

Reproduced with permission from Daily Tax Report, 143 DTR GG-1, 7/27/15. Copyright © 2015 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

Trusts

Trust Protector's Right to Wield Superpowers Gets Nod From State Courts

When the trustee isn't so trustworthy, and the beneficiaries can't get along, there's a superhero who is increasingly being called on to save the day—the trust protector.

Trustees and trust protectors are designed to be symbiotic characters in the interactions of a trust's life, but it hasn't always worked out that way in the courts.

In two state lawsuits—*Stevens Trust* and *Minassian*—it was the trust protector's rights that were upheld.

In *Stevens Trust*, gift taxes were in dispute and the trust protector booted a trustee who was making the pursuit of his own legal fees his primary goal (*In re Eleanor Pierce (Marshall) Stevens Living Trust*, 159 So. 3d 1101, 2015 BL 40941, La. Ct. App. 2015).

In *Minassian* the trustee and beneficiaries were battling each other in court, and the trust protector was allowed to amend the trust so that it applied retroactively, to the detriment of the beneficiaries (*Minassian v. Rachins*, 152 So. 3d 719, 2014 BL 338543, Fla. Dist. Ct. App. 2014).

The message: State courts are willing to recognize the role and authority of trust protectors, even when other parties—such as the trustee or the beneficiaries—are in disagreement.

"We're going to start seeing more and more litigation bubbling up at the state court level dealing with the question of what a trust protector is and whether he or she has fiduciary duties, as well as how those duties intersect with the actions of trustees," Jeff Chadwick, an associate with Winstead PC in Houston, told Bloomberg BNA on July 15.

Mild-Mannered Attorney by Day. Trust protectors are often equipped with Superman-like powers to swoop in and rescue the beneficiaries. Their job is to police the trustee and make sure that the wishes of the settlor are observed and that the beneficiaries get all the holdings the trust creator meant for them to get.

The protector's superpowers include the power to remove and replace the trustee, the power to add or delete beneficiaries and the power to change the terms of the trust. These so-called hot powers come in handy when the beneficiaries decide to sue because they think their assets are being frittered away by a rogue trustee or the beneficiaries don't want dad's new wife to get the family heirlooms.

For tax reasons, some of the trust protector's hot powers can't be given to a trust creator or beneficiary

because they could cause adverse tax consequences to those parties, Dana G. Fitzsimons Jr., principal and fiduciary counsel with Bessemer Trust in Atlanta, told Bloomberg BNA on July 13. The trust assets could inadvertently be subject to the estate tax. There could also be so much control that, depending on state law, the trust assets might be reachable by creditors.

If the *Stevens Trust* case shows anything, it is that a state statute sanctioning trust protectors doesn't have to exist for a trust protector to prevail in court, advisers said. It is also a test case for how the courts will view the nature and scope of the trust protector's duties when they are in conflict with trustees.

The *Stevens Trust* case came to a head in 2010 when neither the trustee for a trust owned by the widow of oil tycoon J. Howard Marshall, nor the estate of Marshall wanted to pay gift tax the Internal Revenue Service said was owed.

In 1961, Marshall gave his wife of 30 years—Eleanor Pierce Marshall—some Marshall Petroleum Inc. shares as part of their divorce settlement. In 1984, Eleanor transferred the shares to her revocable trust. The trust had both a trustee and a trust protector, the latter of which was given the right to remove the trustee, with or without cause, if he wasn't representing the interests of the beneficiaries. The trustee also had the power to name a successor trustee.

More and more litigation is "bubbling up at the state court level dealing with the question of what a trust protector is and whether he or she has fiduciary duties."

JEFF CHADWICK, WINSTEAD PC

Marshall is perhaps most famous for marrying Anna Nicole Smith when she was 26 and he was 89. Their 14-month marriage just before Marshall's death led to a protracted court battle over his estate between Smith and Marshall's two sons. That battle ended up in the U.S. Supreme Court.

In 1995, Marshall sold his Marshall Petroleum Inc. shares back to the company at below market value. The IRS later determined that what he had really done was make a gift of the stock to MPI's shareholders, which included Eleanor.

Neither Marshall nor his estate paid the gift tax, which caused the IRS to cast an eye upon Eleanor and

the other MPI shareholders. That's when the trustee's on-again, off-again relationship with the trust began, according to the lawsuit.

