Managing The Risks of Fiduciary Litigation:

Guidelines For Institutional Trustees

Proskauer

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Introduction

These **Guidelines** are designed to help institutional trustees navigate what has become one of the most significant risks facing any fiduciary: **the risk of litigation**.

At Proskauer, our experienced trust administration and litigation lawyers have witnessed a sizeable increase in the quantity and scope of **fiduciary litigation that is routinely threatened and often prosecuted against institutional trustees**.

A review of recent fiduciary litigation cases in the United States indicates a number of areas where disputes repeatedly arise. A large majority of reported cases involve the following categories of dispute:

- Creation of the trust;
- Construction of trust terms;
- Breach of fiduciary duty claims;
- Liability for investment decisions; and
- Compensation of trustees or their attorneys.

These categories suggest the areas where trustees should be especially focused on avoiding fiduciary litigation.

Although the circumstances of every trust administration are unique, we have called upon our collective experience and expertise to create a set of guidelines that can meaningfully help to **manage the risks** of litigation against fiduciaries.

Proskauer's fiduciary litigation team is based in New York, Florida and California, but our reach is nationwide and the depth of our practice is unparalleled.

These guidelines are not intended to supplant the carefully considered advice of counsel. Nevertheless, we believe that there are **key principles and strategies that institutional trustees should keep in mind** to help prevent litigation where possible, and to maximize the likelihood of success when litigation is unavoidable. The goal is to reduce the incidence of claims and to bolster potential defenses against those that materialize.

We have broken down these principles and strategies into six sections, corresponding broadly to the typical stages of trust administration and litigation:

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I. Pre-Acceptance

Strategies for Managing the Risks of Litigation Before Accepting Trusteeship.

Overview

The weeks or months before agreeing to serve as a trustee are critical in terms of managing the risks of litigation. **Three major activities will typically occur during this stage:**

- The trustee's review of the trust instrument and assets
- The trustee's review of any prior trust activity
- The trustee's decision whether to accept or decline trusteeship

Issues related to the creation or construction of trusts represent a significant number of reported trust litigation cases. For that reason, the pre-acceptance process is of crucial importance in avoiding fiduciary litigation.

A. Reviewing the Trust Instrument and Trust Assets

Trustees should carefully review the trust instrument before agreeing to act. A **diligent and thoughtful review** can often identify issues that could give rise to beneficiary discontent and disputes. Litigation may be prevented by addressing and resolving those issues prior to accepting a trusteeship. Occasionally, this type of "issue-spotting" may reveal concerns that simply cannot be addressed until a trustee is in place – something that a potential trustee may or may not be willing to undertake.

Here are some examples:

i **Execution, Amendment, Capacity** - Trusts must be properly executed.[1] If a party's signature is missing and that party is living, the potential trustee or beneficiaries may be able to arrange for that party to properly execute the instrument. If the party whose signature is missing is not living, a beneficiary or the trustee (after accepting trusteeship) may have to petition the court to confirm a proper execution if the necessary facts can be established.[2] Whether or not an amendment is valid often depends on whether the provisions of the trust have been followed: failure to follow those provisions may leave attempted amendments invalid, with a trustee perhaps administering a trust under (what turns out to be) the wrong terms.[3] The capacity of the settlor can often raise an issue as to whether or not certain provisions of a trust apply.[4]

ii **Title of Trust Assets** – Assets must be properly titled in the name of the trust in order for the trustee to administer them.[5] If not, the trustee (before or after accepting trusteeship) should ask the trust settlor to transfer title to the trust.[6]

iii **Uncertain Language** – Disputes often arise because of imprecise or contradictory language in the trust instrument. As part of the intake process, the trustee should read the instrument with a particular focus on any imprecise or contradictory language. Some examples of uncertain language and the consequences of such ambiguity include:

- An imprecise distribution standard, which can cause tax issues and arguments with beneficiaries as to what they may be entitled or eligible to receive.
- Unclear provisions governing the allocation of items between income and principal. These provisions can raise problems with beneficiaries (for example, the income beneficiary might believe an item should be allocated to income; if the trust is unclear, an attempt by the trustee to allocate the item to trust principal can create a dispute).[7]
- Unclear provisions concerning the trustee's duty to account may lead to challenges for failing to account in the manner that the beneficiary believes the trust requires.[8]
- Unintelligible investment standards may render the trustee's investment decisions vulnerable to attack.[9]
- Unclear language as to who the trust beneficiaries are intended to be can also cause problems. This issue arise can arise even when determining whether a "child" of the settlor is a beneficiary; for example when the child was placed for adoption[10] or where a child was born out of wedlock.[11]
- Other unclear language.

iv **What Law Governs?** – Trust law varies from jurisdiction to jurisdiction. The trustee should ascertain which state's law governs the trust and become familiar with its salient provisions.

v **Forum Selection** – Does the trust contain a forum selection clause that controls in which state or court litigation may be commenced? Does the trust contain an arbitration clause, requiring disputes to be arbitrated?

vi **Resignation Provision** – Does the trust include a provision allowing the trustee to resign without court permission? The right to resign can often help limit a trustee's liability where administration has become contentious. If there is no provision in the trust, resignation is authorized by state law. But state laws often require notice to beneficiaries[12] and/or judicial approval,[13] which could potentially delay and complicate the trustee's resignation.

vii **Tax Requirements** – Prior to accepting a trust it is crucial to identify the applicable tax filing requirements. Discussed in Section III below are some tax filing requirements that a trustee must satisfy during its administration of the trust. Those requirements should be identified carefully and calendared early in the process to avoid later problems.[14]

viii **Mandatory Distributions to Beneficiaries** – Prior to accepting a trust, it is important to know whether the trust instrument requires distributions to be made to a beneficiary. If so, inquiry should be made to determine whether prior distributions were satisfied and whether any distributions will be required to be made soon after accepting the trusteeship. The trustee should calendar distribution dates to ensure that timely distributions are made.

B. Reviewing Prior Trust Activity

i **Accounting History** – If a trustee will be acting as successor to another, the trustee should **ascertain whether the prior trustee properly accounted to the beneficiaries**. If not, the incoming trustee should demand that the prior trustee fulfill its accounting obligations. An accounting presented to the court by a prior trustee should resolve all issues with regard to the past administration of the trust, allowing the new trustee to begin with a clean slate.

The incoming trustee should also make careful note of what its own accounting duties will entail both under the provisions of the trust and applicable law.[15] Early in the process, the trustee should calendar the dates upon which those obligations will have to be satisfied in order to avoid overlooking those responsibilities.

ii **Litigation History** – The incoming trustee should **inquire about past disputes** among the parties, including disputes over trust administration or the administration of a related estate. If the trust has been involved in litigation in the past, but that litigation is now being resolved and that factor is what brings the client to ask the corporate trustee to act (e.g. as part of a settlement agreement), the trustee should determine whether the litigation is over or likely to flare up again. If there are settlement agreements among the parties, they should be carefully reviewed to determine whether there any disputes that remain unresolved. If possible, attempts should be made to resolve open issues prior to acceptance.

C. Deciding Whether to Accept Trusteeship

All trustees would like to accept only "perfect trusts" – the stuff of **fiduciary fairy tales**, where the assets consist only of cash, stocks and bonds, where the beneficiaries are sophisticated and cordial members of the same family, where the trust instrument is concise and clear, and where the beneficiaries do not rely solely on trust distributions for their ability to survive. **Limiting trust relationships to perfect situations is certainly the best approach to avoiding litigation, but it is just not realistic**.

It is the corporate fiduciary's business to take on trust relationships, not turn them down. And institutional trustees generally understand that there are no perfect trusts. In fact, **trust attorneys often advise clients that corporate trustees are just the right fit** for "messy" situations. With proper legal advice and guidance, trustees can successfully manage risks and provide a great service to their clients.

Here are some examples to consider:

- When a decedent creates a marital trust for a second spouse that holds assets ultimately intended to pass to children from a first marriage, a corporate trustee can be ideal. The children can be sure that the second spouse will not have unfettered access to "their" funds, and the second spouse will not have to deal with the children or other family member when seeking distributions from the trust.
- If a trust is administered for a child with addictive behavior, naming a member of the child's family to act as trustee may damage the family relationship. A corporate trustee is often better suited to act in such circumstances.
- If a trust is established to hold the decedent's interest in a closely held, family business (whether as a 100% owner or as an owner of some lesser interest), a corporate trustee may be faced with significant issues in administering such a trust. By way of example:
    - The corporate trustee may be required to take an active role in the operation of a technical business, which may be beyond the ordinary skill set and experience of the corporate trustee;
    - If the business is run by family members, the corporate trustee could find itself being unavoidably dragged into various internecine disputes concerning the operation of the business, including being pressured by various family members to (a) fire and/or continue to employ family members who may be overpaid and underqualified for their positions at the company and/or (b) take legal action against various family employees for real or imagined breaches of fiduciary duty; and

    - The corporate trustee may also be pressured to or not to liquidate the trust's interest in such family business, which may cause additional potential liability for the corporate trustee depending on how it acts.

- When a surviving spouse lacks experience or sophistication in investment matters, naming a corporate trustee to manage assets and assist the spouse with budgeting and other matters can facilitate the administration of the trust – without the "personal agenda" that other family members might have if appointed to fill this role.
- When a parent has been unable to teach a child how to be self-sufficient, establishing a trust that is designated to hold "the last funds the child will receive from his or her parent" can help focus the child to provide for his or her own needs. Naming a corporate trustee helps the parent "stay out of it" – further enabling the child to learn how to act on his or her own.

But a wise institutional fiduciary will take the time to consider whether a trust is *too* messy. A designated trustee is free to decline to serve.[16] **Declining to serve can sometimes be the most prudent choice** to avoid future litigation. Here are some red flags that can sometimes be too red to ignore.

- A revolving door of successive trustees. Regardless of whether the prior trustees have resigned or been removed, turnover is not an attractive quality in this context.
- Beneficiaries with unstable relationships with professionals, such as attorneys, accountants and trustees of other trusts.
- Beneficiaries with a history of litigation – perhaps it's litigation concerning the trust, perhaps it's litigation between the beneficiaries concerning non-trust matters, or perhaps it's just a pattern litigation by one of the beneficiaries that does not even involve the other beneficiaries. Even the very best institutional fiduciaries are unlikely to dissuade individuals whose natural instincts are to litigate disputes.
- Beneficiaries who have asked the fiduciary to serve as part of a resolution of a larger dispute – whether already in litigation or not – that will not be truly resolved by the time the new fiduciary accepts. In such situations, the beneficiaries may be experiencing a temporary "era of good feelings," but unless and until there is a complete resolution of the dispute giving rise to the appointment of a new fiduciary, the red flag is still waving.
- Intractable conflict. If tension among beneficiaries exists and is unlikely to be amicably resolved, the likelihood of litigation is heightened. For example, if a

trust owns a specific asset that one beneficiary wishes to be sold and another beneficiary wishes to hold in the trust, the trustee will likely be sued regardless of which action it takes.

- Unsophisticated or difficult co-trustees. (Much more on that below.)

Here are some **additional important considerations** in deciding whether to accept a trusteeship:

- Trustees must take into account foregone revenue when a trusteeship is declined, as well as lost client relationships. Declining a trust where the settlor is a significant client of the bank or trust company might jeopardize the relationship, further reducing revenues for the bank or trust company.
- The trustee should consider the referral source as well.
  - If the trust comes to the trustee from someone with a long and important relationship with the bank or trust company, the trustee may want to carefully consider being involved in the "messy" situation. Perhaps a review of that existing relationship can give the trustee comfort in taking on the trust.
  - If the attorney referring the trust to the bank or trust company is likely to refer significant other business, or if that attorney has referred significant business in the past, the trustee should probably put forth extra effort in trying to become comfortable with taking on the trust. Further, if that attorney is skilled and will act for the bank or trust company in the relationship, perhaps the trustee can get more comfortable with the proposed trusteeship.
- What fees can be charged?[17] If the trust is going to continue for a significant period of time, it might be more attractive than if the trustee is asked to be involved for only a short period – the longer the trustee can act, the more fees can be generated. When reviewing the trust agreement, note whether the settlor has limited fees in any way.
- If the "problem" with the trust is that it holds non-traditional assets, the trustee should carefully consider whether it has experience and staffing to deal with those types of assets. The nature of the trust's assets should also be considered, such as whether the assets are illiquid, whether there is an over-concentration of certain assets and whether the assets may be jointly owned.
- Claims against prior trustees, attorneys and other professionals as well as family disputes amongst the beneficiaries should be evaluated.

