Prepared for Juan Antunez

Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2220

Date: 30-Apr-14
From: Steve Leimberg's Estate Planning Newsletter
Subject: Steve Salley on Trusts & Their Trustees: The Housekeeper in the Soap Opera

"The multi-generational trust is here and it is here for good. The impossibly long terms of these trusts are proof that they are given shape and content far more by current estate and gift tax demands than trying to tame the uncertainties of the future for the fiduciary.

The economic pressures of estate taxation force the creation of irrevocable entities today with irrevocable governance mechanisms that must accommodate an unimaginable future world with unknown personalities, animosities, and law. Preparing for the Housekeeping for such trusts is critical, but so is foreseeing the Soap Opera.

The current complexities of trust administration are beyond the ken of most laymen, and litigation and conflict have made professional trustees, individual and corporate, appropriately cautious in accepting the trustee mantle. The fact that professionals still do accept the responsibility is testimony both to the critical role of trusts in our society and as well as to their cautious confidence that, properly prepared, trustees can meet the demands of the role."

In his commentary, **Steve Salley** suggests that trust and fiduciary document drafters may not be doing anyone, including settlors, beneficiaries, or trustees, a favor by underestimating the critical role of the trustee's knowledgeable participation in the will or trust as it is drafted. As Steve notes in his commentary, the amateur trustee, who he refers to as the "Trustee Naïf," is unlikely to be able to meaningfully participate without counsel in a process pursuant to which he or she may assume years of responsibility and risk.

Stephen Salley, a Partner with **Banyan Family Business Advisors LLC**, was a tax attorney for thirty years, most recently as a shareholder at Greenberg Traurig.

He was a certified tax attorney practicing in taxation, tax litigation, estate planning and closely held business representation. In 2004 he left the practice of law and joined GenSpring Family Offices LLC, one of the nation's largest multi-family offices. At GenSpring he worked for nearly a decade as the head of that firm's Family Business Center and as its Chief Fiduciary Officer. In January of 2014 he joined Banyan Family Business Advisors, a firm that offers a comprehensive suite of advice and support for families as owners of Family Enterprises. His principal focus at Banyan is to assist in integrating each family's unique tax, fiduciary, and estate planning considerations into Banyan's comprehensive advice structure. He can be contacted at ssalley@banyan-fba.com, or through the firm's website, www.banyan-fba.com.

Mr. Salley speaks and writes frequently on tax, succession planning, estate planning and fiduciary issues for high net worth families and their family businesses. He has been a member of the Executive Council of the Florida Bar's Tax Section; co-chair of the American Bar Association's Committee on Estate Planning for Business Interests and Owners; and was previously the Florida Bar Liaison to the United States Tax Court. For a tax attorney he can on occasion be a fairly amusing conversationalist.

Here is his commentary:

COMMENT:

For those estate and trust lawyers who have attained "a certain age", the 1981 movie "Body Heat" was a revelation and a bit of a vindication... trust law could be the stuff of lust and mayhem! Among the film's memorable aspects (and there were many), was the stunning realization that, absolutely central to the sex and murder in the film was ...wait for it...the Rule against Perpetuities. For one brief moment being a geeky lawyer was a license to lecture our spouses and friends on how the dust and drear of ancient law could be the stuff of wildly salacious soap opera. Sadly that moment appears to have passed.[i]

These days I get surprisingly little cocktail party mileage out of speculating on how the generation assignment rules for the GST could fuel an entire genre of Maury Povich moments in the era of DNA testing. Still, I propose that fiduciary law need not have been completely relegated to the Nonfiction section under "yawn". Body Heat does illustrate something many of us have learned to our discomfort ...that amid the arid technicalities and punctilios of fiduciary administration can lurk both mind-numbing administrative detail and painful melodrama. This article is a plea for the lawyerly academy to share that sensitivity with grantors and fiduciaries earlier rather than later and invite the potential fiduciary to assess risk properly

informed. While it is admittedly tough to dramatize potential fiduciary nightmares in a distant future for nominee trustees, asking unsuspecting trustees to assume responsibility without a fair grounding in the possible miseries inherent in the role strikes me as…at least…handing the unsuspecting a pig in a poke.[ii]

