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Keeping It in the Family: The Pitfalls of Naming a Family Member as a Trustee

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by
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I. Introduction

This article is concerned with trusts in which either the settlor, trustee, or beneficiaries are members of the same family. For example, the settlors may be the parents,[1] grandparents,[2] or other relatives[3] of the trust beneficiaries. Trustees may be settlors,[4] parents of the beneficiaries,[5] children of the settlor,[6] and other family members,[7] while beneficiaries may include either the settlor, the settlor's spouse, children, grandchildren, or other

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1 *E.g.*, Trolan v. Trolan, 243 Cal. Rptr. 3d 264, 268 (Ct. App. 2019); Peterson v. Peterson, 835 S.E.2d 651, 653 (Ga. Ct. App. 2019); McPherson v. McPherson, 705 S.E.2d 314, 315 (Ga. Ct. App. 2011); Rennacker v. Rennacker, 509 N.E.2d 798, 799 (Ill. App. Ct. 1987); Hurtig v. Gabrielson, 525 N.W.2d 612, 612 (Minn. Ct. App. 1995); *In re* Estate of Reugh, 447 P.2d 549 (Wash. Ct. App. 2019).

2 *E.g.*, Rollins v. Rollins, 790 S.E.2d 157, 159 (Ga. Ct. App. 2016); Cassibry v. Cassibry, 217 So. 2d 698, 700 (Miss Ct. App. 2017); *In re* McDonald, 953 N.Y.S 2d 751, 753 (App. Div. 2012).

3 *In re* W.N. Connell & Marjorie T. Connell Living Trust, 393 P.3d 1090, 1091 (Nev. 2017) (stepfather).

4 McCormick v. McCormick, 455 N.E.2d 103, 106 (Ill. App. Ct. 1983).

5 *E.g.*, *Rollins*, 790 S.E.2d at 159; *In re* Trusts for McDonald, 953 N.Y.S. 2d 751, 752 (N.Y. App. Div. 2012); *Reugh*, 447 P.3d at 550.

6 *E.g.*, *Peterson*, 835 S.E.2d at 676; *Rennacke*r, 509 N.E.2d at 799; Gillespie v. Seymour, 823 P.2d 782, 786 (Kan. 1991); Cassibry v. Cassibry, 217 So. 3d 298, 700 (Miss. Ct. App. 2017); *In re* Estate of Ternansky, 141 N.E.2d 189, 191 (Ohio Ct. App. 1957); Fletcher v. Fletcher, 480 S.E.2d 488, 489 (Va. 1997); Kerger v. Kerger, 780 P.2d 923, 926 (Wyo. 1989).

7 *Peterson*, 835 S.E.2d at 676 (spouse); *Rollins*, 790 S.E.2d at 159; Laubner v. J.P. Morgan Chase Bank, 898 N.E.2d 744, 747 (Ill. App. Ct. 2008)

relatives of the settlor.[8] These persons will be referred to as "family members."

Virtually all family members have disagreements with other family members and sometimes these disagreements can destroy relationships and even lead to bitter, long-term feuds. As the cases discussed below will show, testamentary provisions by a deceased family member can also cause strife within a family, particularly when a long-term trust is involved. More importantly, the chances of this happening are greatly increased when the decedent chooses a family member to serve as trustee. Some settlors are willing to take this risk because they have confidence in the prospective trustee to administer the trust fairly or because they believe that the cost of administering the trust will be less if a family member serves as trustee instead of a bank or other corporate trustee. Nevertheless, a settlor should think twice about appointing a family member as trustee. In particular, a settlor should avoid naming a surviving spouse as sole trustee if some of the beneficiaries are adult children from a prior marriage.

Part II of this Article discusses some of the fiduciary duties that trustees must satisfy, including the duty of loyalty, prudence, and impartiality, the duty to inform, and the duty to account. Part III is concerned with special problem areas such as support trusts, discretionary trusts, and the modification of "irrevocable" trusts by decanting. Finally, Part IV describes a number of precautionary measures that settlors and trustees should take to reduce the chance of future conflicts within the family.

II. Duties of Trustees

A trust is a fiduciary relationship in which one or more persons (trustees) hold legal title to property for the benefit of equitable owners (beneficiaries).[9] Although trust property at one time usually consisted of real property occupied by a beneficiary, currently it is far more likely to consist of intangible personal property such as stocks and bonds.[10] This means that trustees are

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(stepmother); *Cassibry*, 217 So. 3d 298 (spouse); *Connell Living Trust*, 393 P.3d at 1091 (stepfather); Rowe v. Rowe, 347 P. 2d 968, 970 (Or. 1959) (cousin).

8 *Rollins*, 790 S.E.2d at 159 (brother).

9 GEORGE T. BOGERT, TRUSTS § 1 at 1 (6th ed. 1987).

10 John H. Langbein,*The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 637-38 (1995).

no longer mere titleholders of trust property, but instead they must be active managers as well. Furthermore, to carry out these increased managerial responsibilities, trustees are usually given more discretion than was typical in the past.[11]

Trustees are fiduciaries and, thus, are subject to a variety of fiduciary duties for the protection of trust beneficiaries. The most important of these duties are the duties of loyalty, prudence, and impartiality.[12] In addition, trustees who exercise discretion must act in good faith and in the best interests of the trust beneficiaries.[13] Unfortunately, family members who serve as trustees often either are not aware of these fiduciary duties or choose to ignore them. If a serious breach of duty occurs, litigation may ensue causing the trustee to be removed or subjected to a surcharge by the court.

A. *The Duty of Loyalty*

One of the most important fiduciary duties is that of loyalty which means that the trustee must avoid self-dealing or conflicts of interest. This is true even when the trustee is also a family member and a beneficiary under the trust.[14]

1. *Self-Dealing*

Self-dealing occurs when a fiduciary engages in a transaction involving individually owned property of the trust or the property of the trustee. This includes the sale or leasing[15] of trust property to the trustee, the borrowing of trust property by the trustee, and the sale of the trustee's property to the trust.[16] Self-dealing may be a problem when both the trust and trustee own shares in a family-run business.

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11 Richard C. Ausness, *Discretionary Trusts: An Update*, 43 ACTEC L.J. 231, 231 (2018).

12 Louise Lark Hill, *Fiduciary Duties and Exculpatory Clauses: Clash of the Titans or Cozy Bedfellows?*, 45 U. MICH. J.L. REFORM 832, 832 (2012).

13 Sully v. Sully, 76 N.W.2d 239, 245 (Neb. 1956).

14 *E.g.*, *Peterson*, 835 S.E.2d at 670; *Rennacker*, 509 N.E.2d at 715; *Cassibry*, 217 So. 3d at 709 (Miss. Ct. App. 2017).

15 Estate of Stevenson, 605 N.W.2d 818, 822 (S.D. 2000).

16 Stegmier v. Magness, 728 A.2d 557 (Del. 1999); Keye v. Gautier, 684 So. 2d 210, 211 (Fla. Dist. Ct. App. 1996); Estate of Schulman, 568 N.Y.S.2d 660, 663 (N.Y. App. Div. 1991).

