INTRODUCTION

The title of this presentation is intentionally broad: how you define a “problem” may depend on which
difficult circumstances you have encountered in your practice. A “future problem” is only one that has
not yet bit you on the ankle. This material will focus on several areas where difficulties frequently
arise in fiduciary administration and will suggest ways to resolve them short of litigation. The point of
view will be that of the fiduciary who is charged with understanding (or interpreting) the decedent or
settlor’s intent and giving effect to that intent while negotiating beneficiary needs and concerns and
responding to changes in family dynamics, the investment climate, or the law. One measure of the
fiduciary’s success, albeit a negative one, is whether he has successfully avoided litigation. But a
more positive yardstick will measure increased cooperation among family members, the heightened
quality and frequency of communication among all parties, and the implementation of innovative
techniques that effectively serve the family and its fiduciaries.

I. HANDLING CONFLICT WITH BENEFICIARIES OR CO-FIDUCIARIES

Like death, the arrival of conflict in the administration of an estate or trust is not a question of “if” but
of “when”. While many conflicts between fiduciaries and beneficiaries or between fiduciaries are
easily resolved, a good number are so serious they impede efficient administration and may result in
litigation. What can be done to (1) avoid this conflict, (2) plan for its eventual emergence during
administration, and (3) minimize its impact on the family and the fiduciary? Both the draftsperson and
the fiduciary can take steps to achieve these goals.

A. CHOOSING THE FIDUCIARY

An essential preliminary to effective administration is the draftperson’s understanding of the testator’s
or settlor’s wishes and the organization of those wishes in a document that lucidly expresses them and
also anticipates numerous issues that may arise at a later date. Then, the settlor should consider the
most suitable trustee or trustees and confer appropriate powers to allow the fiduciary the necessary
scope of action. When serving, the trustee must be able to communicate the settlor’s wishes and the
steps it will take to implement them to the beneficiaries and, if required, to co-fiduciaries.

1. Understanding the Settlor’s Purpose at the Drafting Stage

While trusts may be created for myriad purposes, most trusts seek to achieve certain common results.
Keydel and Wallace have identified three basic categories to describe the essential purpose of most
A trust may seek to achieve more than one purpose, of course, but it is critical that the draftsperson assist the settlor to understand which is paramount. Within these categories, the settlor may well have clearly-formed or more inchoate ideas regarding, for example, favoring one beneficiary over another or countenancing more or less flexibility in the face of changing circumstances. It is a worthwhile endeavor for the draftsperson to spend the necessary time to help the settlor clarify these issues. Only when there is full understanding of the trust’s purpose and the settlor’s issues can draftsperson and settlor be effective in choosing the “right” trustee for the job.

2. Choice of Trustee for Commonly-Used Trusts

Keydel and Wallace’s trust categories provide an excellent framework for understanding how a trust can be crafted to tailor the trustee’s duties, responsibilities, and powers to the settlor’s purpose. Their analysis also considers whether certain trust structures make it easier for the trustee to fulfill its role.

2.1 Balancing Present/Future Beneficiaries’ Interests –
These trusts are the traditional “income to A, remainder to B” trusts. In such arrangements, it is crucial that the trustee can act impartially. Thus, neither A nor B would be a likely trustee candidate. But merely not having a direct interest in the trust may not guarantee impartiality, which could be compromised by the trustee’s relationship to A or B, or, more indirectly, by the trustee’s lack of experience. For example, a trustee who is not a professional fiduciary may be unaware of the many decisions that affect the interests of the income beneficiary and the remainderman, such as source of payment of expenses, allocation of receipts, or certain income tax elections.

If the settlor wishes to favor one beneficiary or class over the other, that intent should be expressed in the clearest possible terms, both to guide the trustee and to forestall future litigation. An unambiguous statement that the trust is for the primary benefit of A, and that the settlor intends B to receive only what may be left at the end of the trust term, is valuable guidance. It also leaves both A and B in no doubt as to where they stand in relation to one another.

2.2 Protecting the Beneficiary From Himself –
There are several reasons why a settlor may feel the need to protect a beneficiary from himself. A trust for a beneficiary with a mental or physical illness requires different trust terms from one for a young and inexperienced beneficiary, or for one who demonstrates general improvidence and irresponsibility.

2.2.1 The Beneficiary as Co-Trustee --
Sometimes, the need for protection may diminish as the beneficiary grows older and/or gains experience. Examples include not only children or young adults but surviving spouses who may not have participated in financial decision-making during the marriage. The settlor can structure the trust to allow the beneficiary to participate
in trust management as a co-trustee alongside a professional fiduciary. While the professional trustee may perform more of the day to day administrative “work”, it can and should consult regularly with the co-trustee beneficiary. For this type of arrangement to work, the professional trustee must undertake to educate the inexperienced co-trustee as part of its duties.