- If a trustee finds that the beneficiaries of the proposed trust are people that are abusive, unreasonable, and argumentative, the trustee should strongly consider declining to act. “Life is too short“ is the phrase that comes to mind when these relationships are proposed – not only will litigation invariably result, but the relationship will be exhausting and will likely detract from the trust officer‘s other relationships.
- All institutional trustees have internal procedures for reviewing a trust prior to acceptance. Therefore, the trustee should also remember to follow its own **internal procedures** in deciding whether to accept the trust (and should continue following these internal procedures throughout the trust administration).

II. Administration

Strategies for Managing the Risks of Litigation During Administration.

Overview

Fiduciaries are charged with **a difficult, often thankless task**. Trustees must complete the administrative tasks required by a trust while complying with applicable legal requirements. This balancing act must be undertaken with awareness that litigation relating to the administration of a trust is always a risk.

In terms of the risks of litigation, there are **countless pitfalls and traps** in the course of any particular trust administration. As a general matter, trustees should remain cognizant that litigation is always a possibility, and any document generated during the course of estate administration, including internal memoranda, notes and emails, may ultimately be the subject of discovery. A trustee should not put into writing any thought or comment that it would not want to share with the settlor, beneficiaries and the court.

There are at least five areas of trust administration that seem to appear repeatedly in fiduciary litigation:

- Communication with beneficiaries
- Fees/commissions
- Working with co-fiduciaries
- Investment decisions
- Distributions

A. Communication

Lack of communication is often the primary complaint of beneficiaries, and it is often a catalyst for litigation. Communicating with beneficiaries is generally invaluable for maintaining good relationships and cultivating support for the trustee's actions if a dispute arises. Some states mandate by statute that trustees communicate fully and transparently with beneficiaries regarding the trustee's actions.[18]

There are **numerous ways to maintain solid lines of communication** with beneficiaries.

i **Statements** – Beneficiaries often ask to be copied on the trust's quarterly or monthly account statements. Though in some jurisdictions beneficiaries are not entitled to these statements by law, the following factors might be helpful in determining whether the trustee should nonetheless provide them:

- The trust's terms - Some trusts include provisions that prohibit a beneficiary from challenging a trustee's acts if the beneficiary receives statements and fails to object within a specified period of time.
    - In California, a beneficiary may be prohibited from challenging a trustee's actions if the beneficiary receives statements and fails to object within 180 days if certain requirements are met and if the account adequately disclosed the existence of a claim.[19] Without these special trust provisions, in California, a claim that is adequately disclosed on an account is barred if not raised within three years.[20]
    - In Florida, the beneficiaries are barred from bringing claims for actions adequately disclosed in a trust disclosure document which includes a limitations notice, unless brought within six months of receiving the document.[21]
    - In New York, the beneficiaries are entitled to statements if the trustee is seeking annual commissions.[22]
- Though the law is unclear as to whether a beneficiary would be foreclosed from objecting if the beneficiary then receives an accounting that describes the transactions set forth on the statements, the trustee is in a better position to argue that the beneficiary has waived his or her rights to object.
- Providing statements allows beneficiaries to feel informed – and with more communication there is less likelihood that the beneficiaries will pursue legal action against the trustee.
- However, the trustee needs to make clear to the beneficiaries that the trustee, not the beneficiaries, is administering the trust. Providing statements where not required may incorrectly suggest to aggressive beneficiaries that they are entitled to have control or influence over investments – something to be discouraged by the trustee.
- Providing statements may prompt beneficiaries to disclose concerns earlier in the administration of the trust. If, for example, beneficiaries object to the investment mix of trust assets, hearing that objection sooner provides the trustee with the opportunity to address those concerns and limit the trustee's exposure.
- Maybe because a beneficiary is angry that money was left in trust for him or her rather than outright, or wasn't named to act as trustee of his or her trust,

some beneficiaries simply decide that they will object at every opportunity. Limiting these opportunities to object eases trust administration; if information comes (for example) in the form of a formal or informal accounting each year, the beneficiary gets one chance to object to the trustees' actions, and will need to hire and pay a lawyer to do so. Trustees should be mindful that judicial accountings are expensive and problematic for trustees. By the time one year is accounted for, it is time to account for the next. However, once a court approves an accounting, the beneficiaries are foreclosed from objecting to any acts that occurred during that accounting period.

ii **Meetings** – If beneficiaries feel that the trustee is paying attention to them and communicating with them, the risk of litigation will likely be reduced. Accordingly, regular meetings with beneficiaries are encouraged.

Annual meetings are recommended as a minimum, and quarterly meetings should generally be the maximum. Often times, if a trustee begins with quarterly meetings, the frequency can be scaled back after the beneficiaries get comfortable with the trustee's administration of their trust.

Importantly, if a beneficiary requests a meeting with the trustee at any time, the trustee should try to accommodate – again, paying attention to and communicating with beneficiaries generally reduces the risk of litigation.

iii **Accountings** – Providing accountings at least annually is generally recommended or required by the trust instrument or statute. Even if not required, annual accounting provides a great benefit to trustees because once those accountings are approved, the trustee's acts for the accounting period generally cannot be challenged.

If accountings are not provided on an annual basis and the beneficiaries ask for an accounting at a time when there is friction between the beneficiaries and the trustee, items that might have been ignored in earlier years when the relationship was a happy one might instead be subject to scrutiny and challenge. Getting approval of an accounting which discloses those acts during those happy times allows more to be put beyond the scope of challenge in less happy times.

Beneficiaries may object to the cost of annual accountings. Where an annual accounting is undertaken at the trustee's discretion, the trustee should minimize the cost of preparing the accounting. Note that seeking a waiver of accounting and consent to all trustee acts is an option to minimize cost and gain trustee protection for acts taken during the year – especially if the beneficiaries have been receiving statements. But this option likely will not provide the trustee with the same protection as a formal accounting.

When accounting, trustees should also consider whether to seek a judicial accounting or voluntary accounting. Voluntary accountings are usually more informal and cost effective. Judicial accountings will provide the trustee with greater protection from future liability. In a voluntary accounting, the trustee seeking to be relieved must usually provide a copy of such accounting to all interested parties and obtain receipt and releases from such interested parties which the trustee may record.[23] However, having the releases judicially approved may be necessary in particularly contentious matters.[24]

B. Fees/Commissions

Each corporate fiduciary has its own practices for determining how and when to charge, modify and collect fees. This section should be considered in the context of the trustee's general practice.

i **Determining Fees** – The fee can be based on many factors, including statutory requirements, the fiduciary's relationship with the interested parties and industry standards.[25]

Statutory Fees – Where the task is governed by statutory fees,[26] the statutory fee is the maximum that can be charged. Beneficiaries may request a reduction from the statutory fee, in which case an analysis must be made as to whether the relationship can be profitable if a reduction is made.

Non-Statutory Fees – If the task is not governed by a statutory fee, then typically a "reasonable fee" is allowed.[27] Corporate fiduciaries are generally aware of fees charged in the industry so what is "reasonable" can be determined.

- Sliding scale fees (where the fee is a percentage of the value of the trust assets and a smaller percentage is usually charged for larger trusts) are very typical for continuing trusts. Sometimes sliding-scale fees are coupled with a minimum. Beneficiaries are familiar with this type of fee and generally find it acceptable.
- Many institutions charge a fixed fee for the "estate settlement" aspect of a revocable trust (this includes marshaling assets, paying creditors, filing an estate tax return, and distributing the assets to successor trusts or heirs). In setting the fixed fee, discounts are generally provided if there is an opportunity to administer the continuing trusts when the estate settlement ends. If the beneficiaries can remove and replace the trustee, it is best to get the agreement to act as trustee of the continuing trusts in writing (for a

specified period – for example, two years) at the time any discount to the estate settlement fee is agreed upon.

- One approach that corporate fiduciaries often take is to include "add-on" fees (such as for the sale of property) to their fixed fee for estate settlement type services. It is very important that the beneficiaries be made aware of these fees up front. If it is likely that a property will be sold, the fact that this additional fee will be charged should be disclosed to the beneficiaries; if the add on fees are only disclosed in "boilerplate" language, beneficiaries are often angry to "discover" these fees when the sale occurs.

ii **Collecting Fees** – Most trustees charge fees directly against the administered assets on a quarterly basis. This allows the trustee to be paid regularly, and payments throughout the year reduce the need to generate cash at year-end for this purpose.

Of course, where court approval for fees is required, fees should not be taken without a court order. When extraordinary fees are requested,[28] it is recommended that a request be made as each extraordinary project is completed because "smaller" extraordinary fee requests are more likely to be approved in full rather than one "larger" request at the conclusion of the administration.

Before increasing trustee fees, a careful review of the trust instrument and state law is recommended. Some states, such as California,[29] require a trustee to give the beneficiaries notice prior to increasing trustee fees.

iii **Using Fees as a Negotiating Tool** – A reduction or other modification of fees can be used to settle disputes with beneficiaries. It is generally recommended that trustees resist discounting up front in order to reserve this opportunity.

C. Working with Co-Fiduciaries

Co-trustee relationships are increasingly common. Reaching an agreement with co-trustees as to how that relationship will work "up front" goes a long way toward making the relationship efficient and effective. Where a beneficiary who may have the power to remove a trustee is the co-trustee, this relationship becomes even more important. Here are some strategies for navigating co-trustee relationships:

i Before embarking on the administration of the trust, it is very important to determine the trust settlor's intention regarding the co-trustees. That intention can dictate how the co-trustees are to act, what roles they are to fill, and what they are to be paid (for example, often times family members are permitted to act only if they waive their fee).

ii Where trustees have been assigned different roles (*e.g.*, the "investment trustee" or the "distributions trustee"), the specific responsibilities of each trustee should be defined and agreed upon. Procedures should be established regarding how the co-trustees who act in their different roles can cooperate in order to allow each other to best complete their assigned roles. For example, if you are the distributions trustee, you will need to know how the investments are performing before you are able to decide how to respond to a beneficiary request for a discretionary distribution.

iii A determination must be made about whether trustees must act unanimously or whether a majority vote controls. If not addressed in the trust instrument, this issue is often governed by law.[30] The trust instrument should be reviewed to see if there is a tie-breaking mechanism should the co-trustees deadlock.

iv Often times there is a "lead" trustee among the co-trustees. For example, if a bank is to act as co-trustee with a decedent's surviving spouse, the bank will generally take the lead in administering the trust. In these situations, care must be taken to keep the bank's co-trustee informed and to seek the co-trustee's consent and approval of trustee acts where a vote is required under the trust instrument. If the bank's co-trustee must approve investments or distributions, it is a good idea to make sure that such approval is documented in a writing (a protocol might be established that the co-trustee email approval, for example); written evidence of the co-trustee's approval may become important later if a dispute arises.

v If ministerial acts can be delegated under the governing instrument or state law,[31] any delegation should be properly documented to facilitate trust administration.

vi If a "special trustee" has the power to direct the trustee's acts, protocol must be established to be sure that can be achieved in a timely manner. Again, follow the instrument; if the trustee's acts are protected by the direction of a special trustee *in writing*, be sure to get the approval in writing.

vii If a lead trustee is going to undertake the bulk of the work, a greater portion of the reasonable fee for trust administration should be allocated to the lead trustee. Reducing that agreement to writing with the co-trustee at the start of the administration avoids disputes later.[32]

viii The co-trustees should schedule regular meetings to discuss trust business.

ix The co-trustees may be represented by separate counsel in their roles in administering the trust, or they can be represented by the same attorney. If the same attorney will represent them, the engagement letter should address potential conflicts issues. If different attorneys will represent them, they should agree on the payment of fees up front so there is no dispute later.

D. Investment Decisions

Trustees must invest with care, but must also yield results. Here are some points that the trust's portfolio managers should keep in mind:

i First, the trust instrument must be carefully reviewed for directions regarding investment standards. The specific words used in a trust instrument matter.

ii Even fairly standard language requires careful review – review the trust's boilerplate for:

- Language that permits the trustee to hold specific assets without liability;
- Language that directs the trustee to sell or not to sell a particular asset;
- Language that dictates a growth and income asset mix;
- Language that requires certain liquidity to be maintained;
- Language that requires or prohibits certain investments; or
- Language that excuses the trustee from diversifying investments.[33]

iii If the trust is silent, look to applicable law.[34]

iv Where there is any confusion regarding investment standards in the trust, consider asking the court to interpret the trust so that there is no question as to what standard the trustee is to follow.[35]

v Duty of Impartiality – Trustees must balance the interests of the life tenants and the remaindermen, unless the trust instrument directs otherwise.[36]

vi Duty of Loyalty – Trustees must be "pure" in motive and deed. Trustees may not take any actions with respect to trust assets for the benefit of anyone other than the trust's beneficiaries.[37]

vii Decisions by Committee – Where an institutional trustee appoints a committee to make investment or distribution decisions, the committee is bound by the same standards as an individual trustee. The fact that a decision is made by a committee does not insulate the decision from scrutiny.