In 2009, shortly before the IRS's assertion of liability for the unpaid tax, the trustee of Eleanor's estate petitioned the court to resign, which the court granted. The IRS was coming after administrative fees paid from the trust estate and certain charitable amounts that had been set aside in lieu of paying the gift taxes. In 2013, when the trust protector learned that the IRS would consider payment of the trustee's attorney fees as a violation of the federal priority statute, the trust protector removed him.

The trustee appealed his removal to the Louisiana Court of Appeal, asserting, among other things, that the office of trust protector wasn't recognized by the Louisiana Trust Code, and that it violated public policy. In fact, he said the office of trust protector couldn't be recognized until the office and its duties were defined by the Louisiana Legislature.

No State Law, No Problem. Most wealth advisers saw nothing strange in allowing the trust protector to exercise duties that were clearly given to him in the trust document—with or without a state statute to approve it.

Chadwick said the *Stevens Trust* decision makes sense, given the decedent's "clear and unambiguous" direction in the case and the desire of the judicial system to honor the intent of the settlor whenever possible. Although trust protectors aren't expressly allowed under the Louisiana Trust Code, the court said there was no law forbidding them.

The legal argument that was made—that trust protectors themselves somehow inherently violate the public policy of the state of Louisiana, and therefore the trustee couldn't be removed by the trust protector—was rejected by the Louisiana court, Fitzsimons said. "The legal holding in the case strikes me as correct and not at all surprising," he said.

The Louisiana Court of Appeal said trust protectors fulfill a valuable role as the eyes of the settlor, with the ability to hold trustees accountable, he said.

I Lost It at the Track, Honey. The issue in *Minassian* was less clear-cut and perhaps more important in terms of what it means for trust protector cases. In that case, the trust protector was using his power to try to influence the extent to which the decedent's children could challenge what a widow was doing with the trust, attorneys said. At issue was whether the children from a former marriage would have standing to challenge their father's second wife's rate of spending—when horse racing and legal gambling were the pastimes.

Rick Minassian died in 2010 and was survived by his wife, who was named as trustee of a bypass trust that was funded with approximately \$2.5 million.

The wife, in just 19 months, had withdrawn more than \$800,000 from the trust, apparently to enable her gambling lifestyle, attorneys said. The husband's children sued the wife for breach of fiduciary duty.

At trial in the Broward County, Fla., Circuit Court, the wife claimed that the children weren't beneficiaries because the bypass trust terminated at her death. But the court said they were beneficiaries and that the trust would be divided into separate shares once she passed away.

While the wife's appeal was pending, she, as the sole trustee, triggered a trust protector clause—her husband

had named the trust drafting attorney the trust protector, which gave him the right to modify the trust and clarify ambiguities. The trust protector did just that, stipulating that the trust would terminate at the wife's death and the children would become beneficiaries of new trusts—if any assets remained.

While the trial court agreed with the children that the trust protector's amendment was invalid—because it didn't further the beneficiaries as a group or the husband's probable wishes—the Florida District Court of Appeal ultimately said that the terms of the bypass trust were ambiguous and ruled in favor of the wife.

Wrong on Several Levels. The appeals court decision was wrong on a number of levels, Chadwick said. First, the court gave "heavy weight to extrinsic evidence from the trust protector on meetings and telephone conferences he had with the husband regarding his wishes for his wife—instead of relying on the plain terms of the trust instrument."

More fundamentally, Chadwick said, the court failed to recognize a bedrock principle of trust law involving current and remainder beneficiaries. "If this particular trust had no remainder beneficiaries to enforce its terms, then all that is left is a pool of assets controlled by the wife who can do whatever she wishes as sole beneficiary and sole trustee," he said. "Do you really have a trust in that instance? I don't think so."

The trust protector, who was the drafting attorney, seemed comfortable putting his thumb on the scale in the middle of an active dispute.

DANA G. FITZSIMONS JR., BESSEMER TRUST

The court was apparently focusing on whether the children were future beneficiaries of the trust, which arguably would give them standing, or somehow beneficiaries of a trust that might be created in the future that might not give them standing, Fitzsimons said.

"But what is far more interesting than the standing question in this case is that the trust protector, who was the drafting attorney, seemed comfortable putting his thumb on the scale in the middle of an active dispute," Fitzsimons said. "I suspect that not all trust protectors would want to exercise their powers in a way that advantages one beneficiary over another in that way," he said.