The literature of trust drafting traditionally compares two separate species of trustee, the professional (read corporate) and the individual (read accommodating). Oceans of ink have been spilled on when to select an individual vs. corporate fiduciary (or some combination). These analyses usually tum, (albeit tacitly) on three implicit assumptions about corporate trustees ...they are (i) expensive, (ii) inflexible, and (iii) morbidly risk averse. Individual trustees somehow represent an antidote to these unspoken concerns, being (likewise tacitly) assumed to be "grantor friendly" in cost, expediency, and tractability. The conceded disadvantages of using individual trustees are largely attributed to their lack of the corporate trustee's fiduciary *infrastructure* ... that is, the individual usually lacks *systems* for the enervating routines of investment, accounting, tax and fiduciary reporting, discretionary documentation, and the like. Grossly oversimplified, the bias often seems to be that the individual trustee may need support for the *mechanics* of trust operation, that is, the *housekeeping* aspects of fiduciary administration. The corporate trustee has all those systems but at a high cost in inflexibility, expense, and bureaucratic “bumbling”.[iii]

In these ramblings I will refer to the parallel agonies of the trustee …trust mechanics and stressful interpersonal relationships, (including litigation)… as *housekeeping* and *soap opera*. Housekeeping is the repetition and attention to detail demanded of a trustee, all those relentlessly technical aspects of compliance with fiduciary responsibilities. Soap Opera, on the other hand, is the potential inter-personal clashes, family dramas, and accusatory correspondence from outraged plaintiff’s counsel that too often stress the life of the trustee who thought he or she was just being helpful.

I further suggest we divide the individual trustee category into two very different subcategories, the "Knowledgeable Professional" and the "Trustee Naïf .” Most knowledgeable professionals, (often attorneys, accountants, or investment professionals), bring to the fiduciary engagement some deficiencies in formal fiduciary infrastructure, but they are familiar with and can arrange for the legal, investment, and accounting responsibilities they must shoulder, (the "Housekeeping"). Equally importantly, they usually have sufficient experience with the potential for melodrama that lies in those odd entities we antiseptically refer to as estates and trusts, (the "Soap Opera"), to protect themselves and their firms to the extent drafting will allow. The "Trustee Naïf ' has neither the Housekeeping nor Soap Opera experience to assess the risk or engage in appropriate self-protection.

What is worse, both horns of the fiduciary pickle can seem to the uninitiated comfortingly remote at the time they are invited to serve. In short, they are sitting ducks.

I am grateful to an excellent article by **Lauren Wolven** and **Jeffrey Zaluda** [iv] for the following cautionary language:

> Serving as a trustee used to be an honor bestowed by a long time client or friend...Trustees rarely were questioned with respect to their actions, and trustees hardly gave a thought to personal liability… It is an increasingly risky business to serve as trustee, however, as fiduciary litigation is on the rise ... Many law firms now prohibit attorneys from accepting such positions or require that the decision be vetted by a special committee... The hesitation on the part of those individuals arguably most familiar with fiduciary law to serve in a fiduciary capacity should serve as a warning."

A second (and in my view elegantly understated) caution from the same article seems equally apt:

> Children and grandchildren who are beneficiaries *may not have the same positive view of the planning techniques employed or the same relationship with the trustee* that the settlor had, which can lead to difficulties. Even a cautious and conservative fiduciary will find that when *real life circumstances and people* are thrown into the mix, the textbook line that a fiduciary may not cross can become blurry rather quickly." (*Emphasis added*).

Query: Is the term “real life people and circumstances” a euphemism for “Soap Opera”.

Just sayin’.