When self-dealing occurs, the transaction cannot be an arm's length one because the trustee is both the buyer and the seller. Therefore, self-dealing is subject to a "no further inquiry" rule which allows the settlor or the trust's beneficiaries to void the transaction even though the trustee acted reasonably and in good faith.[17] Although, the settlor may waive these requirements either expressly or by implication,[18] the trustee must still act in good faith and in the best interests of the beneficiaries.[19]

Stegemeier v. Magness[20] illustrates these principles. In that case, the settlor appointed his brother, Donald, to be the trustee of two testamentary trusts established in his will.[21] The settlor's widow, Anne, was named as the beneficiary of the first trust as well as the income beneficiary of the second or residuary trust.[22] The corpus of the second trust was to be divided among the settlor's six daughters at Anne's death.[23] Three of the daughters were also Anne's children and the other three were daughters of the settlor by a prior marriage.[24] The residuary trust's assets included certain property in a real estate development known as Harmony Crest. The property was subject to a power of sale held by Charles Allmond and Anne Magness who were the co-administrators of the settlor's estate.[25]

In 1982, Donald and Anne formed a corporation, Magness Builders, to obtain construction loans to develop the Harmony Crest property.[26] Donald owned 51% of the new corporation's stock and Anne owned 49%.[27] Over the next few years, Charles

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17 Vrendenburgh v. Jones, 349 A.2d 22, 33 (Del. Ch. 1975); Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein*, 47 WM. & MARY L. REV. 541, 545 (2005); *but see In re* Thomas, 311 A.2d 112, 114 (Del. 1973) (finding no self-dealing when a partnership of which the trustee was a member exercised a pre-existing option to purchase trust-owned land).

18 Huntington Nat'l Bank v. Wolfe, 651 N.E.2d 458, 464 (Ohio Ct. App. 1994).

19 *Cassibry*, 217 So. 3d at 707.

20 *Stegmier*, 728 A.2d 557.

21 *Id.* at 559.

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.* at 559.

26 *Id.* at 560.

27 *Id.*

and Anne exercised their power of sale to transfer all of the Harmony Crest property to Magness Builders who then constructed homes on the property and sold them to third parties.[28] In 1993, two of the residuary trust's remainder beneficiaries, Susane Stegemeier and Diane Mulrooney, brought suit against Charles, Anne, and Donald for breach of their fiduciary duties.[29] The trial court held in favor of the defendants and Susane and Diane appealed.[30]

The principal question before the appeals court was whether the standard applicable to a corporate fiduciary should be applied or whether the higher standard applicable to a trustee was more appropriate.[31] Under the former rule, self-dealing by a corporate director was permitted if a majority of the other directors approved.[32] However, the court held that the corporate fiduciary standard was not applicable to trustees.[33] Instead, it declared that the defendants had engaged in self-dealing by Harmony Crest selling the trust's property to Magness Builders without informing the remainder beneficiaries of the trust and without obtaining their permission.[34] The court remanded the case back to the lower court to determine if the trust had received a fair price from Magness Builders for the property.[35] If the trust did not receive a fair price, the defendants would have to pay the difference between a fair price and the price actually received by the trust.[36]

Cassibry v. Cassibry provides a somewhat more complicated example of self-dealing.[37] In that case, Napoleon LePoint Cassibry, Jr. died in 1998, survived by his wife, June, and his three sons, Napoleon, Graham, and John.[38] In his will, Napoleon, Jr. created a Family Trust funded by stock in the Cleveland State

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28 *Id.*
29 *Id.*
30 *Id.* at 562.
31 *Id.*
32 *Id.*
33 *Id.*
34 *Id.* at 564-65.
35 *Id.* at 566-67.
36 *Id.*
37 217 So. 3d 698.
38 *Id.* at 700.

Bank (CSB) and a half-interest in the family home.[39] Napoleon Jr's son, also named Napoleon, was named as trustee.[40] The trust was created primarily for the benefit of June, but Napoleon was also authorized to pay such income to himself and his brothers or their issue that he deemed advisable for their "maintenance, health and education" and at June's death to transfer any remaining trust assets in equal shares to himself and his two brothers.[41]

In 1999, June established the Cassibry Children Irrevocable Trust (Children's Trust), whose beneficiaries were Napoleon, John, and Graham, and appointed Napoleon as trustee.[42] The Children's Trust was created to avoid potential estate taxes and to protect against lawsuits brought by John's ex-wives.[43] The Children's Trust provided that Napoleon as trustee had the discretion to pay any amount of income or principal as he deemed advisable for the health, education, maintenance, support, or comfort of any beneficiary.[44] June subsequently created another trust, know as the June C. Cassibry Irrevocable Trust (JCC Trust) to receive certain life insurance proceeds at her death.[45] Napoleon, John, and Graham were named as beneficiaries and Napoleon was appointed as trustee.[46]

In 2004, Napoleon purchased 20,000 shares of Paragon stock in his own name and he and John formed a partnership, CBP, to purchase another 20,000 shares of Paragon stock.[47] To purchase these shares, Napoleon obtained a $200,000 personal line of credit at CSB and a $200,000 line of credit from the Family Trust.[48] These lines of credit were secured by shares of CSB stock held by the Children's Trust and the Family Trust along with other bank stock and the life insurance contract owned by the

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39 *Id.*

40 *Id.* To avoid any confusion with the French Emperor of the same name. I will not refer to the son of Napoleon, Jr. as Napoleon III, but instead I will simply call him Napoleon.

41 *Id.*

42 *Id.*

43 *Id.*

44 *Id.* at 701.

45 *Id.*

46 *Id.*

47 *Id.*

48 *Id.*

JCC Trust.[49] Napoleon also withdrew $190,000 from the Family Trust's checking account and apparently deposited some of it into his personal account.[50]

Unfortunately for Napoleon and John, the value of the Paragon stock fell sharply in 2007 so Napoleon was forced to sell the CSB stock that was used as collateral to purchase the Paragon stock.[51] Since Graham had not participated in the Paragon stock purchase, Napoleon and John had to distribute one-third of the Children's Trust CSB stock to him.[52] Napoleon also sold June's home and purchased a condominium for her with the proceeds.[53] When June died in 2008, Napoleon used the insurance proceeds that were paid into the JCC Trust to pay off the debts associated with the Paragon stock purchase even though the JCC Trust did not authorize this action.[54]

In 2009, Graham sued Napoleon claiming that he had breached his fiduciary duty as trustee of the three trusts and had misappropriated assets from the trusts to borrow money personally to finance the purchase of the Paragon stock.[55] The chancery court ordered an accounting which concluded that Napoleon had withdrawn a total of $426,373 from his parents' estates.[56] After a bench trial, the court declared that Napoleon's cash withdrawals and loans for his personal benefit were a "blatant example of breach of fiduciary duty" and ordered him to pay Graham 7,757 shares of Paragon stock, $109,190 from the JCC Trust, and an additional damage award of $143,665.[57] The lower court also awarded John $109,190 from the JCC Trust.[58]

On appeal, the appellate court concluded that Napoleon's "loans" to himself from the Children's Trust constituted a breach of the duty of loyalty even though the trust allowed the trustee to make loans to trust beneficiaries.[59] Citing the Restatement of

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49 *Id.*
50 *Id.*
51 *Id.* at 701-02.
52 *Id.* at 702.
53 *Id.*
54 *Id.*
55 *Id.*
56 *Id.*
57 *Id.* at 703.
58 *Id.*
59 *Id.* at 704-05.

Trusts,[60] the court declared that "[e]ven express authorization to engage in transactions otherwise prohibited under a trustee's duty of loyalty does not 'completely dispense with the trustee's underlying fiduciary responsibility to act in the interests of the beneficiaries and to exercise prudence in administering the trust.'"[61] Accordingly, the appeals court affirmed the lower court's damage award against Napoleon.[62]

As mentioned earlier, the settlor may allow a trustee to engage in self-dealing. However, courts tend to interpret such waivers strictly. Trustees who are family members should avoid self-dealing at all costs no matter how much they think that their actions are proper and consistent with the settlor's wishes. Even if the trustee ultimately prevails, the litigation triggered by self-dealing is certain to be costly to the trust and damaging to family relations.

2. *Conflicts of Interest*

The duty of loyalty also requires trustees and other fiduciaries to avoid conflicts of interest. Furthermore, it is not necessary to show that the fiduciary's actions were actually affected by a conflict of interest; rather, it is enough to show that the fiduciary allowed himself to be placed in a position where his interests might conflict with the interests of the trust beneficiaries.[63] The reason for this is obvious. As Professor George Bogert observed many years ago:

> It is a well-known quality of human nature that it is extremely difficult, or perhaps impossibly, for an individual to act fairly in the interests of others whom he represents and at the same time to consider his own financial advantage. In most cases, consciously or unconsciously, he will tend to make a choice which is favorable to himself, regardless of its effect on those for whom he is supposed to be acting.[64]

Notwithstanding this pessimistic view of human nature, settlors often create "structural" conflicts of interest by appointing family members as trustee who are either beneficiaries them-

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60 RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c (2) (2007).