The decision was groundbreaking, Juan C. Antunez, a partner with Stokes McMillan Antunez P.A. in Miami, told Bloomberg BNA on July 14. It was the first time an appellate decision construed the Florida Trust Code in a way that upheld the application of trust protectors in Florida trusts, he said.

The trust protector was able to effectively trump what the trial court had decided, Antunez said. When the court ruled against the wife, she simply triggered a trust protector provision that allowed him to rewrite the trust in a way that favored her litigation position.

"It took the dispute resolution process out of the courtroom, and instead applied this separate private process which the settlor and his attorney had built into the trust agreement," he said. "In essence they were

able to use this mechanism to privatize an inheritance dispute.

The case should give certainty to lawyers nationwide, Antunez said. The provisions that were interpreted by the appellate court in Florida were part of the Uniform Trust Code, and those same provisions are found in all of the other states that have adopted a uniform trust code, he said.

'Private Trust Company Experience.' By all accounts, the use of trust protectors is on the rise.

"People want more customized trustee engagements," Jonathan M. Forster, a shareholder in Greenberg Traurig LLP in McLean, Va., told Bloomberg BNA on July 14. "They want almost a private trust company experience. They have different asset classes and they want to treat those asset classes differently. Having publicly traded securities is one thing. Having a family compound is another, and having a closely held operating business is yet another."

With the increase in the federal estate and generation-skipping transfer tax exemptions, and the extension or elimination by many states of their perpetuities periods, many clients are creating trusts that may hold assets for the benefit of long-term dynasty trusts that can span hundreds of years, Forster said. "People realize they can't contemplate everything that is going to be relevant over that period of time."

Enter the trust protector, with the flexibility and muscle to shift the players and change the terms of the trust. When the trustee misbehaves, beneficiaries don't have to go through a lengthy court battle to get the trustee removed; they simply turn to the trust protector, who has the authority to cast him or her out.

State Law Lagging. However, when it comes to clarifying the trust protector's fiduciary duties, state statutes haven't caught up with practice and neither has the body of law emanating from the courts, advisers said.

The trust protector is a very new concept for most states, Gideon Rothschild, a partner with Moses & Singer LLP in New York, told Bloomberg BNA on July 14. Many states don't have specific provisions in their statutes for trust protectors. For states that have passed the Uniform Trust Code, there is a provision that deals with trust advisers and whether or not they are fiduciaries, and each state's laws are different, he said.

While some states have enacted the Uniform Trust Code, others have made changes to the version that was recommended. Some have added specific provisions for trust protectors saying they are fiduciaries; other states say they aren't. But even when one of those default provision exists, it can be overridden.

"At the end of the day, it depends on what your state law might say and what the document says as to whether they are fiduciaries or not," Rothschild said.

Reluctant Fiduciary. For some advisers, the answer to the question of whether a trust protector is a fiduciary is clear.

"It's ridiculous to say that trust protectors don't have any fiduciary duties," Alexander A. Bove Jr., an author and a principal with Bove & Langa P.C. in Boston, told Bloomberg BNA on July 14. "Lawyers go to such lengths to avoid being a fiduciary. But to what end, because if they make a mistake, they are still going to have liability. Why try to say you aren't a fiduciary, when in fact you are?"

The trend toward exculpating the trust protector from liability is a bad one, Bove said. Trust protectors can't have it both ways—holding extraordinary and broad oversight powers but with no accountability to the beneficiaries or the trust, he said.

"I want this person to think carefully about exercising their position," he said. "I don't want them to personally benefit other than to be paid for their services, and I want them to act in a sensible manner, in the best interest of everybody. That spells fiduciary."

Other attorneys aren't as adamant about it. A trust protector may be given fiduciary duties, but it isn't necessary in every instance, Forster said.

How often does the trust protector want to be a fiduciary? "Never," Forster said. "Why would they want a heightened sense of liability? Do they want to be sued more often or less often?" Imposing more liability on trust protectors will make it harder for them to get insurance and less likely to take the job, he said.

It is one thing to be held to a prudent person standard, he said, but quite another to be held to a fiduciary standard, which is the strictest duty of care recognized by the U.S. legal system, "and is almost that of a guarantor."

Trustee Liability. A trust protector may not have a duty of care, but the trustee—who is unquestionably a fiduciary—does. This has raised interesting questions about what liability the trustee has in deferring to the instructions of the trust protector, advisers said.

"The key question appears to be not whether the use of a trust protector is allowed, but how insulated the trustee will be when carrying out the directions of the protector," Fitzsimons said.