I hear the objections already ...the attorneys and accountants for the grantor have every intention of smoothing the path for the Trustee Naïf in her administration. (Doubtless these are sincere protestations, but fraught with potential for conflicts of interest and complications from the unexpected). Similarly, the settlor bridles at the mere mention of a Soap Opera in *her* family. Admittedly the newspapers are full of accounts of blood-curdling inter-family litigation, but those are dysfunctional families, while *this* family is a paragon of stability and selfless love. (No doubt my flippancy here does a disservice to many situations where these concerns are truly remote. Nonetheless hyperbole can help make the point.)

Just for fun, consider the following exchange of emails between two business partners, Denny and Reggie:

To:DennyS@>complexcity.comFrom: ReggieB@>complexcity.com Date: 04/07/2013 10:08 am

Denny, just got back from Bill Lester's office and I have great news. Bill says the new investors are willing to buy a minority interest in the Reynolds stock for the crazy price we proposed! (Prepare the champagne my boy! If my liver can stand another weekend like last week we're gonna celebrate!)

We've come a long way, and I couldn't have done it without you. I was just thinking in the car that you've been there for me more than anyone ... We've been through five wives, (okay, four were mine!), two near bankruptcies, and a lot of sleepless nights. Now we are on the verge of something really big. You're more a brother than a partner to me. (1 know... a junior partner, but quit your complaining. We've both done pretty well, huh?)

On another topic, I need a favor. Like all lawyers Bill couldn't just get rich enough on the stock deal! He finally got me to talk to his estates guy, Link Stafford, and it looks like I should put some of my remaining Reynolds stock in trusts for my kids before the value goes through the roof! I'd like you to be my trustee. Don't worry, I am only going to give them nonvoting stock so nothing will

change between us. Besides, if something does happen to me you will always have complete control since you are already named the trustee in my will for Doris, (assuming she puts up with me that long). You know me, the business the kids, and their various mothers, so you are the ideal candidate to run things for me. And you are cheap!

How about we sneak down to New Orleans this weekend and really celebrate? You know I love ya, man!

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To: ReggieB@>complexcity.com

From: DennyS@>complexcity.com

Date: 04/07/2013 1:15 pm

That is great news! I never thought we'd see the day where this much money would come to two old con men like us! New Orleans here we come!

On the trust thing, I am pretty clueless about all that but you know I'm flattered beyond belief by your confidence in me.

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To: DennyS@complexcity.com

From: ReggieB@BSCcomplexcity.com Date: 04/15/2005 3:41p.m.

Denny, heard from the trust guy at the law firm. He would like you to drop by and sign the trust document when you get a minute. You should see this paper stack! Gotta be 60 pages long. That firm always did charge by the page, didn't they? Thanks again my friend, R

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To: ReggieB@complexcity.com From: DennyS®complexcity .com Date: 05/07/2013 1:15 p.m.

I have to go by the law firm to sign the stock sale documents docs on Monday. I'll sign the trust then. Is that soon enough?

BTW, should I have a lawyer review the trust for me? Don't want to slow things up, just a babe in the woods here.

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To: DennyS@complexcity.com From: ReggieB@complexcity.com Date: 05/07/2005 4:18 p.m.

Nah, we've wasted enough time and money on lawyers this year! My kids love you and Doris will get over the New Year's Eve thing, I promise! Bill's firm and the accountants will really drive the bus on the trust stuff. You may have to sign some stuff occasionally...there is always a ton of paper for anything that law firm touches.

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I will admit that poor Denny is the poster boy for the Trustee Naïf, but I suspect this is not completely a caricature of many conversations between grantors and their associates that happen every day. It is striking, however, to reflect on Denny's acceptance of risk and burden, potentially for years, based on the flimsiest of understandings of what he was doing. What was Denny's trust pre-acceptance review process? Apparently he only required (i) feeling flattered, (ii) being a little dependent on his "senior partner", and (iii) being offered blithe reassurance that the role was largely that of a passive caretaker. You, gentle reader, as a knowledgeable professional, may have winced at a few hints from the email exchange and wondered at the lack of examination of some reasonable trustee self-defense, either by way of protections in the trust itself, fiduciary insurance, or even, (tactfully), declining trusteeship in favor of others better equipped for such an honor. A few of the most obvious points the observant Knowledgeable Trustee might have alerted on...

a) Multiple marriages and children from different marriages;

b) Closely held business interests in trust;

c) Overlapping and inconsistent fiduciary roles, (testamentary QTIP Trustee, trustee for children of different ages and relationships, fiduciary responsibilities as a controlling stakeholder in the business, etc.);

d) A business in transition and facing significant volatility. Said another way, an investment fraught with entrepreneurial risk and all the tough calls owners of such entities have to make.