Disputes over trustee investment decisions often lead to litigation. Speculative investments[38], investments that favor income beneficiaries over remaindermen[39], and losses incurred on stock that was over-weighted in the trust's portfolio[40] are examples of where trustees may be sued over investment decisions. Where a trustee fails to diversify but due to a reasonable process determined to hold concentrated stock, the trustee may avoid surcharge.[41]

E. Distributions

Trustees often struggle in determining how to make distributions to the satisfaction of the beneficiaries without violating the settlor's intent. Initially, the trustees must determine the settlor's intent by carefully reading the language of the trust instrument and any side letters of instruction from the settlor. If there is any confusion in the language, consider seeking a court order interpreting the trust.[42]

Trustees must make distributions in a manner that satisfies the settlor's intent even when the beneficiaries may be unhappy with such distributions.[43]

i **Ascertainable Standards** – If the standard for distributions is "support, health and maintenance" or another ascertainable standard, the trustee must make appropriate inquiry into the beneficiary's needs in this regard:

- Does the instrument indicate when that measurement of need is to be made (*e.g.*, "accustomed manner of living at date of decedent's death")? If so, data must be gathered about the beneficiary's needs at that time.
- Does the instrument require the trustee to take into account the beneficiary's other resources? If so, information regarding the beneficiary's other resources must be gathered.
- Alternatively, does the instrument *permit* the trustee to take into account the beneficiary's other resources? If so, then that information must be gathered – but the trustee must then determine the extent to which the beneficiary's other resources should be taken into account. If the beneficiary has significant resources, perhaps that fact should be given more weight than if the beneficiary doesn't have significant resources? Trying to understand the settlor's intent in this regard can lead to some conclusions. Obtaining court approval of the trustee's approach in this regard can also be helpful.[44]

ii **Balancing Beneficiary Interests** – Consideration of the life beneficiaries' needs versus remaindermen's needs, and the intention of the settlor regarding each class of beneficiary, will also help dictate whether distributions are prudent or not.[45] Of course, specific language in the trust instrument on this subject should be carefully reviewed.

- For example, the trust may provide that "the interest of my surviving spouse takes precedence over the interests of the children-remaindermen." This language makes distributions to the spouse easier to justify on a discretionary basis.

- If the trust says the settlor's intention is to preserve assets for generations beyond the children's generation, again, the choice as to whether to distribute to children or maintain for grandchildren is easier.

Additionally, if the trust contains an ordering provision as to where discretionary principal should be paid first, second and third, be sure to follow that rule.

F. Contingent General Powers of Appointment

Many law firms draft trusts with complex tax planning provisions. Does the trust authorize or require the trustee to grant a general power of appointment to a beneficiary in order to avoid or reduce estate and generation-skipping taxes? Trustees must determine under what circumstances the power of appointment should be granted. To determine whether to grant the power, is the Trustee obligated to gather information about the trust beneficiary's own assets? Can the Trustee rely on oral statements made by the beneficiary? A trustee who fails to grant a power of appointment could be held liable for any resulting adverse consequences.

III. Tax Planning

Strategies for Managing the Risks of Litigation Through Effective Tax Planning

Overview

Trustees are charged with ensuring that **applicable tax filings** are timely made. This is true whether the trustee is the tax return preparer or retains an independent accountant to prepare the trust tax returns. The following are **general considerations** to keep in mind not only for administration purposes but also for managing the risks of litigation:

- Keeping track of filings
- Timing issues
- Estimated taxes
- Transfer taxes
- Other miscellaneous tax issues

A. Keeping Track of Filings

One of a trustee's primary responsibilities is to file income tax returns for the trust. Trustees must be aware of the tax filing requirements, both federal and state. Failure to do so can lead to complaints from beneficiaries and disputes with the IRS or state taxing authorities.

i **Filing Deadline** – Generally, a trust's tax year is the calendar year, which makes the trust's income tax returns due on April 15 of the following year. The trustee can request a five-month extension of time to file the trust's income tax returns, making the income tax returns due on September 15. However, any tax liability is still payable on April 15, unless an extension of time to pay the tax is also obtained.

ii **State Income Taxes** – Each state has its own requirements, which must be examined to determine whether a state tax return must also be filed.[46]

For example, New York source income must be reported, and taxes paid, in New York.[47] New York source income includes income from real or tangible personal property located in New York, any gains or losses derived therefrom, and any income the trust receives related to a business, trade, profession or occupation carried on in New York.

A trust created by a New York resident at the time it became irrevocable is a New York resident trust. Generally, New York resident trusts are taxed in New York on their worldwide income and must file New York income tax returns even if they have no New York source income. Nonresident trusts on the other hand are taxed only on their New York source income.

A trust must file an income tax return in California if at least one of the trustees resides in California. Even if there is no California trustee, if there is a beneficiary residing in California who is entitled to distributions from the trust, the trust must file income tax returns in California. This can be a trap for the unwary!

California source income must be reported and tax paid to California on that income regardless of the situs of the trustee or the beneficiary.

Other states also impose income taxes on certain trusts, particularly when the Trustees are "residents" or "inhabitants" of the taxing state. Accordingly, the residency of the entity (and individuals) acting as Trustees should be evaluated from time to time. Changing a Trustee so that the entity acting as Trustee is no longer a "resident" or "inhabitant" can often prevent the trust from incurring potentially unnecessary state income taxes.

iii **Preparing Form 706** – Trustees may have a role in preparing federal (Form 706) and state estate tax returns. Where there is no concurrent probate, the trustee is the "statutory executor" under Internal Revenue Code (IRC) Section 2203. In such circumstance, the trustee is responsible for ensuring that the Form 706 is filed in a timely fashion.

iv **Section 645 Election** – For a revocable trust, after the settlor's death, the trust must file its own tax returns in accordance with the general rule set forth above. The executor of the decedent's estate will also be required to file estate income tax returns. Unlike a trust, an estate's tax year is based upon a fiscal year, rather than the calendar year. The longest fiscal year for an estate ends on the last day of the month preceding the decedent's death.

As a result of the differing tax years of an estate and revocable trust, the tax return filing deadlines for the estate and the revocable trust will differ, requiring tax returns to be filed at different times during the year.

For simplification purposes, the executor of the settlor/decedent may make an election pursuant to IRC Section 645 to treat the decedent's estate and the trust as one taxpayer for a certain period of time. If the election is made, the executor and the trustee will file one consolidated tax return reporting all of the income and expenses in the estate and the revocable trust. The executor typically is responsible for ensuring that this tax return is filed but the trustee must be sure to provide the executor with tax information relating to the trust.

The trustee must carefully monitor the status of the Section 645 election. Once the election expires, the trustee will be responsible for filing income tax returns on behalf of the trust.

If there is no estate, the trustee is still permitted to make a Section 645 election and file its tax returns based upon a fiscal year.

B. Timing Issues

Like many other situations, trustees must consider timing issues relating to assets in order to best utilize the trust's assets, satisfy the beneficiaries' needs and comply with the settlor's intent.

i **Realizing Gains**

- If a trustee is acting for a revocable trust, the assets of that trust will receive a basis equal to fair market value at the death of the person with the right to revoke the trust because the trust assets will be included in such person's gross estate at that time. If one assumes assets appreciate in value over time, there would be a basis increase, or "step-up," at the time of death. Selling highly appreciated assets just before the death of the person with the right to revoke forfeits this income tax benefit. The trustee should consider refraining from doing so until protected from a claim by the beneficiaries.
- Of course, not all assets appreciate in value. If an asset has depreciated during the person's lifetime, the asset will suffer a basis "step-down" at the time the person with the right to revoke a trust dies. In this instance, the trustee should consider selling depreciated assets prior to death in order to lock in the benefits of the loss.
- There are other instances where a sale may make sense. Two examples appear below:
  - Trusts formed to hold principal residences, called qualified personal residence trusts ("QPRTs"), are grantor trusts for income tax purposes. This means that the capital gains of the trust are reported on the grantor's return. If a parent has transferred his or her principal residence to a QPRT, the trustee might consider selling it before the QPRT term ends.[48] The benefit is that the taxable gain flows through to the parent's income tax return, and the $250,000 exclusion (or, $500,000 for a couple) under IRC Section 121 is available to offset the gain. If the QPRT term ends and the residence is transferred to the children, this benefit is lost (though if, at the

end of the QPRT term, the residence is transferred to a continuing trust for the children and such continuing trust is a grantor trust, then the sale can take place in the continuing grantor trust and it will receive the same benefit).

- Often times individuals make sales to intentionally defective grantor trusts ("IDITs") – with the intent to transfer appreciation on the asset sold to trusts for children and grandchildren without incurring gift tax. The sale to the IDIT is ignored for income tax purposes – which means there is no gain on the sale, but the purchaser IDIT keeps the seller parent's low basis. If acting as the trustee of the IDIT, a sale of that low basis (now appreciated) asset back to the grantor for cash or other assets that have no inherent gain allows the repurchased asset to be subject to estate tax at the grantor's death, achieving a basis step-up – while the asset used to buy the asset back escapes estate taxation (accomplishing the purpose of the sale to the IDIT with the added benefit of a basis step-up for the asset sold). This technique is particularly important as the estate and capital gains tax rates (including state, Federal and Obamacare tax) are currently almost the same.

ii **Harvesting Losses** – Deciding when to harvest losses is a major decision in the administration of a trust. There is no magic to the solution to this problem. The sale of depreciated investments to offset capital gains with capital losses is something that the trustee should consider carefully on a regular basis.

C. Estimated Taxes

Trustees have a duty to pay estimated federal taxes and should consider making distributions to the trust beneficiaries to pay their estimated taxes.

i **Paying Estimated Taxes**

For non-grantor trusts, the trustee must generally make estimated federal income tax payments for trust income each January 15, April 15, June 15 and September 15 (or the first business day following if such date falls on a weekend or holiday). However, no estimates are due for the first two years after death for an estate or revocable trust.

Some states require estimates; others do not. Applicable law should be carefully reviewed in this regard.[49]

Care should be taken to calculate the estimates properly. Overpaying estimated tax can lead to beneficiary complaints about losing the earnings on the amounts overpaid. However, payments necessary to avoid penalties should be timely made.

Note that where a trust overpays estimated tax because more is distributed to beneficiaries than anticipated, the trustee can elect to treat the payment as a payment of estimates by the beneficiaries, and should coordinate with the beneficiaries and their accountants in this regard.

Of course, grantor trusts don't make estimated tax payments. The settlor is responsible for reporting the trust's income and expenses. The trustee should make sure to provide tax information to the settlor on a timely basis so that the settlor can timely file tax returns.

ii Helping Beneficiaries Pay Their Estimated Taxes

It is good practice to distribute cash from the trust to the beneficiaries to allow them to make their estimated tax payments. Beneficiaries are much happier if they don't have to spend their own funds to make tax payments on trust income not yet received.

If the beneficiary cannot be counted on to use distributions to make his or her estimated tax payments, the trustee should consider making the estimated payments directly to the taxing authorities on the beneficiary's behalf (with beneficiary consent and consultation with the beneficiary's accountant strongly recommended).

D. Transfer Taxes

i Creating Fractional Interests to Reduce Transfer Taxes

A trustee may be able to create fractional ownership interests to reduce transfer taxes. Discounts which can be used to reduce estate taxes are available for lack of control and lack of marketability. Proper funding on a first death where there is no estate tax due can set up the availability of these discounts at the second death. However, care must be taken because any "step-up" in basis at the second death will be limited to the discounted value of the asset at the second death.

For example:

- On a first death, a revocable trust typically requires the assets to be divided between a marital trust and a credit shelter trust (sometimes called a bypass trust or unified credit trust). How these trusts are funded will determine whether discounts are available at the second death. If possible and practical, a portion of an entity interest can be used to fund each of the marital trust and credit shelter trust so that when the surviving spouse dies, the marital trust, which is subject to estate tax on the surviving spouse's death (while the bypass trust is not), owns a minority interest in the entity. Discounts for minority interest and lack of marketability may then be available.

- In jurisdictions, such as California, where joint revocable trusts are routinely used, upon the death of the first spouse, opportunities for discounts for minority interest and lack of marketability may be available by dividing assets between the deceased spouse's share and the survivor's share. Then, if possible and practical, a portion of the deceased spouse's share can be used to fund each of the bypass trust and the marital trust (as in the prior example).