2.2.2 A Two Trust Alternative –
An alternative to having a professional co-trustee serve for the entire amount of the beneficiary’s trust assets is to divide those assets into two shares. The one the settlor wants protected for the trust duration would follow the arrangement above, with true control in the hands of the professional trustee. The balance would be solely in the hands of the beneficiary/trustee, as a sort of “mad money” trust. Should the beneficiary not handle this trust well, the first trust is still available for his support.

2.3 Avoiding Taxes, Predators, and Creditors –
Often, tax considerations, a discussion of which are beyond the scope of this outline, make it impossible for a settlor or beneficiary to act as his own trustee if the trust is to include discretionary trustee powers. Rather than forcing the settlor to decide to make a tradeoff between flexibility and taxability, he can appoint an independent trustee to exercise the needed tax-sensitive powers. If there is no question of beneficiary competence or prudence, the settlor can grant the beneficiary power to approve or veto all investment decisions. This is a meaningful power and ensures that the family investment philosophy can be implemented.
If the trust has been established to respond to concern about threats such as divorce settlements or lawsuits, the beneficiary can also hold investment authority as a co-trustee without jeopardizing the trust’s protective nature.

B. THE FIDUCIARY’S DUTIES AND POWERS

At issue here is not which specific powers or duties the trustee should possess, per se, but how those powers should be structured. The goal is to provide flexibility to allow the trustee to react to unforeseen circumstances or to provide the muscle or agility to respond to problems of which the settlor is well aware.

1. Ensuring Flexibility

Most estate planners do not need to be reminded to include both broad general administrative powers and powers tailored to the client’s situation, such as the power to continue a business or to deal with a beneficiary with special needs. In addition, the settlor can consider whether a trustee’s role should be expanded or diminished if certain events occur in the future. For example, if a family member trustee of a purely tax protection trust becomes capable of making the investment decisions, or retains a professional investment adviser, the independent trustee’s role could be limited, by written notice from the family trustee, to exercising tax sensitive discretionary powers. Similarly, an independent trustee’s role could be expanded should the family trustee fail to meet criteria set by the settlor, such as attainment of a college degree or steady employment.
1.1 Powers for Anticipated Problems –

In the 2001 program of this course, panelist Steven M. Fast recommended giving the trustee “unassailable authority over a subject likely to engender criticism”. In other words, when you know the family is very concerned about an issue, and possibly divided in its approach, arm the professional trustee with the power it needs and protect it in its exercise of that power with strong exculpatory language. The clause should be drafted with specific reference to the case at hand. Do not state that the trustee has the power to retain “all assets” owned by the settlor at death; give the trustee the power to retain “XYZ” stock, if that is the equity that concerns the settlor and his family. The settlor should also consider vesting this power in an independent trustee to preserve family harmony.

If contention is inevitable, Mr. Fast recommends providing a mechanism for resolving discord. There are several to choose from: vest an independent trustee with power to make sensitive decisions; require arbitration or mediation; name a person to break a tie; or nominate an outside party who is familiar with the settlor’s family, such as an attorney, accountant, or non-beneficiary family member, to resolve disputes. While these alternatives are not foolproof, they may permit the family to cool off while the process runs its course, thus allowing reason, and not just emotion, to enter the equation.

C. CO-FIDUCIARY ISSUES AND CONCERNS

Not all clichés point to the truth, and “two heads are better than one” may not be the case in fiduciary administration. While there are several persuasive reasons for having two trustees serve, the settlor should provide a roadmap for trustee interaction to avoid future conflict on a number of issues.

1. Benefits of a Co-Trustee

As discussed above, one reason to nominate a co-trustee is to allow a beneficiary to learn about managing assets for his own benefit or to give a beneficiary decision-making power without causing unwanted tax consequences. In addition, commentators often recommend including a family member as a co-trustee of a discretionary family trust when a professional corporate trustee is serving. (A family co-trustee is not as crucial when the trust is more “cut and dried”, for example, a charitable remainder unitrust that passes ultimately to a public charity.) The family member can serve several important purposes, including:

(a) understanding and communicating the settlor’s wishes;
(b) understanding and communicating the family dynamic;
(c) coordinating with the family’s outside advisors, such as attorneys and accountants; and
(d) communicating with family members in a language they understand.

An effective and professional corporate fiduciary should be able to fulfill all these duties, and in fact its ability to do so consistently is a hallmark of a qualified institution. Nevertheless, no amount of close association with the settlor during his life or frequent meetings with family members can replace the unique familial relationship among the beneficiaries.

2. Areas of Potential Dispute