The Office of the Comptroller of the Currency and virtually all other state and federal regulators demand that corporate trustees conduct detailed pre-acceptance reviews *before* trust acceptance, reviews that might have illuminated for Denny both the Housekeeping responsibilities and the Soap Opera possibilities in a more

systematic way. I realize that we started this discussion by noting the common assumption that corporate trustees are perceived to be bureaucratic, (or, more charitably, systematic). On the assumption that such caution on the part of experienced trustees *may* be the result of years of painful experience, it seems not a bad idea to at least explore whence their sensitivities arose. Is it possible, as Wolven and Zaluda suggest...

> *The hesitation on the part of those individuals arguably most familiar with fiduciary law to serve in a fiduciary capacity should serve as a warning.*

There is a fascinating article, (and if one wants to be challenged as to the elusive nature of the entire concept of fiduciary duty, a startling one), by the Reporter for the Uniform Power of Attorney Act, Professor Linda Whitton, in which she compares the presumed difference in context within which a POA's powers are created as opposed to those of a trustee.[v] One observation is chillingly germane hereto the Trustee Naïf:

> **The lack of attention given to the agent's perspective** can be explained in part by the nature of the power of attorney relationship. A power of attorney is generally the **co-creation of the principal and the principal's lawyer.** Appointing the agent is a **unilateral act,** typically completed by the principal **without the participation of the person named as agent** and possibly without that person's knowledge**.** The principal's lawyer likely will not have contact with the named agent until such time as such principle becomes incapacitated." (Emphasis added).

Query whether the trust Denny is signing was not a “co-creation” of the grantor and his counsel? Should or could Denny have "participated" in the trust construction under which he will labor for years? Clearly the Professional Individual Trustee and the Corporate Trustee are capable of participating and exercising reasonable influence over the duties and liabilities they are assuming. The Trustee Naïf is simply in a different position.

So let's return to Denny, but as his knowledgeable advisor. Using the OCC’s Handbook for Corporate Fiduciaries[vi] as a guide, what are the questions he should ask and have answers for? In short, let’s run through the "bureaucratic" pre-acceptance review of the trust he has been asked to assume, using the OCC's handbook to assist Denny in visualizing both the Housekeeping and the Soap Opera.

As a predicate, the mood of the OCC Handbook is a bit dour, (no doubt a shock to our brethren who look to federal regulatory pronouncements for a Jane Austen-like wit). Simply stated, regulators of the banking and trust business show a deep

concern for the *liability* assumed as by a trustee in the corporate setting. The OCC describes, (tellingly under a chapter entitled "Risk Management"), a process for pre-acceptance review of trusts and their terms, their assets, and the trustee's reasonable ability to administer the trust in a way that would avoid liability. (Curiously there is little credence given to being *flattered* by the appointment.)

The manual contains the following introductory statement:

> The possibility of lawsuits claiming that a party did not adequately perform its fiduciary responsibilities should motivate banks to *describe* and *document* their fiduciary activities and responsibilities as well as *monitor compliance carefully.*

This understatement lies at the base of the frequent complaint heard about corporate trustees, that they are bureaucratic, overly committee-driven, and the like. The defensiveness of corporate trustees, when compared to the fiduciary liabilities a Trustee Naïf often assumes without reflection, (again with a nod to Wolven and Zaluda) "should be viewed as a warning" to amateur fiduciaries. At the least the process prescribed for corporate trustees may represent a logical structure for analyzing…in advance… the joys and potential pangs of trusteeship.