Most trusts allow for non-pro rata distribution of assets – so in many cases, for ease of administration, the trustee might choose to fund "whole assets" to each of the trusts. However, this type of whole asset funding will typically not allow discounts at the second death.

ii Utilizing Bypass Trusts for Transfers to Future Generations without Transfer Taxes

The Bypass Trust is typically created to utilize the decedent spouse's remaining estate tax exemption. It is not subject to estate tax when the surviving spouse dies and the assets pass to the next generation. Further, if proper allocations are made on the decedent spouse's estate tax return, the Bypass Trust is exempt from the generation-skipping transfer tax ("GST"), so that when the children die, the assets can pass on to future generations without being subject to either estate or GST taxes.

For these reasons, the Bypass Trust is the *last* place from which monies should be spent for the benefit of a surviving spouse and/or children. The trustee should seek to exhaust the assets of the surviving spouse (including assets in the Survivor's Trust in a community property jurisdiction) and/or the Marital Trust first before making distributions to the surviving spouse and children from the Bypass Trust.[50]

As alternatives to distributing cash from the Bypass Trust to the surviving spouse, consider the following to preserve the tax benefits afforded by a Bypass Trust:

- The trustee can loan money from the Bypass Trust to the survivor. When the survivor dies, the debt owed to the Bypass Trust will be deductible for estate tax purposes and in effect, the Bypass Trust "remains full" so that the transfer tax benefits are not lost.
- If the beneficiary wants to purchase a vacation home or use the cash to invest in a business, the Bypass Trust itself could make the purchase. As an asset of the Bypass Trust, the survivor, as a beneficiary of the Bypass Trust, can use the house or benefit from the business – and the Bypass Trust again "remains full" so that the transfer tax benefits are not lost.

iii Managing GST Exempt and GST Non-Exempt Shares to Maximize Future Transfers Outside of Transfer Tax System

Assets in GST Exempt trusts pass from generation to generation without any transfer tax, while assets of GST Non-Exempt trusts are taxed once the assets pass to a person two generations or more below the transferor. For this reason, Non-Exempt trust assets should be spent on children, while Exempt trust assets should be preserved for lower generations.

Distributions from Non-Exempt trusts to lower generations will cause the immediate imposition of GST taxes, which is another reason to avoid spending such funds on generations more than one generation below the transferor.

- Consider loans and/or purchases of assets in GST Exempt trusts to keep those shares "full." A loan to a grandchild or lower generation person from a Non-Exempt trust can postpone the imposition of the GST tax.

If a taxable distribution is made from a GST Exempt Trust, the trustee should file Form 709-GS(D) and if a taxable termination of a GST Exempt Trust occurs, the trustee should file Form 709-GS(T).

iv Modifying the Trust Without Settlor or Beneficiary Consent

At the time of execution of a noncharitable irrevocable trust, a settlor may be unaware of existing circumstances (or future circumstances) that would defeat or substantially impair the purpose of the trust. If this occurs, as long as the settlor and each beneficiary consent, every state permits the modification or termination of a noncharitable irrevocable trust.[51]

While obtaining each party's consent may be the quickest way to modify or terminate a noncharitable irrevocable trust, if a modification or termination on consent shifts a beneficial interest in the trust, this method exposes the settlor and the beneficiaries to transfer taxes. In order to limit the exposure to transfer taxes, the trustee could decant the trust, or seek to judicially modify or terminate the trust.

Most jurisdictions, except Idaho, New Jersey, and New York, allow a trustee to modify the terms of a noncharitable irrevocable trust without the consent of the settlor and beneficiaries, if, due to circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust.[52]

While the trustee is required to serve the settlor and the beneficiaries with a copy of the Petition for Judicial Modification or Termination (the "Petition"), the settlor and the beneficiaries are not required to respond to the Petition. If the settlor and the beneficiaries fail to respond, the trustee will be permitted to modify the trust after obtaining a default final judgment. For example, in Florida, once a Clerk's Default is entered against the settlor and the beneficiaries, the court must enter a default final judgment against the settlor and the beneficiaries and modify the trust in accordance with the Petition.[53]

E. Miscellaneous Tax Issues

i Contributor Due Diligence

Understanding the identity and citizenship status of a trust's contributors is crucial. For example, a trustee is responsible for the payment of so called "covered transfer taxes" if the trust is a "domestic trust" or "electing foreign trust" and the contributor is a "covered expatriate."[54] Recently proposed regulations state that the burden of determining whether a taxable distribution has been received from a covered expatriate lies with the US recipient, thereby creating a potential risk for the trustee of a US recipient trust.[55] Accordingly, it is critical to become familiar with the trust's contributors, especially when such contributors are non-US persons.

ii Managing Income in Respect of a Decedent ("IRD")

IRD is income that is payable after the death of the person who was entitled to it and that would have been taxable to him or her if the person had lived to receive it. The income is not includible on the decedent's final income tax return because it was not payable until after death, but the recipient of the IRD is subject to income tax on the IRD.

Typically, IRD is included in the decedent's gross estate for estate-tax purposes. For income tax purposes, IRD is taxed to the first person it "touches." Therefore, if a trustee has discretion, it should consider allocating the IRD item to a beneficiary in a low income tax bracket. It is important to remember that the recipient of the IRD may be entitled to a deduction under IRC 691 in an amount equal to the recipient's proportionate share of estate taxes payable on the IRD. This alleviates some of the impact of the double taxation of IRD items.

If a trust receives distributions from retirement plans, those distributions are IRD and taxed to the trust. To the extent the IRD so received is allocable to trust accounting income, the trustee can cause distributions to be made to beneficiaries in lower income tax brackets in the same taxable year, thereby helping reduce the tax applicable to that IRD.

Note that to the extent such distributions of IRD are allocable to trust principal and not to trust accounting income, this approach is not effective. For example, assume that after death an IRA earns $100 of income and that a distribution of $400 is made from that IRA to the trust to satisfy the required minimum distribution rule. $100 of that distribution received from the IRA is trust accounting income, so that a distribution of $100 would carry out that distributable net income ("DNI") to the beneficiary. However, a distribution of $400 will still only carry out $100 of DNI; the other $300 is allocable to principal and is trapped at the trust level unless the trustee takes the proper steps to establish a pattern of distributing that principal to the beneficiary on a regular basis.[56]

iii Taxable Income versus Tax-Exempt Income

The planning in this situation is akin to planning for individuals. In choosing investments, the after income tax rate of return should be carefully considered.

For non-grantor trusts that distribute income, investing in assets that generate taxable income can make sense if the beneficiary to whom distributions will be made is either in a low income tax bracket or has losses that can offset that taxable income. By timing distributions of DNI to carry out the taxable income, the lower brackets or losses of the recipient beneficiary can be used to keep the income tax on that income as low as possible.

For grantor trusts, taxable income investments that provide a greater return for the children beneficiaries have the added benefit of the parent's estate being "reduced" by the income tax that the parent is required to pay on the grantor trust's income. The effect is to make a "transfer" to the trust that isn't treated as a transfer for gift or tax purposes. The result is a savings of the 40% (or more in states that impose an income tax) transfer tax on the tax paid by the parent grantor for that trust and a 40% (or more in states that impose an estate tax) estate tax on the tax paid by the parent grantor because those monies are no longer a part of the parent grantor's estate.

Also, for grantor trusts, where the grantor has losses that might go unused, generating taxable income (or capital gains) to take advantage of those losses which would otherwise expire at the grantor's death can accomplish additional benefit. The trustee should explore this option.

iv Utilizing the "65-Day Rule"

The "65-day rule" permits the trustee of a complex trust to elect to treat distributions of DNI from a trust prior to March 6 of a tax year to be characterized as distributions occurring in the prior calendar year of the trust for federal income tax purposes. This technique can be used to avoid income taxation at a trust's typically higher level by providing a distributions deduction for the trust in that prior year and causing that income to be reported on the beneficiary's return for that prior year.

The election is made on a timely filed return (including extensions) under IRC Section 663(b).

Many states do not have a corresponding rule. As a result, in those states, including California, it is best to do income tax planning and actually make distributions before the tax year ends rather than rely on the 65-day rule to solve the problem. Trustees should determine whether applicable state law allows for the benefit of the 65-day rule for state income tax purposes as part of the intake of the trust.[57]

The 65-day rule is of no benefit to "simple trusts," as they are deemed to have distributed all of their trust accounting income to the beneficiary whether or not distribution is actually made.

v Managing a QTIP Trust to Balance Interests of Life Tenant and Remaindermen

There is an inherent conflict between the surviving spouse, as the life tenant (who is entitled to all the income of a QTIP Trust), and the children, as remaindermen (who are entitled to the principal of the QTIP Trust after the surviving spouse dies). Simply, the spouse wants the trustee to invest in assets that produce the most income, while the children want the trustee to invest in assets that produce the most growth. Often, a growth asset produces less income, while an income-producing asset shows little growth. The conflict can be more problematic when the children are from a prior marriage and not the descendants of the surviving spouse.

- **Unitrusts –** One option is to convert the QTIP Trust to a unitrust under applicable state law.[58] The Unitrust requires a fixed payment of a percentage of the trust assets (typically 3% - 5%) to the spouse each year. That fixed payment is the trust accounting income ("all the income") to which the survivor is entitled – but after the conversion, the payment can be from what would otherwise be income and principal. The result is to put the life tenant and remainderman on the same side of the table regarding investments; both want the total return (whether income or growth) for the trust to be as much as possible. Where the trust is of a greater value, the spouse gets more income because the percentage payout is applied against a larger base. And, where the trust is of greater value, the remainderman inherits more. This is truly a "win-win" situation, and resolves the investment conflict beautifully.

  Note that if the spouse is allowed discretionary principal distributions before the conversion of the QTIP Trust to a unitrust, those discretionary distributions can also be retained as part of the unitrust.

  The conversion doesn't have to be permanent. If it later makes sense to convert back to a regular QTIP Trust or to adjust the percentage payout either higher or lower, those changes can be accomplished.[59]

- **Power to Adjust** – Trustees may also implement the power to adjust, if available. The power to adjust authorizes a trustee to adjust between income and principal to enable the trustee to make appropriate present and future distributions to the beneficiaries, if the adjustment would be fair and reasonable to all of the beneficiaries.[60]

Other Options – Another option is to invest in a diversified portfolio of stocks and bonds, in an attempt to benefit both the spouse and remaindermen. This is the more traditional approach to solving the conflict issue. Beneficiary consent or court approval in selecting the investment mix can help protect the trustee from challenge.[61]

IV. Preemptive Steps

Options for Seeking Consent or Pre-Approval of Fiduciary Action

Overview

Various options may be available for a trustee to get **a "green light" for fiduciary action *before* the action is taken.** These methods can significantly reduce a trustee's exposure to the risks of litigation. Here are some methods to consider:

A. Consent of Beneficiaries

Obtaining beneficiary consent prior to taking action may protect the trustee from being challenged by the consenting beneficiaries.

- Courts of equity will not permit a beneficiary to complain that an act by the trustee was a breach of trust where the beneficiary, with full knowledge of the facts, consented to, or later ratified, the act.[62] Many states have enacted statutes codifying this doctrine.[63] However, consent can be found to be ineffective under certain circumstances.[64]
- Care should be taken to ensure that the consent doesn't become "stale," leaving the trustee open to attack. For example, assume that the trustee obtains the beneficiary's consent to a particular investment strategy. As economic times change and a beneficiary's circumstances change, a beneficiary who consented to a particular strategy may no longer find it appropriate. Obtaining **supplemental consents** in these types of situations can be of great help to protect the trustee.
- The **degree of formality required for valid consent may differ** from one jurisdiction to the next. However, even in the absence of a formal consent, a simple email exchange regarding a planned course of action – depending on the type of action and other circumstances, such as the nature of the relationship between the trustee and the beneficiaries – may make it very difficult for a beneficiary to later challenge the action. Care should be taken to fully disclose all relevant facts, possible alternatives and the basis for the trustee's proposed course of action.
- A beneficiary's decision to retain legal counsel to advise as to whether or not consent should be provided can be a positive development. The **beneficiary's attorney can sometimes facilitate communication** with less

sophisticated beneficiaries, which, in turn, may result in the beneficiary consenting to the proposed action or to some acceptable variation thereof.

B. Petition for Court Approval

Every state allows a trustee to seek judicial instructions concerning a proposed course of action,[65] and in most states, the proceeding is governed by statute.[66] Notice to the beneficiaries is generally required, giving each beneficiary an opportunity to weigh in with his or her interpretation of the matter presented to the court.[67] When the court decides the issue, the trustee will have clear guidance to move forward without fear of challenge.

