedule regular meetings with John monthly and review all transactions including discretionary and investments – but for review purposes only.

5. Trouble on the Run!

It was made clear by the client team that by resigning, John would no longer be able to approve discretionary payments and approve investments. Immediately recommend that the bank resign and run for the hills; there are only going to be more problems with this family going forward.

FACT PATTERN C: Potential Undue Influence by the Caregiver

Ron Rehoboth is the beneficiary of a \$20 million trust of which First State Bank and Trust Company has been serving as trustee for over 20 years. The trust is a simple trust, which distributes all income to Ron. In addition, Ron has a 5 by 5 withdrawal power (which allows him to withdraw up to the greater of \$5,000 or 5% of the trust's principal assets each year). Ron has never been married and he never had any children, although his 70 year old sister lives nearby and has adult children (who will be the remainder beneficiaries of Ron's trust upon his death). Ron is now 85 years old and has hired a caregiver who works every weekday from 8am to 6pm. About a month ago, Ron named the caregiver as Agent in his new General Power of Attorney with full powers. It is unknown if the General Power of Attorney was prepared by Ron's longtime attorney or by someone else.

Today, the trust officer receives a phone call from the caregiver. The caregiver is requesting to withdraw, as part of Ron's 5 by 5 power, \$30,000 so she can pay for Ron's living expenses. In fact, the caregiver stops by the trust officer's office and shows her the original General Power of Attorney document, which on its face appears to be in good order.

What should the trust officer do? Does your answer change if this involves Ron's personal investment account and his portfolio manager instead of a trust/trust officer?

Top Five Answers on the Board:

1. Turn a Blind Eye!

Recognize the General Power of Attorney and honor the request from the caregiver as Agent on behalf of Ron.

2. I Can't Hear You!

Simply ignore the caregiver's request and Ron's new General Power of Attorney and refuse to make the distribution.

3. Talk it Out!

Meet with Ron to determine if he is competent, wants the withdrawal and, more specifically, that he understands that he signed a new General Power of Attorney which has given his caregiver essentially unfettered powers to manage his financial affairs (although the caregiver will, at least theoretically, be held to a fiduciary standard as to action as Agent).

4. Call in Reinforcements!

Contact Ron's sister and/or her children before making any decisions, given that they are the remainder beneficiaries of the Trust and you think that they might also be beneficiaries of Ron's estate (or at least were before). Consider also calling Ron's attorney.

5. Punt to the Authorities!

Report the incident to Adult Protective Services.

FACT PATTERN D: Directed Trustee Pushed for Risky Investment

Your Bank serves as a directed trustee of the Dawson Trust. The current beneficiary is Richard, who also serves as investment advisor, and the remainder beneficiaries are Richard's three adult children. Richard receives mandatory distributions of all income, and can receive principal distributions, in the sole discretion of the Bank (as trustee), for medical expenses or other emergencies, taking into account Richard's other assets. The trust contains a provision waiving the Prudent Investor standard. The trust also provides that the trustee has no duty to monitor the investment advisor, to question the actions of the investment advisor and is only liable for willful misconduct when taking a directed action.

Richard directs the Bank to invest all of the assets in high yield corporate bonds of Everglades Stilt House Concepts, Inc., which have, incidentally, little to no potential for growth, and are rated CCC ("extremely speculative") by Standard & Poor's.

The remainder beneficiaries have heard of Richard's investment plans, and have expressed their opposition in writing to the Bank.

What do you do?

Top Five Answers on the Board:

1. I Hear and Obey!

You are a directed Trustee—make the investment. You don't even need that waiver of the Prudent Investor standard!

2. We've Got to Have SOME Law!

Determine that the investment is too risky and refuse to make the investment. After all, it's not illegal!

3. But Think of the Children!

Determine that the non-growth/all-income nature of the investment is unfair to the interests of the future beneficiaries and refuse to make the investment unless the other beneficiaries also agree (and maybe indemnify).

4. Can't We All Just Get Along?

Suggest conversion of the trust to a Unitrust.

5. Go to Court!

Petition the Court for instructions.

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