61 *Cassibry*, 217 So. 3d at 707.

62 *Id.* at 709.

63 Bloodworth v. Bloodworth, 579 S.E.2d 858, 862 (Ga. Ct. App. 2003).

64 BOGERT, *supra* note 9, § 95 at 342.

selves or who have business relationships that may involve conflicts of interest.[65] For example, in *Huntington National Bank v. Wolfe*, the settlor named his brother, John, as co-trustee of a trust the primary asset of which was stock in a closely held corporation that employed him.[66] When the trustees decided to sell some of the company's stock back to the company rather than distributing it in kind to one of the beneficiaries, the court upheld their decision, declaring that "[t]he settlor must have understood that his Co-Trustee [John] would take into consideration the interests of the corporation as well as the interest of the beneficiary in making any decisions concerning the family corporation's stock held by the Trusts."[67] Even though John was eventually vindicated, the impact of this litigation on the family must have been devastating.

Peterson v. Peterson provides a more recent example of a structural conflict of interest.[68] Charles Peterson died in 1994, survived by his wife, Mary, and his three sons, Alex, David, and Calhoun.[69] In his will, Charles established a marital trust and a residual "by-pass" trust and named Mary and the children co-trustees of the trusts.[70] The marital trust provided that Mary should receive all of the income from the trust during her lifetime; in addition, she was given a general power of appointment over the trust property.[71] Any property remaining in the marital trust at Mary's death was to be added to the by-pass trust.[72] In addition, the trustees were authorized to invade the corpus of the by-pass trust to provide for Mary's comfortable support and for the proper support and education of the settlor's descendants.[73]

In 2016, Mary demanded that the trustees turn over all of the property in the marital trust to her and also required all of the assets of the by-pass trust to be transferred to Calhoun.[74] When Alex and David refused, Mary sued to terminate the trusts

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65 Langbein, *supra* note 10, at 665.
66 651 N.E.2d 458 (Ohio Ct. App. 1994).
67 *Id.* at 462.
68 835 S.E.2d 651 (Ga. Ct. App. 2019).
69 *Id.* at 653.
70 *Id.*
71 *Id.*
72 *Id.*
73 *Id.*
74 *Id.* at 654.

and force them to make the transfers, while Calhoun sued to have them removed as trustees.[75] The trial court granted summary judgment on the plaintiffs' claims and ordered Alex and David to be removed as trustees if they did not agree to transfer the trusts' assets to Mary and Calhoun.[76] However, the appeals court reversed, holding that the exercise of Mary's power of appointment to transfer trust assets was not absolute, but was subject to her fiduciary duties as a trustee.[77] According to the court, allowing Mary to transfer the trusts' assets to herself and Calhoun would conflict with the settlor's intent that the trust property be used to provide support for all of his children.[78] In other words, she put her own interests ahead of those of the trust and the other beneficiaries of the trust.

B. *The Duty of Prudence*

The duty of prudence covers the management and investment of trust property. This includes the duty to make such property productive as well as the duty to diversify and otherwise invest trust assets in a prudent manner. Presently, it takes a high degree of expertise to satisfy the duty of prudence when the trust is largely made up of common stocks.

Unless directed otherwise, the trustee should remove unproductive property from the trust. Unproductive property includes property that produces little or no income even though it may be appreciating in value.[79] The same principle also applies to the retention of underproductive property.[80]

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75 *Id.*

76 *Id.*

77 *Id.* at 655.

78 *Id.*

79 For example, property such as gold coins or Dutch Masters paintings may increase significantly in value, thereby benefitting remainder beneficiaries, but provide no income for income beneficiaries. One way to avoid this problem is to employ the "unitrust" concept in which the share of income beneficiaries is calculated in terms of a percentage of the trust corpus each year. WILLIAM M. MCGOVERN, SHELDON F. KURTZ & DAVID M. ENGLISH, WILL, TRUSTS AND ESTATES § 9.6 at 401 (4th ed. 2010).

80 Rutanen v. Ballard, 678 N.E.2d 133, 138 (Mass. 1997); *but see* Champagne v. Champagne, 734 A.2d 1048, 1050-51 (Conn. App. Ct. 1999).

1. *Retention of Unproductive and Underproductive Property*

Family members who assume the office of trustee sometimes falsely assume that it is safe to retain the settlor's existing portfolio. However, unlike the settlor, the new trustee is required by the duty of prudence to dispose of unproductive or underproductive property as soon as is reasonably possible. For example, failure to make trust property productive resulted in liability in *Witmer v. Blair*, notwithstanding the fact that the settlor's niece received no compensation for serving as trustee and acted in good faith.[81] In that case, the settlor Henry Nussbaum appointed his niece, Jane Ann Blair, as trustee of a testamentary trust to provide for the college education of the children of his daughter, Dorothy Janice Witmer, living at the time of his death.[82] If no child survived (or failed to pursue a college education), the trust was to revert to Henry's daughter, Dorothy Janice Witmer.[83] When Henry died in 1960, his only granddaughter, Marguerite, was seven years old.[84] Later, Marguerite and other trust beneficiaries filed suit against Jane Ann seeking and accounting and her removal as the trustee, as well as an award of actual and punitive damages, claiming that she had breached her fiduciary duties.[85] The lower court ordered an accounting and the removal of Jane Ann as trustee, but refused to award damages for breach of fiduciary duties.[86]

On appeal, the appellate court found that Jane Ann had failed to make the trust property productive.[87] Between 1962 and 1971, Jane Ann had kept all the trust assets in a checking account and a savings account that paid only ½% interest.[88] In light of the fact that Marguerite would not be ready for college for several years, the court concluded that Jane Ann should have invested the trust assets in certificates of deposit or other invest-

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81 588 S.W.2d 222, 225 (Mo. Ct. App. 1979).

82 *Id.* at 223.

83 *Id.*

84 *Id.*

85 *Id.* at 222.

86 *Id.*

87 *Id.* at 225.

88 *Id.*

ments that would have provided a better rate of return.[89] Relying on the testimony at trial of an accountant, the court determined that the trust would have earned an additional $2840 between 1962 and 1971 (when Marguerite might have needed money for college expenses) if Jane Ann had invested most of the trust's assets in one-year certificates of deposit.[90] Therefore, it found that Jane Ann had failed to make the trust property profitable and remanded the case back to the lower court with instructions to award the plaintiffs $2,840 in damages.

2. *Failure to Make Prudent Investments*

For more than one hundred and fifty years, the "prudent man" rule, which first appeared in *Harvard College v. Amory*,[91] was the principal standard governing investment choices by private trustees.[92] The Harvard College case involved the power of the trustee to invest in the stock of companies engaged in manufacturing and insurance.[93] In that case, the court upheld the right of the trustees to do so, declaring that that trustees should "observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital invested."[94] This formulation focused on the avoidance of loss rather than on the maximization of return.[95]

This traditional "prudent man" rule was widely criticized during the latter half of the twentieth century[96] and eventually

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89 *Id.*

90 *Id.*

91 26 Mass. (9 Pick.) 446 (1830).

92 Jerold I. Horn, *Prudent Investor Rule, Modern Portfolio Theory, and Private Trusts: Drafting and Administration Including the "Give-Me-Five" Unitrust*, 33 REAL PROP. PROB. & TR. 1, 3 (1998).

93 Paul G. Haskill, *The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory*, 69 N.C. L. REV. 87, 88 (1990). The rule in England at that time limited investment to government bonds and real estate. *Id.*

94 *Harvard College*, 26 Mass. at 461.