Courts may decline to provide instructions where there is no doubt as to the meaning of the instrument.[68] Courts also will not pre-approve actions in response to issues that have not yet arisen,[69] or provide guidance regarding the exercise of a discretionary power.[70] New York courts generally will not entertain actions seeking advice and direction where it would involve substituting the court's business judgment for that of the trustee.[71]

- This approach generally works best **when the beneficiaries are afforded an opportunity to participate** in a court proceeding so that they can express any objections they may have to the proposed action and will be bound by the result.
- This approach may prove particularly effective **when a trustee is faced with two different options** over which the various beneficiaries disagree but either of which would be acceptable to the trustee.
- This approach is **significantly more expensive** than seeking the beneficiaries' prior consent (discussed above) or a Notice of Proposed Action (discussed below). But when beneficiaries cannot agree, or where they otherwise object, it may be the best alternative available to the trustee.
- In very contentious trust administrations, this approach **may also prove to be the quickest approach**. If there is an action that must be taken in the very near future, an expedited or *ex parte* application to the court may be available in limited circumstances. Injunctive relief also may be available in order to prevent irreparable harm.

C. Notice of Proposed Action (California and Other States)

In fifteen states, including California,[72] trustees may be able to use **Notice of Proposed Action ("NOPA") Proceedings** to protect themselves from beneficiary challenge.

- If a trustee sends NOPA prior to taking an action (which could include deciding not to take an action) to the beneficiaries of the trust, and if no one objects within a specified period, usually between 30 and 60 days, the trustee may act without risk of a later attack by the beneficiary.
- It is important that the proposed action be properly described in the NOPA, and that relevant facts be presented. Because the NOPA only protects the trustee from liability for taking the action as described, when the trustee takes the action it should be taken *exactly* as described in the NOPA.
- In California and other states, if a beneficiary provides signed consent to the NOPA before the notice period expires, that consent can be withdrawn. Therefore, consent should either be provided in an irrevocable form, or the notice period should be permitted to expire even if consent on the NOPA form is given. (Note that a "regular" consent, outside the context of the NOPA, allows the trustee to act as soon as the written consent is received. The difference in the context of a NOPA is that consent is deemed to have taken place even if not actually given in writing; no objection within the notice period is a deemed consent).
- If a beneficiary objects to the NOPA, the trustee cannot take the action without court approval. Note, however, that by mailing the NOPA, the trustee in this context shifts the burden of proof to the objecting beneficiary who must now demonstrate why the act should not be taken (rather than the trustee having the burden to show why taking the act makes sense).

V. Alternative Dispute Resolution

Options for Resolving Disputes Outside of Court

Overview

Despite a trustee's best practices and best efforts, disputes may arise during the course of a trust administration that cannot or, for various reasons, simply will not be resolved without litigation.

However, before or even after litigation has commenced, **alternative dispute resolution options are often available to the parties**.

A. Mediation

Mediation can prove to be an effective alternative to litigation in resolving beneficiary disputes.

A mediator is **a neutral person** (often a retired judge or a lawyer who practices in the field of trusts, estates and tax law) who attempts to facilitate a settlement between disputing parties. The mediator typically has no authority to decide an issue or to compel the parties to resolve their dispute. The **mediator's role is solely to attempt to broker a deal**.

Here are some additional characteristics, benefits and best practices associated with mediation:

i Mediation often has a **high rate of success**. Having had the opportunity to air their grievances to a neutral party, beneficiaries sometimes feel that they have had had their day in court, which is a need that – in and of itself – often drives a beneficiary to pursue litigation.

ii Because the process is so informal, **it can be designed and redesigned to fit the dispute** at hand. This can include how the facts and the law are presented, including in a private submission made only to the mediator. This flexibility can be critical to achieving a resolution.

iii In most cases, the parties have the opportunity to **select the mediator** and can choose a practitioner with relevant expertise who will understand the issues and the nature of the dispute more readily than a state court judge. Also, because the process is privately financed, the arbitrator(s) are more likely to read the briefs, wade through the evidence and take the time to understand the case.

iv Mediation can be **cost-efficient if conducted prior to the discovery process** that is so extensive and time-consuming in litigation. Even when mediation is conducted after discovery has already taken place, a successful mediation will eliminate the need for a trial, which can be even more expensive.

- v Mediation can **provide a reality check** for beneficiaries and trustees alike. A third-party neutral, particularly one with the right credentials, can educate a beneficiary about the merits of his or her position. The same, of course, is true for trustees and, perhaps more importantly, the various professionals and committees at an institutional trustee who are in the position of having to recommend or authorize a settlement.
- vi A mediator, together with the parties to the mediation, have **virtually unlimited flexibility** in attempting to craft a creative resolution. Arbitration or trial often leads to a "yes" or "no" decision, whereas a mediation can explore various avenues for resolution.
- vii In some jurisdictions, such as Florida, the courts typically require every case to be mediated in an attempt to resolve the dispute before trial.
- viii If a resolution is reached, **diligent efforts should be made to reduce the agreement to writing, fully executed by all parties** before the parties leave the mediation. A "memorandum of settlement terms" or an "agreement in principle" is often nothing more than a recipe for weeks or months of further negotiations and threats of litigation. The far better practice is to come to the mediation with a laptop and a form of settlement agreement so that the deal can be completely memorialized and executed that same day (or very late that night).
- ix A settlement agreement should usually **include broad, general releases**, through which all parties are released from any potential liability for any and all conduct through the date the releases are executed (except, of course, for any breach of the agreement itself).
- x If a particular matter cannot be resolved as part of the settlement, that matter should be specifically carved out from the release and any other applicable provisions. Sometimes, the parties develop sufficient comfort with and confidence in the mediator that they **might choose to have the mediator make a binding decision as to unresolved issues** at a later date.
- xi The settlement agreement should also ideally **resolve any issues concerning the payment of attorneys' fees and expenses**. For example, the trustee may want to include a provision foreclosing any objections to the use of trust assets to pay its attorneys' fees and expenses.
- xii The parties should consider obtaining **court approval of a mediated settlement agreement**.[73] Court approval may prevent a later attack on the validity of a settlement because the time to attack judgments for any reason is limited.

Judicial approval is particularly helpful where there are minor, unborn, or unknown beneficiaries – if court approval is obtained, the settlement is binding on such beneficiaries. In addition, court approval may be <u>required</u> when the settlement requires the transfer or retitling of property or when the settlement involves certain kinds of trust modification or reformation. Court approval is also recommended if the court will agree (as it often will) to retain jurisdiction for the purpose of enforcing the settlement agreement. This provides for a more expedient resolution in the event of a breach (sometimes with a penalty for doing so in the form of attorneys' fees for the party who must petition to enforce the agreement).

B. Arbitration

Arbitration is a process by which **the parties agree to be bound by the decisions of a neutral person made outside of court**. Some points to note about arbitration:

i The arbitration process is generally considered **more cost-efficient and expedient than the judicial process**. The hearing itself is generally less formal than a trial, and the rules of evidence are generally adhered to less closely, if at all.

ii **Many of the advantages of mediation apply to arbitration as well**, including the ability to select an arbitrator with relevant expertise, flexibility in designing the process and faster resolution. The main distinction is that the arbitrator will make a final decision that will be binding on the parties, whereas mediation is voluntary and the parties are under no obligation to resolve the dispute. This, of course, can be either a positive or a negative depending on the parties involved.

iii Arbitration decisions are **not ordinarily subject to appeal,** unless the governing arbitration clause provides for appeal procedures. This means that the dispute will be resolved sooner, but there may be no opportunity to correct errors in the decision.

iv Arbitration provisions are increasingly being included in trust instruments by settlors who want to spare their beneficiaries the cost and delay of litigation. **Mandatory arbitration provisions in trust instruments** are enforceable in a growing number of states, including Florida, against beneficiaries who are not parties to the trust instrument.[74] In these jurisdictions, arbitration may be compelled only as to matters of trust administration, not the validity of the instrument itself.

v Institutional trustees may benefit from the **inclusion of an arbitration clause** in trust instruments they are asked to administer. The American Arbitration Association has promulgated Arbitration Rules and Mediation Procedures for

Wills and Trusts.[75] Experienced litigation counsel can assist with determining the enforceability of an arbitration clause in a particular jurisdiction and crafting an effective arbitration clause.

C. Negotiation

Mediation, arbitration and the judicial process each have their place within any discussion of dispute resolution, but, occasionally, **a concerted effort at negotiation between the parties' attorneys can prove just as effective** in putting an end to disputes. Here are some considerations to keep in mind:

i Settlement discussions or offers of compromise are generally inadmissible in court, thereby freeing up the parties and their lawyers to attempt a negotiated resolution. Often, **opening up the lines of communication** in this manner will, in and of itself, create some room for dispute resolution. (Remember that lack of communication is invariably one of a disgruntled beneficiary's biggest complaints.)

ii In the context of a negotiation, **new issues or opportunities for resolution are often identified** that were not initially obvious to either party. Sometimes a resolution can be facilitated by concessions in connection with the trustees' fees or improved communication with the beneficiaries. Some disputes may turn out to have relatively simple solutions, once the parties start talking with each other.

iii But where negotiation may prove most effective is where a trustee brings its expertise and sophistication to the table. For example, a trustee and its counsel may be able to propose tax solutions that are beneficial to all parties.

Here are a few examples:

- If a charitable beneficiary and a non-charitable beneficiary are arguing over what portions of a trust they are entitled to, utilizing their different income tax brackets may be useful in resolving the dispute.

  Assume (1) a trust has $1,000,000 of assets, consisting of $900,000 of principal and $100,000 of income earned during the tax year, (2) the charity believes it is entitled to 60% of the trust assets and the non-charitable beneficiary is entitled to 40% of the trust assets and (3) the non-charitable beneficiary believes he and the charity are each entitled to 50% of the trust assets.

  If the trustee distributes $100,000 of trust income and $300,000 of principal to the non-charitable beneficiary, the non-charitable beneficiary will net $360,000 (after paying income taxes at (assume) 40% on the $100,000 of income the non-charitable beneficiary received). The charity will receive $600,000 of principal and net $600,000.

If, however, the trustee distributes $100,000 of income and $500,000 of principal to the charity, the charity will net $600,000, since it doesn't pay income tax on the $100,000 of income it received. The non-charitable beneficiary will receive $400,000 of principal and net $400,000, since it did not receive any trust income as part of its distribution. By utilizing the tax law, the non-charitable beneficiary received another $40,000. That additional money can be used to bridge the gap between the two parties.

- A trustee and beneficiary are arguing over whether a particular asset (i.e. a horse) belongs to the trust or the beneficiary in a non-community property state. The trustee believes the horse belonged to the decedent whose trust it is administering, while the surviving spouse/beneficiary believes that the horse belongs to him or her. Assume the horse was purchased for $10,000 but is now worth $1,000,000, and that the surviving spouse intends to sell the horse.

  If the spouse owns the horse and sells it, the spouse will incur $990,000 of capital gain and (assuming a combined federal and state rate of 27%) and pay $267,300 of capital gains tax. The spouse will net $732,700.

  On the other hand, if the horse belonged to the decedent, there would have been a basis step-up to $1,000,000 at time of death. The trust could sell the horse and there would be no capital gain. This determination would net the family $267,300 (the amount of capital gains tax that didn't need to be paid when the horse was sold).

  That $267,300 is "found value" that can be used to resolve the dispute between the trust and the spouse. Since, after the sale, the spouse would net only $732,700, that is what the spouse is really fighting over. If there is a reason for the spouse to believe that the horse belonged to the decedent (and, therefore, the trust), a settlement may be able to be reached with the spouse to pay her $267,300. The effect is that the tax law created the funds to bring the matter to resolution.

iv In particularly contentious matters, even if a settlement is reached and agreed by all the parties, the trustee should consider having their settlement judicially-approved. In a recent New York case, all that was needed to force a trial was an affidavit of a party who signed a release claiming the release was not fairly procured.[76] Having the settlement judicially-approved mitigates against the risk of potential litigation after a settlement has been reached.

VI. Litigation

When All Else Fails, Resolving Disputes Through the Judicial Process

Overview

No one likes litigation. It is **inconvenient, risky, expensive, and requires a substantial commitment of time and resources**. There are times, however, when litigation is unavoidable.

No two litigations are alike, and we could not possibly provide litigation advice in this format. Here is an overview of some aspects of fiduciary litigation and some of the strategic considerations that typically arise.