The handbook specifically requires a national bank to *actually* review a prospective account before accepting it. The review must document whether the banks can *"effectively administer the trust account",* whether it has the *"expertise and systems,* in place to properly manage ***this particular account,"*** and whether the anticipated future operations of the trust meet the banks ***risk and profitability standards .*** (Are you surprised Denny never asked about compensation, indemnification, waivers of accounting, appointment of investment or trust advisors or committees, or even fiduciary liability coverage? I'm not.)

Significantly the Manual is insistent the bank "*has no moral or legal obligation to accept all business that is offered*". (Denny may have had a bit of discomfort in declining, but the idea that he is uniquely the person to assume this role is both dubious and dangerous).

> (a) Due Diligence: The corporate trustee must have a *due diligence process* in place for reviewing each prospective trust account. In that review is an assessment of *risk management issues that can be foreseen* and documentation of the discussions and analysis that led to the acceptance of the trust. (Denny should be getting a feel for the need for process ...infrastructure ...to meet the Housekeeping concerns of trusteeship. There is little room for the haphazard trustee. Interestingly, it is the experience of most experienced trustees that the grinding detail of Housekeeping is

ironically the best defense in the Soap Opera).

(b) Trust Assets: Not only is the trust itself subject to review, but the anticipated *assets which would be used* to fund it require specific due diligence. This caution is specifically applicable in the case of *family business interests,* or other "difficult", (a truly triumphant euphemism), assets such as real estate. (Denny should find it significant that family businesses are specifically identified as assets which will require special care and analysis. Again the experienced trustee will have had not only experience in the mysteries of owning closely held businesses but, as a product of that experience, probably has stiff hurdles in place before accepting fiduciary responsibility over such at times unpredictable enterprises. The particular risks of the Family Enterprise and the fiduciary owner are far too broad for treatment here but will be the subject of a separate article to follow).

(c) Conflicts of interest. The OCC specifically notes that banks frequently have many relationships with a family, being its lender, trustee, depository, investment manager, and the like. The conflicts of interest that could arise out of these many roles have to be objectively analyzed *prior* to acceptance of the trust. (Reggie could be in the unenviable role of trustee of multiple trusts with differing beneficiary needs and desires while being his own partner *as trustee*! It is not difficult to write a truly ugly Soap Opera from the multiple roles Reggie will apparently assume after the grantor's demise.)[vii]

(d) Protective Mechanisms. The OCC specifically contemplates that the bank should review and include where appropriate exculpatory clauses, indemnifications or other actions which would limit the opportunity for the bank to suffer loss from the fiduciary role. (The Knowledgeable Trustee has already begun to imagine the host of structures that might be available to Denny, including serving only as a trust advisor, being appointed as co-trustee, selecting a "safe" and trustee-friendly situs for the trust, etc. The *availability* of such mechanisms to ease Reggie's risk is not the issue…the issue is *whether he knows he needs them* and is represented adequately to demand them as a price of his service.

Conclusion

The multi-generational trust is here and it is here for good. The unimaginably long terms of these trusts are proof that they are given shape and content far more by current estate and gift tax demands than trying to tame the uncertainties of the future for the fiduciary.

The economic pressures of estate taxation force the creation of irrevocable entities today with irrevocable governance mechanisms that must accommodate an unimaginable future world with unknown personalities, animosities, and law. Preparing for the Housekeeping for such trusts is critical, but so is foreseeing the Soap Opera.

The current complexities of trust administration are beyond the ken of most laymen, and litigation and conflict have made professional trustees, individual and corporate, appropriately cautious in accepting the trustee mantle. The fact that professionals still do accept the responsibility is testimony both to the critical role of trusts in our society and as well as to their cautious confidence that, *properly prepared*, trustees can meet the demands of the role.

My suggestion here, admittedly leavened with a good bit of tongue in cheek overstatement, is simply that we may not be doing anyone ...settlors, beneficiaries, or trustees ...a favor by underestimating the criticality of the trustee's knowledgeable participation in the trust *as it is drafted*, *implemented*, *or if necessary, as modified*.