95 Loren C. Ipsen, *Trends in the Liability of Corporate Fiduciaries*, 24 IDAHO L. REV. 443, 443 (1988).

96 According to these critics, the prudent man rule, as interpreted by many courts, was deficient because it tended to focus upon the performance of each asset in isolation rather than on the performance of the portfolio as a whole, it focused on the nominal value of the trust corpus and ignored the effect

replaced by such alternatives as the Uniform Prudent Investor Act, Third Restatement of Trusts, and the Uniform Trust Code, which incorporated modern portfolio theory and other financial concepts.[97] According to modern portfolio theory, a particular investment that might seem to involve excessive risk viewed in isolation, may actually reduce overall risk to the portfolio and, therefore, be a more prudent investment.[98] In other words, portfolio theory tries to correlate expected risk and return in order to identify an optimal portfolio that will produce the highest return for a given risk.[99]

In re Estate of Collins[100] represents an extreme example of a trustee's failure to exercise prudence with respect to the selection of investments. Although the trustees in *Collins* were business associates rather than family members, the principles set forth by the court in that case are applicable to trustees in general. When the settlor, Ralph Collins, died in 1963, he established a testamentary trust for the benefit of his wife and children and named a business partner, Carl Lamb, and his attorney, C.E. Millikan, as trustees.[101] The trust principal was $80,000.

Two clients of Millikan, Downing, and Ward, wanted to borrow $50,000 to develop some property that they owned and Lamb and Millikan agreed to loan them the money on behalf of the trust.[102] The loan was secured by a second mortgage on 9.38 acres of unimproved property in San Bernardino County as well as by 20% of the stock in Downing and Ward's company.[103] Unfortunately, the building boom in the area burst and the company, as well as Downing and Ward, went bankrupt.[104] In

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of inflation on the purchasing power of money. The rule also prohibited certain classes in investments entirely, while providing a safe harbor for other types of investment. In addition, it discouraged trustees from delegating certain management responsibilities and also deterred them from considering new types of investment products. Horn, *supra* note 92, at 7.

97 Edward C. Hallbach, Jr., *Trust Investment Law in the Third Restatement*, 77 IOWA L. REV. 1151, 1159-63 (1992).

98 Ipsen, *supra* note 95, at 450.

99 *Id.*

100 139 Cal. Rept. 644 (Ct. App. 1977).

101 *Id.* at 646.

102 *Id.* at 647.

103 *Id.*

104 *Id.*

addition, the holder of the first mortgage foreclosed, effectively destroying the security of the second mortgage.[105]

In 1973, when Lamb and Millikan sought to be discharged as trustees (having reduced the trust's principal to almost nothing), the beneficiaries sought to have them surcharged for the loss sustained by the trust as the result of their imprudent investments.[106] The trial court discharged the trustees and the beneficiaries appealed.[107] The appellate court reversed, finding that the trustees had failed to follow the prudent person standard by investing two-thirds of the trust principal in one investment and by investing in real property secured by only a second mortgage.[108] The court also determined that the trustees had failed to make an adequate investigation of either the borrowers or the collateral.[109] Specifically, the court found that the trustees failed to discover that at the time the loan was made, there were six notices of default and three lawsuits pending against Downing and Ward.[110] In addition, they did not have the property in question appraised but instead relied on a statement by a real estate broker that property in the area was currently selling for $18,000 to $20,000 an acre.[111] Finally, they failed to secure possession of or earmark the company stock that was supposed to provide backup security for the loan.[112] Consequently, the appeals court remanded the case back to the trial court with instructions to surcharge the trustees.[113]

The duty of prudence also requires a trustee to avoid speculative investments,[114] to monitor the performance of trust investments and to reduce industry and firm risk by diversification. As far as choosing investments is concerned, the trustee should invest trust assets with the care, skill, and caution of a prudent in-

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105 *Id.*
106 *Id.* at 646.
107 *Id.*
108 *Id.* at 648.
109 *Id.*
110 *Id.* at 647.
111 *Id.*
112 *Id.*
113 *Id.* at 650.
114 *But see* RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. e (2007).

vestor.[115] In many cases, this may require the services of a professional financial advisor or investment manager.

3. *Failure to Diversify Investments*

According to modern portfolio theory, a prudent investor will try to minimize inherent risks and avoid "uncompensated" risks. Uncompensated risks are those associated with a particular firm or a market sector. Unlike market risk, these risks can be avoided by diversification. Although the duty to diversify may be waived by the settlor, as the *Mueller* case[116] illustrates, this does not relieve the trustee of the duty to act prudently. In *Mueller*, L.J. Mueller, the sole stockholder of the L.J. Mueller Furnace Company, died in 1931. In his will, L.J. Mueller created two trusts funded by shares of Mueller Company stock.[117] The first trust provided that income would go to Mueller's widow, Jean, for life with a remainder to his children, Robert and Elizabeth.[118] A second trust was created for the benefit of Ruth Mueller and Patricia Maslowski, two children of Mueller's deceased son.[119] Another son, Harold, received a substantial amount of Mueller Company stock outright.[120] Jean and Harold were named as co-trustees of both trusts.[121]

In 1938, Harold put some of his Mueller Company stock into an *inter vivos* trust and named himself as trustee.[122] Under the terms of the trust, Jean was to receive the income for life and Robert and Elizabeth were named as the remainder beneficiaries.[123] In 1954, the Mueller Company was acquired by the Worthington Corporation and the Mueller Company stock in all three trusts was exchanged for Worthington Company stock.[124]

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115 Bryon W. Harmon & Laura A. Fisher, *The Prudence of Passivity: An Argument for Default Passive Management in Trust Investing*, 44 ACTEC L.J. 147, 153 (2019).

116 *In re* Trust Created Under the Last Will and Testament of L.J. Mueller, 135 N.W.2d 854 (Wis. 1965).

117 *Id.* at 857.

118 *Id.*

119 *Id*

120 *Id.*

121 *Id.*

122 *Id.*

123 *Id.*

124 *Id.*

In 1958, the county court approved the accounts of the trustees of the two testamentary trusts.[125] However, when the trustees sought court approval in 1962 for their accounts, some of the trust beneficiaries objected, claiming that the trustees should have diversified the trust assets by selling the Worthington Company stock no later than November 1961.[126]

The lower court ruled that the trustees should be surcharged for failing to sell the Worthington stock within a reasonable time and this was affirmed on appeal.[127] The court observed that Harold served as a director of the Worthington company and knew that it, along with a number of other electrical companies, was about to be sued by the United States for antitrust violations.[128] In addition, Harold knew that Worthington was in a profit squeeze.[129] Furthermore, Harold sold much of his own Worthington Company stock during this period when it lost half of its value.[130] On the other hand, Harold in his capacity as trustee failed to sell any of the Worthington Company stock owned by the three trusts until 1963.[131] Consequently, the court concluded that Harold and Jean must reimburse the two testamentary trusts $147,000 and the *inter vivos* trust $100,000.[132]

As the *Mueller* case illustrates, trustees often inherit a trust with an unbalanced portfolio.[133] In such cases, the trustee must take steps to diversify the trust portfolio within a reasonable time.[134] Sometimes a settlor will insert a retention clause in the trust that authorizes the trustee to retain the assets in the original portfolio even though the resulting portfolio is seriously unbalanced.[135] However, as *Wood v. U.S. Bank* suggests, courts tend

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125 *Id.*

126 *Id.* at 858.

127 *Id.* at 864.

128 *Id.* at 862.

129 *Id.*

130 *Id.*

131 *Id.*

132 *Id.* at 857-58. The trial court had ruled that Harold would have to indemnify Jean for any damages that she had to pay to the trusts, but the appellate court reversed and held that she was equally responsible. *Id.* at 866-67.

133 *In re* Estate of Janes, 681 N.E.2d 332 (N.Y. 1997).

134 *Id.* at 339.