A. Be Alert for Signs that an Issue May Be Ripening Into Litigation

Issues that end up in litigation frequently start small and develop over time into full-blown adversarial disputes. The best way to manage the risk of litigation is to identify such issues and take steps to resolve them early. **Counsel should be consulted at the first sign of a potential problem.** In our experience, certain events and behavior indicate that a problem may be developing. Here are some examples:

- i Beneficiaries start **asking questions** or asking for information they never requested before.
- ii Beneficiaries or family members retain **new lawyers**.
- iii The trustee receives a **communication from a lawyer**. The trustee should never deal directly with a lawyer or respond to a communication from a lawyer. All communications from lawyers should be referred to counsel for response.

B. Offense or Defense

One decision encountered early on by a trustee is **whether to initiate litigation or to wait** until the litigation is commenced by a beneficiary. There are subtle differences in these options for the trustee and experienced counsel to weigh carefully.

- i The plaintiff sets the table for the lawsuit. That is because it is **the plaintiff who makes the claims, frames the issues, and seeks redress**. The plaintiff is also the one with the right to put on its evidence and present its case at trial first, before any of the other parties.
- ii There may be optical advantages for a trustee to be the plaintiff, e.g., in those instances when the trustee can be presented as proactively carrying out its

fiduciary duties, asking the court to right a wrong, seeking pre-approval of fiduciary action, or seeking confirmation that the path chosen was proper.

iii On the other hand, **being the defendant has some advantages**. As the defendant, the trustee will appear impartial and reasonable. As the plaintiff, a hostile beneficiary can appear litigious and unreasonable. As the defendant, the trustee responds to the issues framed by the adversary, which better enables the trustee to identify weaknesses in the adversary's position and formulate defenses.

iv Another strategic advantage to sitting back and waiting, rather than initiating the litigation, is that **some beneficiaries will never actually commence a lawsuit**. In contrast, when the trustee files a lawsuit, the dispute is brought to a head and a full-fledged fight usually ensues.

v **Even as a defendant, a trustee has the ability to file counterclaims**, where appropriate or necessary, which can put the trustee in the position of being both a defendant and a counterclaim plaintiff.

C. Discovery

Discovery is a major component of all civil litigation, including fiduciary litigation. "Discovery" is a broad name for the procedures that are used in litigation to learn information from the other parties about their view of the facts, including those supporting their claims and defenses. Other than the actual trial, discovery is **usually the most expensive and time-consuming** aspect of litigation. But it also is one of the most essential aspects of litigation because it allows the parties to discover the relevant facts in the adversary's possession before trial. Discovery strategy in every case evolves as information is learned, and discussions with counsel can aid in developing the most cost effective mechanisms for doing so. Here are some general explanations and strategic considerations regarding discovery:

i **Documents and Interrogatories** – Parties are entitled to ask each other to provide copies of documents, and answers to written questions, relevant to the dispute. **Gathering documents is a significant task in virtually every case**. Counsel will be directly involved in document review and production and the drafting of interrogatory responses. Interrogatory responses must be sworn or affirmed as true, so careful review by the individuals with knowledge is vitally important.

ii **E-Discovery** – In the electronic age, parties are responsible for preserving, searching and producing electronic documents and information of all kinds. Once litigation is "reasonably anticipated," an institutional trustee must implement a "litigation hold" designed to prevent the deletion or destruction of any documents or information that may be relevant to the dispute, including emails, electronic documents, information that has been deleted, if still available, and information stored on back-up tapes. Electronic discovery is a burden that usually falls more heavily on an institutional trustee, because of the trustee's vast electronic systems and significant recordkeeping obligations. Counsel can guide you through document preservation, document searches and review of the documents for production.

iii **Depositions** – A deposition is **a proceeding whereby an attorney elicits sworn testimony from a witness outside of the courtroom**. Depositions are essential to gaining a clear picture of the relevant facts and preview testimony that can be expected at trial. Depositions are expensive – both in terms of counsel's preparation to take a deposition and preparing one's own witnesses to have their depositions taken.

iv **Experts** – Many fiduciary litigations involve complex financial, accounting or other issues beyond the comprehension of the average person, including judges. In such cases, **expert consultants or witnesses are often employed**. Such experts are individuals who possess the knowledge and experience to review the relevant materials and render opinions about them. Experts are generally paid for their time and effort. **Early retention of experts** can help a party understand the issues early in the discovery process. Experts can also be valuable when it comes time to settle a case. Trustees and their attorneys will generally work closely together on whether to retain experts or consultants, and for what purposes.

D. Trial

If a litigation does not settle, **the lawsuit will culminate with a trial or final hearing**. The strategic considerations involved in a trial are too case-specific and numerous to list, but here are a few characteristics of a trial and points to keep in mind:

i **The trial date is set by the court and is often very difficult to reschedule**, not only because of the court's scarce resources and crowded calendars, but also because the courts generally sense that parties are more motivated to settle when faced with a real trial date – and all of the expense and uncertainties that come with a trial – not too far off in the future.

ii **Fiduciary litigations are *almost* always tried before a judge and not a jury**. The term for this is a "bench trial." The judge will hear testimony of witnesses, review documentary evidence, hear arguments of counsel, and serve as the ultimate trier of facts and arbiter of the entire process. At the conclusion of the trial, or within several months thereafter, the judge will issue a decision (often in writing). Unlike a jury, a judge is not apt to be swayed by emotional rhetoric or colorful facts, but (hopefully) can be counted on to decide the case by applying the law to the facts.

iii A trial can often be very time-consuming and, with few exceptions, will **require the presence in the courtroom of the trustee** or, in the case of an institutional trustee, a corporate representative (usually a trust officer) every day of the trial.

iv Extensive preparation for trial is essential. In addition to all the time counsel will spend preparing exhibits, examinations and arguments, testifying witnesses will spend **substantial amounts of preparation time with counsel.** The inevitable, considerable distraction from the trustee's other business and routines should not be underestimated.

v **Corporate trustees are held to a high standard** in fiduciary matters (fairly or unfairly).

E. Appeal

Upon the conclusion of the trial and the rendering of a decision by the judge, there may be a clear "winner" and "loser," or there may be aspects as to which different parties prevailed. Generally speaking, the parties are afforded the right to appeal unfavorable decisions.

i **As grounds for an appeal, a party must identify an error** in the trial court's handling of the proceedings or in the court's ultimate decision. It is insufficient to simply disagree with the trial court's conclusions and ask for a second opinion.

ii In some jurisdictions, the filing of a notice of appeal will stay or defer the enforceability of a trial court judgment. And in some jurisdictions, a monetary judgment can be stayed pending appeal but only with the posting of a bond. These considerations can often play a significant role in deciding whether to appeal.

iii The appellate court will issue a written opinion **affirming the trial court's decision, reversing the decision, or something in between.** The appellate court may also send the case back to the trial court for additional proceedings or a new trial. Each case, of course, is different.

iv The decision to appeal (or not) should be approached in consultation with counsel. There are many pros and cons, including consideration of the expense and the likelihood of success. One factor to consider is timing. Every jurisdiction is different, but **the appellate process can often take up to two years**.

F. Attorneys' Fees

Virtually all trusts contain language permitting trust assets to be used to pay the trustee's attorneys' fees. In addition, most states expressly authorize the trustee to pay properly-incurred administration expenses, including attorneys' fees, from the trust assets.[77] This can often prove to be a great litigation advantage to a trustee, as **a beneficiary's sobering realization that he or she is effectively paying both side's attorneys' fees may bring the litigation to an early conclusion.**

To the extent the trustee advances payment for such expenses from its own funds, the trustee has a lien against the trust property to secure reimbursement, usually with interest.[78] The trustee may thus withhold funds for reimbursement from trust property before distributing income or principal of the trust.[79]

But this "advantage" is not always available.

- i **There are circumstances under which a trustee may not be permitted to use trust assets to pay its attorneys' fees**. For example, Florida law imposes notice requirements upon a trustee who seeks to use trust assets to pay attorneys' fees to defend an action for breach of duty, and affords a procedure by which a beneficiary may successfully preclude the use of trust assets for such fees unless and until the trustee prevails.[80]
- ii If the trustee does not ultimately prevail in the litigation, in some jurisdictions **the court may have the ability to surcharge the trustee, individually, for attorneys' fees** incurred by the trustee and perhaps even the attorneys' fees incurred by the prevailing party.[81]
- iii Even where the trustee is authorized to use trust assets to pay its attorneys' fees, **beneficiaries can usually challenge the reasonableness of those attorneys' fees after the fact**, which may result in an order requiring that the trustee refund some of the fees to the trust.[82] The court may also deny payment of fees from the trust when the court determines that the services did not benefit the trust, but rather the trustee.[83]
- iv **Careful consideration should be given to the issue of attorneys' fees in connection with any settlement, and the fee issue should be resolved *before* a trustee agrees to resign as part of a settlement**.

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[1] *See* Cal. Prob. Code § 15200, *et seq*. (requirements for creating a trust under California law); Fla. Stat. § 736.0403 (requirements for creating a trust under Florida law); N.Y. Est. Powers & Trusts Law §§ 7-1.14 - 7-1.17 (requirements for trusts and their execution under New York law).

[2] *See* Cal. Prob. Code § 17200 (permitting a trustee or beneficiary to petition California courts concerning the internal affairs of the trust or to determine the existence of a trust); Fla. Stat. § 736.0202 (jurisdiction of Florida courts over trusts, trustees and beneficiaries); Fla. Stat. § 736.0201(4) (providing that a judicial proceeding may determine any question arising in the administration or distribution of any trust, including questions of construction of trust instruments); N.Y. Surr. Ct. Proc. Act §§ 207, 209(6), 1501, 1509 (jurisdiction of New York courts over inter vivos and testamentary trusts).

[3] *See Bowen v. Bowen*, 2011 Utah App. LEXIS 347 (Utah Ct. App. Oct. 14, 2011); *In the Matter of Estate of Moncur*, 812 N.W.2d 485 (S.D. 2012).

[4] *See Jervis v. Tucker*, 82 So. 3d 126 (Fla. Dist. Ct. App. 2012).

[5] *See, e.g.*, Cal. Prob. Code § 15206 (requirements for establishing a trust in relation to real property); N.Y. Est. Powers & Trusts Law § 7-1.18 (requirements for transferring assets to a trust).

[6] In California, there may be procedures available to transfer assets into a trust if they were not transferred by the decedent, thereby obviating the need for a full-blown probate. *See, e.g.*, Cal. Prob. Code §§ 850, 13100, *et seq*.; *In re Estate of Heggstad*, 16 Cal. App. 4th 943 (Cal. Ct. App. 1993). Affidavits may also need to be filed with county recorders' offices on a county-by-county-basis to reflect a change in trustee holding title to real property. *See* Cal. Prob. Code §§ 15210, 18100, *et seq.*; Fla. Stat. § 736.0809 (requires the trustee to take reasonable steps to take control of and protect trust property); Fla. Stat. § 736.0810(3) (requires trustee to cause the trust property to be designated so that the interest of the trust appears in records maintained by a party other than a trustee or beneficiary); N.Y. Est. Powers & Trusts Law § 11-1.1(b)(5) (authorizes trustee to take possession of any trust property).

[7] Cal. Prob. Code §§ 16360, *et seq.* (providing for allocations between income and principal); Fla. Stat. § 738.501 (defining required allocations to principal); N.Y. Est. Powers & Trusts Law § 11-2.1 (providing for allocations between income and principal).

[8] In California, a trustee may be required to account in certain situations, while the trust instrument can waive some of these obligations. *See* Cal. Prob. Code §§ 16000 e*t seq.*, 16060 *et seq.*, 16460 *et seq.*, 17200. In Florida, a trustee has a duty to keep the "qualified beneficiaries" of the trust reasonably informed of the trust and its administration, to account annually and to provide an accounting upon any change of trustee. Fla. Stat. § 736.0813. In New York, a trustee is not required to account annually, but is, however, required to provide statements to any beneficiary receiving income or any person interested in the principal of the trust who requests such statement. N.Y. Surr. Ct. Proc. Act § 2306; *see also* N.Y. Surr. Ct. Proc. Act

§§ 2205 and 2208 (providing for compulsory and voluntary accountings); N.Y. Surr. Ct. Proc. Act § 1506 (relating to the non-liability of a trustee for acts of an executor, but in practice the same rule applies when a successor trustee assumes office); *see also* Turano & Radigan, *New York Estate Administration,* § 16.03[e] (2011). Some trust instruments absolve trustees from liability for a past trustee's errors.