The traditional trust model is for the trustee to perform duties such as managing investments, making distributions to beneficiaries, paying trust taxes and handling the accounting. However, those duties may be carved up so that the trust protector has oversight for some of those roles.

"It's ridiculous to say that trust protectors don't have any fiduciary duties."

ALEXANDER A. BOVE JR., BOVE & LANGA, P.C.

The trust protector role has traditionally been fairly limited, but some people have "gotten a little creative or cute with it," Todd D. Mayo, a principal with Perspecta Trust LLC in Hampton, N.H., told Bloomberg BNA on July 20. Some trust protectors are taking on more of the function of a trustee, he said.

"I have seen trust agreements in which the trust protector has the power to direct the trustee concerning investments. That means the trust protector has been vested with the investment power. And if you add on the distribution powers, now you're really looking at a role that—even though it is called trust protector—has all the hallmarks of a trustee," he said. That may not be the optimal design, he added.

Divided Trusteeship Project. This phenomenon is one of the reasons the Uniform Law Commission has taken on a divided trusteeship drafting project.

“It is becoming increasingly common to name a corporate trustee and give that trustee the custodial function but then assign the other functions to other people who are nominally not trustees,” Robert H. Sitkoff, a Harvard University law professor, told Bloomberg BNA on July 14. Trust protectors are one manifestation of divided trusteeship.

Sitkoff is chair of the ULC drafting committee, which had its first meeting in March and aims to deliver a model law by the summer of 2017.

A number mutations of the trust protector job have emerged. While a bank might be named the custodial trustee, the investments might be at the direction of an investment adviser, and distributions to beneficiaries might be made by a committee comprised of a spouse, the settlor’s attorney and a friend, Sitkoff said. On top of that, veto, consent and removal powers are being given to family members so that, in some instances, some of the trust protector’s powers are being taken away.

With so much movement in so many directions, he said, the question becomes “what is the fiduciary obligation of these non-trustees who are getting powers of direction over one or more functions of trusteeship, and what is the residual fiduciary obligation of a trustee who is getting these kinds of directions?”

There is little legal authority to help trust drafters with the rights and duties of trustees, third parties and beneficiaries in these circumstances, Sitkoff said.

Uniform Act Is Goal. The divided trusteeship project will try to develop a uniform act for adoption by the states that will bring clarity, certainty and uniformity to the various open questions for which there is lacking or divergent authority across the states, he said.

In addition to providing a law for the states, the committee will be reviewing existing uniform trusts and estates acts. It may need to propose amendments to the UTC Section 808 so that it conforms to whatever structure the committee develops, he said.

The divided trusteeship committee is also leaning toward saying that individuals who have the power to direct would presumptively be fiduciaries, but there

would be an extent to which a settlor could provide otherwise in the terms of the trust, Sitkoff said.

That decision will be related to the extent to which the trustee is also a fiduciary. “If the trustee has duties to resist, then the person having the power to direct doesn’t have to have as much duty,” he said.

State of the Union. Thirty-one states have adopted the Uniform Trust Code, according to Fitzsimons. They include Virginia, Florida, Kansas, Minnesota, Arizona and Oregon. The UTC presumes that these parties—whether they are called protectors, directors or advisers—are fiduciaries. However, this is a default provision that is subject to override in the trust instrument.

Trust protectors originated offshore, Todd Beutler, a foreign legal consultant with DLA Piper in Hong Kong, told Bloomberg BNA on July 17. “The U.S. essentially copied and adopted the protector concept that was being used abroad, where they were not always serving in a fiduciary capacity,” he said. “However the U.S. is a little better about handling things on a statutory basis. The U.S. likes to codify the rules.”

As for court cases, there have been only a handful that dealt with trust protectors. “We’re in the early stages of a body of law,” Fitzsimons said. “One of the reasons you see cases is because there is uncertainty and issues to be litigated. What’s interesting is whether the legal development through case law will be short-circuited by the development of a uniform act.”

Until rules of the road are established, Fitzsimons said that perhaps the best path is to carefully draft the trust instrument in a state like Delaware that provides a lot of flexibility to structure the trusteeship in whatever way is desired.

BY DIANE FREDA

To contact the reporter on this story: Diane Freda in Washington at dfreda@bna.com

To contact the editor responsible for this story: Brett Ferguson at bferguson@bna.com

Texts of the Stevens Trust and Minassian opinions are in TaxCore.