135 In some cases, the settlor may even mandate that particular assets be retained. Even then, the trustee may be required to request a court to modify

to interpret retention clauses narrowly, particularly when the asset in question is the stock of a corporate trustee.[136] In that case, the settlor created an *inter vivos* trust with himself as trustee for the benefit of his wife, Dana.[137] Firstar Bank became the trustee at the settlor's death.[138] At that time, approximately 80% of the trust principal consisted of Firstar stock.[139] However, a retention clause was added by the settlor which allowed the trust to retain the trustee's corporate stock.[140] Unfortunately, the Firstar stock declined substantially in value and Dana sued the trustee for failure to diversify.[141] On appeal, the court held that the retention clause did not relieve the trustee of its duty to diversify, but merely waived the trustee's conflict of interest in retaining its own stock in the trust.[142] Therefore, the court concluded, the trustee was still required to sell the Firstar stock as soon as it reasonably could.[143]

C. *The Duty of Impartiality*

The duty of impartiality requires a trustee to treat each beneficiary fairly.[144] Impartiality concerns can arise with respect to investment decisions as well as distribution decisions by a trustee. For example, intergenerational conflicts often occur between the investment goals of income beneficiaries and remainder beneficiaries. In addition, conflicts may arise among beneficiaries of the same generation who may be subject to divergent financial needs and circumstances. Finally, the duty of impartiality may also be a factor where distributions are concerned. For example, disagreements may be present over distribution decisions with respect to sprinkle or spray trusts. Impartiality may also be an issue when the trustee exercises a power to invade the corpus of

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the trust if changed circumstances have made continued retention of the asset inconsistent with the duty of prudence. *In re* Pulitzer, 249 N.Y.S. 87 (Sur. 1931), *aff'd mem*., 260 N.Y.S. 975 (N.Y. App. Div. 1932).

136 828 N.E.2d 1072 (Ohio Ct. App. 2005).

137 *Id.* at 1074.

138 *Id.*

139 *Id.*

140 *Id.* at 1074-75.

141 *Id.* at 874.

142 *Id.* at 1077-78.

143 *Id.* at 1080.

144 Hearst v. Ganzi, 52 Cal. Rptr. 3d 473, 481 (Ct. App. 2006).

the trust for his own benefit, thereby reducing the assets available for other beneficiaries[145].

A potential violation of the duty of impartiality arises when the trustee is also a beneficiary. A common example of this is when the surviving spouse is the income beneficiary and children from a prior marriage of the settlor are remainder beneficiaries. For example, in *Carter v. Carter*, the settlor, Luther Carter, created an *inter vivos* trust and named himself as trustee.[146] When Luther died in 2003, the trust was divided into three smaller trusts, including a marital trust for the benefit of Luther's wife, Audrey, and his daughter, Tiffany.[147] Audrey was appointed trustee of the marital trust and was the sole income beneficiary, while Tiffany was the remainder beneficiary.[148] It was undisputed that Audrey, in her capacity as trustee, invested the entire trust corpus in tax-free municipal bonds.[149] Tiffany brought suit against her stepmother, claiming that her investment strategy failed to protect the corpus of the trust from being reduced because of inflation.[150]

The lower court ruled in favor of Audrey.[151] On appeal, Tiffany argued that Audrey had a duty to treat all beneficiaries impartially without favoring her own interests.[152] However, relying on the language of the original trust (which provided for and described the provisions of the marital trust), the appellate court concluded that the settlor intended for the marital trust to generate income during Audrey's lifetime any way that she deemed appropriate.[153] In other words, Luther had waived the duty of impartiality insofar as protecting Tiffany's interest against inflation was concerned.

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145 *See, e.g.,* Rachins v. Minassian, 251 So. 2d 919, 920 (Fla. D.C.A. 2018); *see also* Joel C. Dobris, *Ethical Problems for Lawyers upon Trust Termination: Conflicts of Interest*, 38 U. MIAMI L. REV. 1, 57 n. 311 (1983).

146 965 N.E.2d 1146, 1148 (Ill. App. Ct. 2012).

147 *Id.* at 1149.

148 *Id.*

149 *Id.*

150 *Id.*

151 *Id.* at 1149-50.

152 *Id.* at 1155.

153 *Id.* at 1155-56.

However, the trustee in *Cooper v. Cooper* was not so lucky.[154] Unfortunately for him, there was no language in the trust authorizing the income beneficiary to maximize income. In that case, De Anne Cooper, who died in 1978, provided in her will that certain property be held in trust during her husband's lifetime.[155] The husband, Fermore (Bert) Cooper, and the Old National Bank (ONB) were named as co-trustees.[156] After Fermore died, the trust corpus was to be divided between the couple's two children, Joyce and Richard.[157] Joyce subsequently petitioned the lower court to remove her father as trustee and to order an accounting.[158] After an accounting was filed, the court found that Fermore had "maintained a policy of investment . . . which maximized the income of the estate . . . to the detriment of the growth of the corpus of the estate."[159] It ordered Fermore to pay $342,493, which it estimated to be the loss to the remainder interest.[160]

On appeal, the appeals court evaluated Fermore's investment decisions from the perspective of the prudent investor rule rather than as a breach of the duty of impartiality.[161] According to the court, only 13% of the trust's marketable securities were made up of common stocks, while 87% of its assets consisted of bonds and bond equivalents.[162] Furthermore, during the period in question, the purchasing power of the trust's corpus decreased about 4% per year.[163] The court declared that the prudent investor standard requires to trustee to maintain a balance between the rights of the income beneficiary and the remainder beneficiaries.[164] Agreeing with the trial court that Fermore failed to satisfy this standard, the appeals court upheld the lower court's damage award.[165]

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154 913 P.2d 393 (Wash. Ct. App. 1996).
155 *Id.* at 395.
156 *Id.*
157 *Id.*
158 *Id.* at 394.
159 *Id.* at 397.
160 *Id.*
161 *Id.*
162 *Id.*
163 *Id.* at 398.
164 *Id.*
165 *Id.*

Fortunately, there are a number of techniques that can be employed in most states to enable trustees to maximize total return without violating the duty of impartiality. The oldest is the principle of equitable adjustment, which is illustrated by the case of *In re Kuehn*.[166] Max Kuehn died in 1957, leaving a widow, Nell, and two sons, Carter and Max, Jr.[167] According to the terms of Max's will, certain property, including an interest in a farm located near Sioux Fall, South Dakota, was placed in trust. Carter and Max, Jr. were the income beneficiaries of this trust.[168] At the death of Max's two sons and their widows, the trust would terminate and be distributed to the lineal descendants of the sons, and if there were none, to certain charities.[169]

Carter died in 1960 and his interest in the trust went to Max, Jr. When Max, Jr. died in 1971, Nell and Max's daughter became the income beneficiaries of the trust.[170] In 1973, the trustee determined that the farm had become underproductive because of its increase in value and sold it.[171] Shortly thereafter, a dispute arose between the income beneficiaries and the charities over the distribution of the proceeds of the sale.[172] At trial, the court adopted a formula proposed by the Restatement (Second) of Trusts § 241 and allocated a share of the proceeds to the income beneficiaries.[173] This application of equitable adjustment was affirmed on appeal.[174]

A more proactive approach is to employ the unitrust concept. Under this concept, the settlor provides that the income beneficiaries are entitled to a certain percentage of the value of the trust corpus instead of the income generated by the trust.[175] This enables the trustee to invest in assets like land or growth stocks that appreciate in value, even though they do not gener-

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166 308 N.W.2d 398 (S.D. 1981).
167 *Id.* at 399.
168 *Id.*
169 *Id.*
170 *Id.*
171 *Id.*
172 *Id.*
173 *Id.* at 400.
174 *Id.* at 401.
175 Joel C. Dobris, *Why Five? The Strange, Magnetic, and Mesmerizing Affect of the Five Percent Unitrust and Spending Rate on Settlors, their Advisors, and Retirees*, 40 REAL PROP. PROB. & TR. J. 39, 42 (2005).

ate much income without prejudicing the interests of the income beneficiaries.