9 *See* Cal. Prob. Code §§ 16002, 16003, 16045-54 (California Uniform Prudent Investor Act); N.Y. Est. Powers & Trusts Law § 11-2.3 (New York Prudent Investor Act); Fla. Stat. § 736.0901 (Florida Prudent Investor Act).

10 *See In re Estate of Boehm*, 816 N.W.2d 793 (N.D. 2012).

11 *In re Dwight*, 37 Misc. 3d 580 (N.Y. Surr. Ct. 2012).

12 Many states allow a trustee to resign by giving thirty days' notice to all beneficiaries of the trust, the settlor (if living) and all co-trustees. *See* Ala. Code § 19-3B-705(a); Ariz. Rev. Stat. § 14-10705(A); Ark. Code Ann. § 28-73-705(a); Fla. Stat. § 736.0705(1); 760 Ill. Comp. Stat. 5/12; Ind. Code § 30-4-3-29(b); Me. Rev. Stat. Ann. tit. 18-B, § 705; Mo. Rev. Stat. § 456.7-705(1); Mont. Code Ann. § 72-38-705(1); Neb. Rev. Stat. § 30-3861(a); N.H. Rev. Stat. Ann. § 564-B:7-705(a); N.M. Stat. Ann. § 46A-7-705(A); N.C. Gen Stat. § 36C-7-705(a); N.D. Cent. Code § 59-15-05(1); Ohio Rev. Code Ann. § 5807.05(A); Or. Rev. Stat. § 130.620; S.C. Code Ann. § 62-7-705(a); Tenn. Code Ann. § 35-15-705(a); Utah Code Ann. § 75-7-705(1); W. Va. Code § 44D-7-705(a). Some states require notice only to the beneficiaries and co-trustees, even if the settlor is living. *See* Alaska Stat. § 13.36.074; 12 Del. C. § 3326(a); Kan. Stat. Ann. § 58-705(a); Ky. Rev. Stat. § 386B.7-050(1). Other states do not require notice to the beneficiaries if the settlor still retains the power to revoke the trust. *See* Mass. Gen. Laws ch. 203E, § 705(a); N.D. Cent. Code § 59-15-05 (705)(1); Vt. Stat. Ann. tit. 14A, § 705; Va. Code Ann. § 64.2-758(A); Wyo. Stat. Ann. § 4-10-705.

13 *See* statutes cited in n. 12; *see also* Cal. Prob. Code § 15640, Conn. Gen. Stat. § 45a-242(b), 12 Del. C. § 3326(b), Ga. Code Ann. § 53-12-220(a), Iowa Code § 633A.4106(1), Md. Code Ann. § 14.5-705(a), Mich. Comp. Laws § 770.7705(1), N.Y. Est. Powers & Trusts Law § 7-2.6(a)(1), Okla. Stat. tit. 60, § 175.38, Pa. Cons. Stat. § 7765, Tex. Prob. Code Ann. § 113.081(a), W. Va. Code § 44D-7-705(b).

14 *See Hobbs v. Legg Mason Inv. Counsel & Trust Co.*, 2011 WL 39044 (N.D. Miss. Jan. 5, 2011), *modified on reconsideration*, 2011 WL 304421 (N.D. Miss. Jan. 25, 2011), where court allowed claim to proceed where trustees failed to file proper IRS forms related to the generation-skipping tax.

15 *See* n.8. In California, information required to be set forth in a trust accounting is governed by Probate Code Sections 1060, *et seq*. and 16063, although the particular form of such trust accounting may vary by jurisdiction. In Florida, information required to be set forth in a trust accounting is governed by Section 736.08135 of the Florida Statutes. *See also* N.Y. Surr. Ct. Proc. Act, Official Form JA-4 (sample trust accounting).

[16] Cal. Prob. Code § 15601 (a person named as trustee may in writing reject the trust, or may reject the trust by not affirmatively accepting within a reasonable time; a named trustee has no liability for rejecting the trust); Fla. Stat. § 736.0701(2) (providing that a person designated as a trustee who has not yet accepted the trusteeship may decline the trusteeship); N.Y. Surr. Ct. Proc. Act § 1504 (trustee may renounce appointment by acknowledged instrument).

[17] *See* Section II.B.

[18] *See* Cal. Prob. Code §§ 16060, 16062; Fla. Stat. § 736.0813 (describing the trustee's duty to inform and account in order to keep the qualified beneficiaries of a trust reasonably informed of the trust and its administration).

[19] Cal. Prob. Code § 16461.

[20] Cal. Prob. Code § 16460.

[21] Fla. Stat. § 736.1008.

[22] *See* N.Y. Surr. Ct. Proc. Act §§ 2306, 2309.

[23] *See* N.Y. Surr. Ct. Proc. Act § 2202.

[24] *See* n. 76, *supra*.

[25] Note that under California law, trustees may not increase their fees (including periodic base fee, rate of percentage compensation, minimum fee, hourly rate and transaction charges (but not extraordinary fees)) without giving 60 days' written notice to the beneficiaries. *See* Cal. Prob. Code § 1586(b). If the beneficiary files objections within that period, the fee cannot be increased until the court orders it or the petition is dismissed.

[26] *See* Cal. Prob. Code §§ 10810 (ordinary services with respect to the probate of an estate), 10811 (extraordinary services with respect to the probate of an estate); Fla. Stat. § 733.617 (providing a sliding scale for the compensation of a Personal Representative for ordinary services involved in estate administration); N.Y. Surr. Ct. Proc. Act §§ 2207(6), 2308, 2309, 2312, 2313 (various compensation provisions for trustees under New York law).

[27] *See* Cal. Prob. Code § 15681 (if the trust instrument does not specify the trustee's compensation, the trustee is entitled to reasonable compensation under the circumstances). Factors the court may use to determine "reasonable compensation" in California are found in California Rule of Court 7.776: (1) the gross income of the trust estate; (2) the success or failure of the trustee's administration; (3) any unusual skill, expertise, or experience brought to the trustee's work; (4) the fidelity or disloyalty shown by the trustee; (5) the amount of risk and responsibility assumed by the trustee; (6) the time spent in the performance of the trustee's duties; (7) the custom in the community where the court is located regarding compensation authorized by grantors, compensation allowed by the court, or charges of corporate trustees for trusts of similar size and complexity; and (8) whether the work performed was routine, or required more than ordinary skill or judgment. Florida law provides that "a trustee is entitled

to compensation that is *reasonable* under the circumstances" (emphasis added). Fla. Stat. § 736.0708. If a trust document provides for specific compensation to a trustee, the court may adjust that compensation if the duties of the trustee are substantially different than what was contemplated when the trust was created, or if the specified compensation would be unreasonably low or high. *Id.* at § 736.0708(2). *See also* N.Y. Surr. Ct. Proc. Act § 2114 (court may review compensation of corporate trustee for reasonableness).

[28] Cal. Prob. Code §§ 15680-81 (allowing extraordinary fees to be requested at any time). Even with fee requests that are uncontested, the court may still have "sticker shock" and disallow portions of the fee, especially when the rate charged is atypical for the geographic area. Note, however, that California courts are generally more permissive of extraordinary trustees' fees than they are of extraordinary attorneys' fees.

[29] Cal. Prob. Code § 15686(b) (requiring trustees to provide the beneficiaries with sixty days' notice prior to increasing trustee fees).

[30] Cal. Prob. Code § 15620 (providing that in California, if the trust is silent the trustees must act unanimously); Fla. Stat. § 736.0703(1) (providing that co-trustees who are unable to reach a unanimous decision may act by majority decision). In New York, where a trust has two trustees, they must act unanimously unless the trust agreement provides that a single trustee's decision trumps in the case of a deadlock. If there are three or more trustees, a majority of the trustees have the power to act. N.Y. Est. Powers & Trusts Law § 10-10.7. A dissenting trustee who promptly expresses such dissent in writing to the other co-trustees can avoid future liability for the actions taken by the majority of the trustees. *Id.* *See also* Restatement (Third) of Trusts § 39 ("Unless otherwise provided by the terms of the trust, if there are two trustees their powers may be exercised only by concurrence of both of them . . . but if there are three or more trustees their powers may be exercised by a majority").

[31] In California, trustees are permitted to delegate investment and management functions if prudent under the circumstances (Cal. Prob. Code § 16052), and may delegate to agents nearly any trust function (Cal. Prob. Code § 16247). However, a trustee may not to delegate the entire administration of a trust and must exercise proper supervision of agents and delegates. *See* Cal. Prob. Code §§ 16012, 16401; *see also* Fla. Stat. § 736.0703(5) (provides that a trustee may not delegate to another co-trustee the performance of a function the grantor reasonably expected the co-trustees to perform jointly, except that a co-trustee may delegate investment functions to a co-trustee); Fla. Stat. § 736.0807; N.Y. Est. Powers & Trusts Law § 11-2.3(c) (granting trustees the power to delegate investment or management functions).

[32] *See* Cal. Prob. Code § 15683 (unless the trust instrument otherwise provides or the trustees otherwise agree, if the trust has two or more trustees, the compensation shall be apportioned among the co-trustees according to the services rendered by them); N.Y. Surr. Ct. Proc. Act § 2313 (imposing a two-commission cap unless the trust provides otherwise, and allowing for apportionment of the commission among the trustees according to the services rendered unless they have agreed in writing otherwise but limiting any one trustee to not more than one full commission).

[33] Trustees may also consider whether such a provision will be enforceable in the relevant jurisdiction. For example, in New York, exculpatory clauses in Wills are contrary to public policy and are void. N.Y. Est. Powers & Trusts Law § 11-1.7.

[34] California, Florida and New York have adopted the Uniform Prudent Investor Act. *See* Cal. Prob. Code §§ 16002, 16003, 16045-54; Fla. Stat. § 518.11; N.Y. Est. Powers & Trusts Law § 11-2.3; discussion in BNA Portfolio 861 T.M. VI.A.

[35] *See* discussion of petitioning a court for instructions in Section IV.B.

[36] *See* Cal. Prob. Code §§ 16003, 16335; Fla. Stat. § 736.0803; N.Y. Est. Powers & Trusts Law §§ 11-A-1.3, 11-2.3 (providing that if a trust has two or more beneficiaries, the trustee must act impartially, giving due regard to the beneficiaries' respective interests).

[37] *See* Cal. Prob. Code § 16002; Fla. Stat. § 736.0802(1); *Boles v. Lanham*, 865 N.Y.S.2d 360 (N.Y. App. Div. 2008) (the trustee's duty of loyalty requires that the trustee administer the trust solely for the interests of the beneficiaries).

[38] *Carlson v. Wells*, 705 S.E.2d 173 (Va. 2014).

[39] *Carter v. Carter*, 2012 Ill. App. LEXIS 84 (Ill. App. Ct. Feb. 7, 2012).

[40] *Karo v. Wachovia Bank, N.A.,* 712 F. Supp. 2d 476 (E.D. Va. 2010).

[41] *In re Hyde*, 44 A.D.3d 1195 (N.Y. App. Div. 2007).

[42] *See* discussion of petitioning a court for instructions in Section IV.B.

[43] *See* Cal. Prob. Code §§ 1600-01, 16335, 16046 (regarding a trustee's duty to administer the trust according to the trust instrument and the directions of the grantor); Fla. Stat. § 736.1009; N.Y. Est. Powers & Trusts Law §§ 11-A-1.3(a), 7-1.17(b) (providing that a trustee who acts in reasonable reliance on the terms of the trust as expressed in the trust instrument is not liable to a beneficiary for a breach of trust to the extent the breach resulted from the reliance).

[44] *See* discussion of petitioning a court for instructions in Section IV.B, *infra.*

[45] *See, e.g.,* Cal. Prob. Code §§ 16003, 16335 (regarding a trustee's duty to administer a trust impartially, taking into account the differing interests of the beneficiaries, to the extent the trust instrument does not provide otherwise); Fla. Stat. § 736.0803 (providing, in the absence of language to the contrary, that the trustee must give due regard to the beneficiaries' respective interests if there are two or more beneficiaries of a trust); *see also* N.Y. Est. Powers & Trusts Law § 11-2.1(a)(1) ("[a] trust shall be administered with due regard to the respective interests of income beneficiaries and remaindermen").

[46] In California, trustees must file Form 541 as well as a separate Schedule K-1 (541) or Franchise Tax Board (FTB) approved substitute for each beneficiary. The application of California's income tax rules to trusts is a complex web based on the combination of (a) the situs of the trust's assets, (b) the residency (or nonresidency) of the trustees, (c) the residency

(or nonresidency) of the beneficiaries, and (d) the nature of the beneficiaries' interest in the trust. *See generally,* Cal. Rev. & Tax. Code §§ 17062, 17742-44, 17951-52, 18505. The New York trust income tax returns are Form IT-205 (for New York resident trusts) and Form IT-205-A (for (1) a nonresident trust having New York State source income, (2) a part-year resident trust or (3) a resident trust with a New York State nonresident beneficiary). *See* N.Y. Tax Law §§ 601, 602, 618, 619, 633 and 634. Florida does not have a state income tax.