It is not my intent to shill for professional or corporate trustees here, but rather to highlight the damage the Trustee Naïf can do to the best plans of settlors while sentencing themselves to conflicts and duties they simply never saw coming. This is the stuff of education not trust forms, of the drafter as artist rather than technician.

One question remains though. Who is the appropriate person to “school” the Trustee Naïf? The grantor’s counsel? The grantor’s counsel with the express agreement of his client? The Trustee nominee’s own counsel? Who foots the bill for this advice? Tough questions.

Or maybe we just suggest Denny rent *Body Heat*.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Steve Salley

CITE AS:

LISI Estate Planning Newsletter #2220 (April 30, 2014) at http://www.LeimbergServices.com

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[i] I am aware of the excellent article in the Real Property, Trust and Estate Law Journal by Randall Roth that analyzes the RAP and fiduciary aspects of the George Clooney film, "*The Descendants*". Frankly the legal issues are probably better raised in that film than in "Body Heat", but the salacious in me finds the soap opera aspects of the earlier film sexier. See Roth, "*Deconstructing How George Clooney Ennobled Old Hawaiian Trusts and Made the Rule Against Perpetuities Sexy*", 48 Real Property, Trust and Estate Journal No.2, 2014.

[ii] I do not pretend to have plumbed the depths of the ethical responsibilities of any attorney to advise the Trustee Naïf during representation of the grantor…clearly "the client". My preliminary reading shows little guidance on this point and each state will have slightly different takes on such an elusive legal relationship. The ACTEC model rule 4.3, though, is interesting. That rule states that the attorney "shall not give legal advice to an unrepresented person, *other than the advice to secure counsel*, if the lawyer knows the interests of the unrepresented person…have a reasonable possibility of being in conflict with the interests of the client". The commentary provides little additional guidance as to the drafter's relationship with the trustee-to-be. Also, ACTEC prepared in 2005 an excellent layman's guide for prospective fiduciaries, "What It Means to Be a Trustee: A Guide for Clients". The introduction to that guide, significantly, states that it is intended as a tool for *clients and their counsel* as they go about "*deciding whether to act as trustee*". It is getting Denny to retain and pay for qualified counsel to protect his interests in the trust drafting that is precisely the gap in communication that seems a bit …unsystematic?

[iii] Note that this dichotomy between corporate and individual trustees often assumes that the individual Trustee somehow represents affordability, approachability, and convenience. This assumption is worthy of re-examination since the affordability and tractability of the "volunteer" trustee may be based precisely on his or her lack of understanding of just how demanding the role can be. If the "pig in a poke" analogy is fair, an informed trustee may turn out to be as

expensive and as self-protective as any corporate fiduciary. Further, the illusion that the friendly trustee is somehow empowered by his or her intimacy with the prejudices and attitudes of the grantor may provide comfort to grantors who misunderstand the very real constraints on trustees. I have previously expressed to a long-suffering LISI readership my thoughts about the limits of this privileged knowledge (in my mind denominated the "in loco parentis" fallacy) as authority for fiduciary action once a trust becomes irrevocable.

[iv] Wolven and Zaluda, "Practical Guidance for Trustee Risk Management", 32 ACTEC Journal 297, 2007. See also, Brooks and Weissbluth, "Risk Management for Trustees: Becoming Ill-Suited for Litigation", SR003 ALI-ABA325, (2009).

[v] Whitton, "The Uniform Power of Attorney Act: Striking a Balance Between Autonomy and Protection", 1Phoenix Law Rev.343 (2008); Whitton, "Understanding Duties and Conflicts of Interest-A Guide for the Honorable Agent 117 Penn ST Law Rev.1037,(2013).

[vi] See The Personal Fiduciary Services Comptroller's Handbook, available at the OCC's website at www.occ.gov.

[vii] For a thought provoking discussion of the proliferating and often conflicting fiduciary roles that can devolve over time on to the shoulders of the "friend and business associate", see Boxx, "*Too Many Tiaras: Fiduciary Duties in the Family-Owned Business Context*", 49Houston LawRev233, (2012).