D. *Administrative Duties*

In the absence of a waiver by the settlor, trustees are subject to a variety of duties associated with trust administration. Family members who serve as trustees are often unaware of these duties and assume that trust beneficiaries will not object if they fail to observe them strictly. However, family members who serve as trustees should be aware of the duty to earmark, the duty not to commingle, the duty not to delegate, the duty to keep accurate records, the duty to inform, and the duty to account.[176] The trustee in *Jimenez v. Lee* managed to violate almost all of these duties.[177] In that case, the plaintiff's grandmother and one of the trustee's clients gave her father a sum of money to be used for his children's education.[178] The father, as "custodian" for his children, subsequently used the money to purchase bank stock.[179] When his daughter found about the bank stock, she sued her father for an accounting.[180] The Oregon Supreme Court concluded that the gifts were made in trust for the benefit of each child's education and further determined that the father held the property in trust.[181] Consequently, he violated various fiduciary duties by failing to earmark the funds as trust property, commingling the funds of the various beneficiaries, failing to keep accurate records, failing to inform his daughter of the existence and value of the trust, and failing to provide a proper accounting. The court imposed a constructive trust on the bank stock and refused to credit the defendant with most of the expenses he claimed because they were not supported by adequate records.[182]

Two of these duties, the duty to account and the duty to inform, can present particular problems for trustees who are also

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176 Scott Bieber, *Trustee's Duties Extend to Remainder Beneficiaries Too*, 38 EST. PLAN. 23, 23-24 (Nov. 2011).

177 547 P.2d 126 (Or. 1976).

178 *Id.* at 128.

179 *Id.*

180 *Id.*

181 *Id.* at 128-29.

182 *Id.* at 130-32.

family members.[183] Ordinarily, a trustee is required to keep and render a full and accurate record and accounting to the beneficiary and this duty is strictly enforced by the courts.[184] As *Raak v. Raak*[185] illustrates, a provision in the trust instrument that relieved the trustees from the duty to keep formal accounts did not relieve them of their duty to account for trust assets in court. In 1983, Berdena Raak created a revocable *inter vivos* trust and appointed her children as trustees.[186] At that time, the trust principal was almost $105,000.[187] In 1984, Berdena revoked the trust and requested the probate court to appoint a conservator.[188] When the trustees returned less than $33,000 to the conservator, Berdena asked the court to order the trustees to render an accounting to determine the location of the missing assets.[189]

The trustees relied upon language in the trust instrument that purported to relieve them of the duty to keep accounts as long as Berdena was alive.[190] However, affirming the decision of the lower court, the appeals court declared that while this may have relieved the trustees from the need to keep formal accounts, it did not relieve them of their duty to account when required to do so by the probate court.[191]

The Uniform Trust Code provides that "[a] trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests."[192] The UTC also declares that the trustee should also promptly respond to a request from a beneficiary for information related to the administration of the trust.[193] The duty to inform is illustrated by *Wilson v. Wilson*, decided by a North Carolina intermediate appellate court in 2010.[194] In that case, Lawrence Wilson, Jr. created irrev-

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183 UNIF. TRUST CODE § 813.
184 Raak v. Raak, 428 N.W.2d 778, 779 (Mich. Ct. App. 1988).
185 *Id.* at 778.
186 *Id.* at 778.
187 *Id.*
188 *Id.*
189 *Id.* at 778-79.
190 *Id.* at 779.
191 *Id.* at 781.
192 UNIF. TRUST CODE § 813 (1) (Unif. Law Comm'n 2010).
193 *Id.*
194 690 S.E.2d 710 (N.C. Ct. App. 2010).

ocable *inter vivos* trusts for each of his two children in 1992 and named his father, Lawrence Wilson, Sr., as trustee for both trusts.[195] In 2007, the trust beneficiaries filed suit against Lawrence, Sr., alleging breach of fiduciary duty.[196]

According to the plaintiffs, their grandfather, the trustee, had allowed their father, the settlor, to take control of the trust and enabled him to invest the trust assets in highly speculative personal business ventures.[197] In addition, the plaintiffs claimed that the trustee had failed to distribute income from the trust to them as required by the trust instrument.[198] Accordingly, the plaintiffs requested the court to order the trustee to provide a full and accurate accounting of the trusts from 1992 until the present date.[199] The plaintiffs appealed after the lower court granted summary judgment and issued a protective order in favor of the trustee.[200]

On appeal, the appellate court observed that the settlor had waived the trustee's statutory obligation to provide information to the trust beneficiaries.[201] However, the court also declared that a statutory provision based on the Uniform Trust Code stated that the trustee had a mandatory duty "to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries."[202] Accordingly, it ruled that the trustee was required to disclose the information sought by the plaintiffs because it was reasonably necessary to enable them to enforce their rights under the trust.[203]

III. Special Issues

There are many circumstances where trustees must be especially careful in their administration and distribution of trust assets. Among these are support trusts, discretionary trusts, and modification of trust provisions by means of decanting.

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195 *Id.* at 711.
196 *Id.*
197 *Id.*
198 *Id.*
199 *Id.*
200 *Id.*
201 *Id.* at 712.
202 *Id.* at 714.
203 *Id.*

A. *Support Trusts*

In a support trust, the trustee is directed to disburse funds from trust income or principal that is sufficient to provide for a beneficiary's "comfortable maintenance and support." If the provision is mandatory, the beneficiary's current standard of living usually determines the amount of support to which the beneficiary is entitled. Unfortunately, as *Laubner v. J.P. Morgan Chase Bank*[204] illustrates, the trustee and the beneficiaries may not always agree on what constitutes conformable maintenance and support, particularly if the trustee is given considerable discretion in the matter.

In *Laubner*, William Alley created an irrevocable *inter vivos* trust in 1994 for the benefit of his four daughters.[205] After William died in 1996, the trust was divided into four separate trusts—one for each daughter.[206] William's widow, Deborah, the daughters' stepmother, and J.P. Morgan were named as co-trustees,[207] The 1994 trust directed the trustees to pay so much of the net income as they deemed advisable for the proper care, support, maintenance, or education of each daughter or her issue.[208] After William's death, the trustees adopted a distribution formula that distributed $11,500 per month to each of the daughters.[209] This amounted to about 3.5% of the trust principal.[210] In 2007, two of William's daughters, Patricia and Pamela, sued to increase distributions from their trusts to $18,000 per month or 5% of the value of the trust principal from the non-GST trusts.[211] Patricia and Pamela also sought to remove their stepmother as trustee.[212]

The plaintiffs alleged that the trustees had abused their discretion by favoring the remainder beneficiaries instead of focus-

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204 898 N.E.2d 744 (Ill. App. Ct. 2008).

205 *Id.* at 747.

206 *Id.* Each trust was further divided into two GST Exempt trusts and a GST Nonexempt trust. *Id.*

207 *Id.*

208 *Id.* at 748.

209 *Id.*

210 *Id.*

211 *Id.* The idea was to exhaust the non-exempt trusts in order to avoid a 45% GST tax at their deaths. *Id.*

212 *Id.* at 749.

ing on the support needs of the income beneficiaries.[213] The lower court dismissed the daughters' claim and they appealed.[214] On appeal, the court concluded that the plaintiffs had failed to show that the current level of distributions was not sufficient to maintain their accustomed standard of living.[215] The court reasoned that as long as their needs were being met, the trustees did not abuse their discretion by keeping the trust principal intact for the benefit of the remainder beneficiaries.[216]

B. *Discretionary Trusts*

Modern trust instruments often authorize trustees to exercise broad discretion over the distribution of trust principal and income.[217] For example, a trustee may be given the power to distribute income from the trust in unequal portions among a group of beneficiaries. This is known as a spray trust. On the other hand, a sprinkle trust allows a trustee to accumulate some of the trust income instead of distributing it to the beneficiaries.[218] In addition, a trustee may be authorized to invade the corpus of the trust and distribute some or all of it to a particular beneficiary.[219] If the trust instrument provides some sort of standard to guide the trustee's exercise of discretion, a court will find that a trustee who has failed to follow the applicable standard is guilty of an abuse of discretion.

However, if no standard is specified, the court will still uphold the validity of the trust as *In re Estate of Ternansky* illustrates.[220] In that case, Rose Ternansky left two-thirds of her estate outright to two of her children, Margaret and Florence.[221] The remaining third was placed in trust for the benefit of her third child, William.[222] Florence was named as trustee for Wil-

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213 *Id.*

214 *Id.*

215 *Id.* at 752.

216 *Id.* at 751-52.

217 Richard A. Ausness, *Discretionary Trusts: An Update*, 43 ACTEC L.J. 231, 238 (2018).

218 *Id.* at 239.

219 Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 COLUM. L. REV. 1425, 1426 (1961).

220 141 N.E.2d 189 (Ohio Ct. App. 1957).

221 *Id.* at 190.

222 *Id.*

liam's trust with uncontrolled discretion to distribute so much of the trust's assets to William as she "may deem advisable."[223] William filed objections to the final and distributive account of his mother's estate, essentially challenging the validity of the discretionary trust.[224] However, William's objections were overruled by the probate court and its decision was affirmed on appeal, which upheld the validity of the trust even though Rose provided no standard to guide Florence in the exercise of her discretion as trustee.[225] Although the court warned that the trustee would not be permitted to exercise his judgment from fraudulent, selfish, or other improper motives. The court also declared that it would not attempt to control the trustee's judgment as long as he acted in good faith to carry out the intention of the settlor.[226]

The settlor may also give a trustee the discretion to terminate the trust prematurely. Thus, in *Sully v. Sully*,[227] Frederick Sully established a testamentary trust for his grandson, Robin, that provided Robin would assume full control of the trust property when he reached the age of 35.[228] However, the trust instrument also authorized the trustee, his uncle Thomas Scully,[229] to terminate the trust and distribute the trust assets to Robin at an earlier age if he determined that Robin possessed sufficient experience, judgment, and prudence to manage the trust assets on his own.[230] When Robin reached the age of thirty, he brought suit when Thomas refused to terminate the trust prematurely.[231]

The county court ruled that Thomas had not abused his discretion when he denied Robin's request.[232] However, the district court reversed and ordered Thomas to terminate the trust and a further appeal was taken.[233] The Nebraska Supreme Court declared that a discretionary power vested in a trustee should not

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223 *Id.* at 191.
224 *Id.* at 190.
225 *Id.* at 191-92.
226 *Id.*
227 76 N.W.2d 239 (Neb. 1956).
228 *Id.* at 243.
229 *Id.* at 247.
230 *Id.* at 243.
231 *Id.* at 242-43.
232 *Id.* at 243.
233 *Id.*

be disturbed by a court unless the trustee acted fraudulently or in bad faith.[234] The trust property consisted of large amounts of real property located in Kansas, Louisiana, and Nebraska.[235] Thomas presented evidence that Robin had done a poor job of managing some of the family's property for his father.[236] Therefore, it concluded that Robin had failed to prove that Thomas had abused his discretion when he refused to terminate the trust prematurely.[237]

C. *Decanting*

Decanting occurs when a trustee who is given discretionary power over distributions in the original trust exercises that option to distribute some or all of the trust property to a new trust with updated provisions.[238] The theory that supports trust decanting is that a settlor who gives the trustee the discretionary power to make distributions from trust property implicitly gives the trustee the right to make distributions in further trust. Unlike some other forms of trust modification, decanting does not require court involvement. Decanting was first approved by a court in *Phipps v. Palm Beach Trust Co.* in 1940.[239] At present, about half of the states have adopted statutes that expressly permit decanting but impose procedural and substantive safeguards to protect the interests of beneficiaries. As *Ferri v. Powell-Ferri* illustrates, decanting provides a trustee with the ability to respond quickly to changing conditions.[240]

In that case, John Paul Ferri, Sr. created an irrevocable *inter vivos* trust in 1983 (the 1983 trust) for the benefit of his son, John Paul Ferri, Jr. (John Jr.).[241] John Jr.'s brother, Michael Ferri, and Anthony Medaglia, were named as trustees.[242] The trust provided that once John Jr. reached the age of 35, he could withdraw principal from the trust in increasing amounts depending

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234 *Id.* at 245.

235 *Id.* at 246.

236 *Id.* at 254

237 *Id.* at 254-55.

238 Lydia Lee Lockett & Peter Blumeyer, *Sour Grapes: when Decanting Gives Rise to Litigation*, 33 PROB. & PROP. 26, 27 (Oct. 2019).

239 196 So. 299 (Fla. 1940).

240 116 A.3d 297 (Conn. 2015).

241 *Id.* at 300.

242 *Id.*

on his age.[243] In 2010, John Jr.'s wife, Nancy, filed for divorce.[244] Fearing that Nancy would claim a share of the trust assets as marital property, the trustees transferred a substantial portion of the trust assets to a new trust (the 2011 trust). John Jr. was the only beneficiary of the 2011 trust, but the sole power to withdraw property from the trust was vested in the trustees rather than in John Jr.[245] The trial court found that John Jr. played no role in creating the 2011 trust or in transferring property from the 1983 trust to it.[246]

Shortly after the transfer of assets to the 2011 trust, the trustees sought a declaratory judgment requesting the court to acknowledge that they had validly exercised their power to transfer assets to the new trust and that John Jr. had no interest in the trust that his spouse could reach in a divorce suit.[247] The lower court granted a summary judgment in favor of the trustees and Nancy appealed.[248]

On appeal, Nancy argued that John Jr. had an affirmative duty to protect their marital property by contesting the trustees' action. The Connecticut Supreme Court acknowledged that a spouse had a fiduciary duty not to waste marital property, as well as a duty to disclose the existence of such property.[249] However, the court concluded that John Jr. had not breached any fiduciary duty and that he had no duty to take affirmative steps to recover marital assets from a third party.[250] Consequently, the appellate court affirmed the lower court's judgment for the trustees.[251]

Decanting has also been used to transfer assets from a conventional trust or a support trust to a special needs trust.[252] A New York Surrogate's Court upheld such a transfer in *In re*

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243 *Id.* Michael testified that the 1983 trust was worth between $60 and $70 million. *Id.* at n.2.

244 *Id.*

245 *Id.*

246 *Id.*

247 *Id.* at 301.

248 *Id.*

249 *Id.*

250 *Id.* at 305.

251 *Id.* at 307.

252 Amy J. Fanzlaw, *New Opportunity, to Decant in Florida, Part II: Successful Execution of Trust Decanting*, 93 FLA. B.J. 22, 26 (Dec. 2019).

Kroll.[253] The *Kroll* case involved a trust established in 1992 by Moses Ratowsky for the benefit of his grandson, Daniel Schreiber.[254] Daniel's mother, Rachel, and Alan Kroll were named as trustees.[255] According to the trust, Daniel could receive income or principal from the trust at the discretion of the trustees.[256] However, Daniel would be entitled to withdraw all or any of the trust principal once he reached the age of 21.[257]

Prior to Daniel's 21st birthday, the trustees transferred the trust's assets to a new supplemental needs trust for the primary benefit of Daniel.[258] At the time, Daniel was suffering from disabilities and was receiving both Medicaid and SSI benefits.[259] The trustees then sought to have the surrogate court approve the transfer.[260] This request to decant was opposed by the New York Attorney General acting on behalf of the Department of Health which administered the state's Medicaid program.[261]

The Attorney General argued because Daniel was entitled to demand a distribution of principal once he reached the age of 21, the new trust would be considered a self-settled trust which would have required a payback provision to reimburse the state for medical expenses paid on Daniel's behalf.[262] However, the court ruled that the trustees had complied with all of the statutory requirements for the effective exercise of the power of appointment contained in the original trust instrument.[263] Therefore, the court concluded that the new trust was a valid third-party supplemental needs trust and no payback provision was required in the new trust.[264]

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253 971 N.Y.S.2d 863 (Surr. Ct. 2013).

254 *Id.* at 864.

255 *Id.*

256 *Id.*

257 *Id.*

258 *Id.*

259 *Id.*

260 *Id.*

261 *Id.*

262 *Id.* at 865.

263 *Id.* at 866.

264 *Id.*

IV. Precautionary Measures

As the foregoing discussion illustrates, appointing family members to serve as trustees creates a risk of sparking ill will and strife within the family. Even worse, disagreements about the trustee's decisions concerning administration of the trust or the distribution of trust assets to particular beneficiaries may lead to expensive and disruptive litigation among family members. It appears that the best strategy for avoiding these situations is for the settlor to appoint someone other than a family member to serve as the trustee. In particular, it is risky to name the surviving spouse as trustee if some of the beneficiaries are not biological children of the spouse. In any event, if the settlor proposes to nominate a family member as trustee who has no legal training, the drafter should take steps to make sure the prospective trustee is aware of the fiduciary duties associated with that office. However, if the settlor insists on appointing a family member to serve as a trustee, there are some additional proactive measures that the settlor and the prospective trustee can take to reduce the risk of family discord in the future.

A better alternative might be to appoint a someone outside the family as the trustee and name a family member as a trust protector with the power to advise the trustee about trust administration and veto certain decisions about investments or the distribution of trust assets. The office of trust protector is a relatively new addition to the law of trusts.[265] Unlike a trustee, a trust protector does not hold legal title to the trust property. However, the trust instrument can give a trust protector power over certain aspects of trust administration or the distribution of trust assets. For example, trust protectors can advise the trustee, oversee certain activities of the trustee such as investment decisions, resolving or mediating disputes between the trustee and one or more beneficiaries, and modifying or terminating the trust.[266]

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265 Richard C. Ausness, *When Is a Trust Protector a Fiduciary?*, 27 QUINNIPIAC PROB. L.J. 277, 278-83 (2014).

266 Richard C. Ausness, *The Role of Trust Protectors in American Trust Law*, 45 REAL PROP., TR. & EST. L.J. 319, 329 (2010).

A. *Actions by the Settlor (or the Drafter of the Trust Instrument)*

Regardless of whether the settlor wishes to have a family member administer the trust, he or she should start by hiring a professional estate planner to draft the trust instrument and carefully review the finished product. If the settlor is determined to name a family member as the trustee, the prospect of disputes among family members can be reduced by careful drafting. In particular, the trust instrument should describe in detail the purpose of the trust, its distributive scheme, and the powers and duties of the trustee.

1. *Purpose of the Trust*

The trust instrument should clearly identify the purpose of the trust. For example, the intended purpose may be to provide for the financial security of the surviving spouse (and claim a marital estate tax deduction), to provide for the financial security of the settlor's siblings, children, step-children, or grandchildren, or to enable family members to retain control of a family farm or business. The purpose of the trust can be further fleshed out in a separate letter of intent addressed to the trustee which may be shared with some or all of the beneficiaries.[267]

If the trust is discretionary, the trust instrument should indicate whether the trustee's exercise of discretion is subject to an ascertainable standard or whether it is "sole and unlimited" in nature. Furthermore, if the settlor intends to provide support for certain beneficiaries, the trust instrument should supplement the usual boilerplate language with a more specific description of what is included in the notion of support. For example, a provision for "comfortable maintenance, education, and support" should indicate whether the term "education" includes post-graduate education or non-traditional alternatives such as study at a performing art academy or a trade school. Finally, a support trust should indicate whether the trustee should take a benefici-

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[267] For a discussion on the use of letters of intent, see Alexander A. Bove, Jr., *Commentary on Discretionary Trusts: An Update by Richard C. Ausness*, 43 ACTEC L.J. 441, 445 ((2018); Alexander A. Bove, Jr., *The Letter of Wishes: Can We Influence Discretion in Discretionary Trusts?*, 35 ACTEC J. 38, 39 (2009).

ary's other resources into account when making decisions about payments for support.

2. *Powers and Duties of Trustees*

Although trustees have certain inherent powers and duties because of the nature of their office, it is better to identify these powers and duties expressly instead of relying solely on judicial decisions and statutory provisions.[268] As far as powers are concerned, the powers listed in the Uniform Trust Code provide a useful starting point. However, it would be helpful if the trust instrument also spelled out the extent to which the trustee could delegate certain functions to agents, such as financial advisors, accountants, attorneys, and other agents. The trust instrument should also make it clear whether the trustee is to be compensated for time spent administering the trust and also if the trustee will be reimbursed for any money spent on trust business.[269]

In addition, the trust instrument should indicate whether the trustee is to be relieved of the duty of impartiality, the duty of prudence, the duty to avoid self-dealing, or the duty to avoid conflicts of interest. This is especially important if the trustee is also a trust beneficiary or if he or she has the power to make discretionary distributions of trust income or principal. This step is particularly important if the principal asset of the trust is real property or shares in a family business. The settlor might also consider whether to add an *in terrorem* clause or an exculpatory clause to protect the trustee against questionable lawsuits by other family members.

Another issue that the trust instrument should address is how a successor trustee will be chosen if a trustee resigns, dies, or becomes incompetent. Possible options include allowing the remaining trustees to choose a successor if multiple trustees have been appointed, authorizing a corporate trustee to appoint individuals as successor trustees if there is a corporate trustee, and finally the trust instrument could allow a trust protector to select a successor trustee if the trust instrument provides for one.

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[268] The Uniform Trust enumerates a number of trustees' powers and duties. UNIF. TRUST CODE §§ 801-17.

[269] The Uniform Trust Code for the reasonable compensation and reimbursement of trustees. UNIF. TRUST CODE §§ 708-09.

3. *Distributive Framework*

Obviously, the trust instrument should identify of all of the potential beneficiaries and their respective rights in the trust. A rigid distributive formula, such as "income in equal shares to *A* and *B*," has the advantage of reducing the grounds for a challenge to the trustee's actions, but it could cause problems if unforeseen changes in circumstances affect a beneficiary's needs. A discretionary power to invade the trust corpus will increase flexibility, but it may encourage a challenge to the exercise of this power from other beneficiaries. One response to this problem would be to require unanimous consent to exercise a power to invade if there are multiple trustees. Another solution might be to require the consent of a trust protector to invade.

B. *Actions by the Trustee*

It is highly desirable, if not essential, for the trustee to maintain a good personal relationship with all of the beneficiaries. This is particularly important if the trustee is also a family member. There are various steps that the trustee can take to encourage such relationships. For example, when the trustee assumes office, he or she may convene a family conference to inform family members about the purpose and provisions of the trust. In addition, the trustee should encourage individual beneficiaries to discuss matters of concern with him or her. Furthermore, the trustee should make periodic disclosures about the trust's performance. Finally, the trustee should inform trust beneficiaries of any issues or events that may affect the trust.

V. Conclusion

A trustee's life is often not a happy one. As the foregoing discussion has shown, this is particularly true when a family member is chosen to serve as a trustee. Consequently, it is generally a good idea for the settlor to appoint a non-family member, such as a bank or corporate trustee, as trustee or co-trustee. However, if the settlor insists on naming a family member as trustee, there are some common-sense measures that the settlor and the trustee can take to reduce the chances of friction within the family. In particular, the settlor should make sure that the trustee is fully aware of the fiduciary duties that are associated

with the office of trustee. In addition, if possible, both the settlor and the trustee should inform other family members of the general purposes of the trust and the trust provisions that directly affect them. Hopefully, these measures will reduce the chances of conflicts within the family after the settlor's death.