[47] *See* N.Y. Tax Law §§ 631-639.

[48] The trustees are prohibited from selling the residence to the grantor, grantor's spouse or an entity controlled by the grantor or grantor's spouse. Treas. Reg. § 25.2702-5(c)(9).

[49] *See* California Franchise Tax Board Form 541 and instructions for fiduciaries making estimated income tax payments. *See also* New York Form IT-206-I and Form IT-2106 for the instructions and form for fiduciaries making estimated income tax payments.

[50] Note that payments to children from the Survivor's Trust will be treated as a gift by the survivor, and no distributions to children may be made from the Marital Trust during the survivor's lifetime.

[51] *See, e.g., Peck v. Peck*, 133 So. 3d 587 (Fla. Dist. Ct. App. 2014).

[52] *See* Ala. Code § 19-3B-412(a); Alaska Stat. § 13.36.345(a); Ariz. Rev. Stat. § 14-10411(C); Ark. Code Ann. § 28-73-412(a); Cal. Prob. Code § 15409(a); Colo. Rev. Stat. § 15-11-806; 12 Del. C. § 3541; D.C. Code § 19-1304.12(a); Fla. Stat. § 736.04113; Ga. Code Ann. § 53-12-62; Haw. Rev. Stat. § 554A-5(a); Ind. Code § 30-4-3-24.4(a); Iowa Code § 633A.2204; Kan. Stat. Ann. § 58a-412(a); Ky. Rev. Stat. Ann. § 386B.4-120; La. Rev. Stat. Ann. § 9:2026(1); Me. Rev. Stat. Ann. tit. 18-B, § 412(1); Mass. Gen. Laws ch. 203E § 412; Mich. Comp. Laws Ann. § 700.7412; Minn. Stat. § 501C.0412 (effective January 1, 2016); Miss. Code Ann. § 91-8-412; Mo. Rev. Stat. § 456.4-412; Mont. Code Ann. § 72-38-412; Neb. Rev. Stat. § 30-3838; Nev. Rev. Stat. § 153.031; N.H. Rev. Stat. § 564-B:4-412; N.M. Stat. Ann. § 46A-4-412; N.C. Gen. Stat. § 36C-4-412; N.D. Cent. Code § 59-12-12; Ohio Rev. Code Ann. § 5804.12; Or. Rev. Stat. § 130.205; Pa. Cons. Stat. § 7740.2; S.C. Code Ann. § 62-7-412; S.D. Codified Laws § 55-3-26; Tenn. Code. Ann. § 35-15-412; Tex. Prob. Code Ann. § 112.054; Utah Code Ann. § 75-7-412; Vt. Stat. Ann. § 412; Va. Code Ann. § 64.2-730; W. Va. Code § 44D-4-412; Wis. Stat. § 701.0412; Wyo. Stat. Ann. § 4-10-413; Unif. Trust Code § 412. Courts of equity in the following states allow such an action: Connecticut (*Connecticut Bank & Trust Co. v. Coffin*, 212 Conn. 678 (1989)); Illinois (*Thorne v. Cont'l Illinois Nat'l Bank & Trust Co. of Chicago*, 151 N.E.2d 398 (Ill. App. Ct. 1958)); Maryland (*Probasco v. Clark*, 474 A.2d 221 (Md. Ct. Spec. App. 1984)); Oklahoma (*Nail v. Am. Nat'l Bank of Bristow*, 21 F. Supp. 385 (N.D. Okl. 1937)); Rhode Island (*Prince v. Lynch*, 2006 WL 1073413 (R.I. Apr. 20, 2006)); Washington (*In re Riddell*, 157 P.3d 888 (Wash. Ct. App. 2007)).

[53] *See Donohue v. Brightman*, 939 So. 2d 1162, 1164 (Fla. Dist. Ct. App. 2006).

[54] IRC §§ 877A(g), 2801.

[55] *See* Prop. Reg. § 28.2801-1

[56] *See* Treas. Reg. § 1.643(b)-1.

[57] New York applies the 65-day rule. *See* N.Y. Tax Law § 601(e)(4) (indicating that a trust's New York adjusted gross income is its federal adjusted gross income with various modifications).

[58] Cal. Prob. Code §§ 16336.4–16336.6 (procedure to convert a trust to a unitrust, and to reconvert a unitrust or change the payout percentage) ; Fla. Stat. § 738.1041 (conversion of income trust to total return unitrust); N.Y. Est. Powers & Trusts Law § 11-2.4 (granting a trustee the power to treat the trust as a unitrust).

[59] *See* Cal. Prob. Code § 16336.6; Fla. Stat. § 738.1041(3); *see also* N.Y. Est. Powers & Trusts Law § 11-2.4(e)(2)(A).

[60] *See* Cal. Prob. Code § 16336; Fla. Stat. § 738.104; N.Y. Est. Powers & Trusts Law § 11-2.3(5).

[61] *See* Section IV, *infra*.

[62] *See* Bogert, The Law of Trusts and Trustees § 941; Restatement (Third) of Trusts § 97; *In re Mendleson's Will*, 261 N.Y.S.2d 525 (N.Y. Surr. Ct. 1965) (income beneficiary who consented to trustee's payment of certain taxes, commissions and a fee from income could not later object to payment upon trustee's accounting); *Matter of Goldstick*, 581 N.Y.S.2d 165, 177-78 (N.Y. App Div. 1992) (beneficiary who initially approved trust loan to her mother was estopped from challenging the trustee's action).

[63] *See* Ala. Code § 19-3B-1009; Ariz. Rev. Stat. § 14-11009; Ark. Code Ann. § 28-73-1009; Cal. Prob. Code § 16463; 12 Del. C. § 3588; D.C. Code § 19-1310.09; Fla. Stat. § 736.1012; Ind. Code § 30-4-3-19; Iowa Code § 633A.4506; Kan. Stat. Ann. 8a-1009; Ky. Rev. Stat. § 386B.10-090; La. Rev. Stat. Ann. 9:2207; Me. Rev. Stat. Ann. tit. 18-B, § 1009; Md. Code Ann., Est. & Trusts § 14.5-907; Mass. Gen. Laws ch. 203E § 1009; Mich. Comp. Laws 700.7909; Miss. Code Ann. § 91-8-1009; Mo. Rev. Stat. 456.10-1009; Mont. Code Ann. 72-38-1009; Neb. Rev. St. § 30-3898; Nev. Rev. Stat. 163.170; N.H. Rev. Stat. § 564-B:10-1009; N.M. Stat. Ann. § 46A-10-1009; N.C. Gen. Stat. § 36C-10-1009; N.D. Cent. Code § 59-18-09; Ohio Rev. Code Ann. § 5810.09; Okla. Stat. tit. 60, § 175.57(G); Or. Rev. Stat. § 130.840; 20 Pa. Cons. Stat. § 7789; S.C. Code Ann. § 62-7-1009; S.D. Codified Laws § 55-4-31; Tenn. Code Ann. § 35-15-1009; Utah Code Ann. 1953 § 75-7-1009; 14A Vt. Stat. Ann. § 1009; Va. Code Ann. § 64.2-800; Wash. Rev. Code Ann. 11.98.108; W. Va. Code § 44D-10-1009; Wis. Stat. 701.1009; Wyo. Stat. Ann. § 4-10-1009 (Wyoming); Unif. Trust Code § 1009.

[64] *See In re Saxton*, 712 N.Y.S.2d 225, 231 (N.Y. App. Div. 2000) (holding consent to act that "essentially amounts to mismanagement" ineffective where no evidence that beneficiaries were fully informed); *In re Grotenrath's Estate*, 258 N.W. 453 (Wis. 1935) (acquiescence to investment cannot be inferred unless beneficiary has actual knowledge of the facts); *St. Germain v. Tuttle*, 44 A.2d 137, 1243 (Vt. 1945) (consent by life tenant to trustee's investment was not binding on remainderman); *In re Walding*, 320 So. 2d 687 (Ala. App. 1975) (consent by minor children ineffective, and mother's consent did not bind the children).

[65] Courts of equity in the following states allow such an action: Alabama (*Adams v. Farlow*, 516 So. 2d 528 (Ala. 1987), *cert. denied,* 485 U.S. 1010); Arizona (*Bell v. Bell*, 39 P.2d 629 (Ariz. 1934)); Arkansas (*Arkansas Baptist State Convention v. Bd. of Trustees of Baptist State Hosp.*, 189 S.W.2d 913, 916 (Ark. 1945)); California (*In re Van Deusen's Estate*, 182 P.2d 565 (Cal. 1947)); Colorado (*In re Estate of Daniels,* 665 P.2d 594 (Colo. 1983)); Delaware (*In re Estate of Crist*, 863 A.2d 255, 256 (Del. Ch. 2004), *aff'd*, 879 A.2d 602 (Del. 2005)); Florida (*Kane v. Hutchinson*, 718 So. 2d 938 (Fla. Dist. Ct. App. 1998)); Hawaii (*Bishop v. Pittman*, 33 Haw. 647 (Haw. 1935)); Illinois (*Stone v. Baldwin*, 73 N.E.2d 635 (Ill. App. Ct. 1947)); Indiana (*Lowe v. Johnson*, 469 N.E.2d 768 (Ind. Ct. App. 1984)); Kentucky (*Vander Boegh v. Bank of Oklahoma, N.A.*, 394 S.W.3d 917 (Ky. Ct. App. 2013)); Maryland (*Benadom v. Colby*, 567 A.2d 463 (Md. Ct. Spec. App. 1989)); Massachusetts (*Cronan v. Cronan*, 190 N.E. 721 (Mass. 1934)); Michigan (*In re Estate of Butterfield*, 341 N.W.2d 453 (Mich. 1983)); Minnesota (*Butler v. Butler*, 230 N.W. 575 (Minn. 1930)); Missouri (*State ex rel. St. Louis Union Trust Co. v. Sartorius*, 164 S.W.2d 356 (Mo. 1942)); Nebraska (*In re Trust of Alexis*, 744 N.W.2d 514, 517 (Neb. Ct. App. 2008)); New Hampshire (*Merrow v. Merrow*, 193 A.2d 19 (N.H. 1963)); New York (*Heyman v. Herman*, 33 N.Y.S.2d 235 (N.Y. Sup. Ct. 1942)); North Carolina (*Commercial Nat. Bank of Charlotte v. Alexander*, 125 S.E. 385 (N.C. 1924)); Ohio (*Sessions v. Skelton*, 127 N.E.2d 378 (Ohio 1955)); Rhode Island (*Worrell v. Beach*, 7A.2d 666 (R.I. 1924)); Utah (*In re Fisk's Estate*, 95 P.2d 502 (Utah 1939)); Vermont (*President & Fellows of Middlebury College v. Town of Hancock*, 55 A.2d 194 (Vt. 1947)); West Virginia (*Arnold v. Arnold*, 24 S.E.2d 102 (W. Va. 1943)).

[66] *See* Cal. Prob. Code § 17200; Conn. Gen. Stat. § 52-251; Fla. Stat. § 736.0201(4); Ga. Code Ann. § 53-12-6; Idaho Code § 10-1204; Ind. Code § 30-4-3-18; Iowa Code Ann. § 633A.6202(f); Kan. Stat. Ann. § 58a-201; La. Rev. Stat. Ann. § 9:2233; Me. Rev. Stat. Ann. tit. 14, § 6051; Mass. Gen. Laws ch. 240, §§ 27, 28; Minn. Stat. § 501B.16(23); Miss. Code. Ann. § 91-8-201; Mo. Rev. Stat. §§ 527.010 – 527.140; Mont. Code Ann. § 72-38-213; Nev. Rev. Stat. Ann. § 153.031(g); N.J. Stat. Ann. §§ 2A:16-53, 2A:16-55, 3B:14-24; N.M. Stat. Ann. § 46A-2-201; N.D. Cent. Code § 59-10-01; N.Y. Surr. Ct. Proc. Act §§ 202 (general jurisdiction to provide advice and direction), 2107(2) (fiduciary can seek advice and direction regarding extraordinary circumstances); Ohio Rev. Code Ann. § 2107.46; Okla. Stat. Ann. tit. 60, § 175.23; Or. Rev. Stat. Ann. § 130.050; Tenn. Code Ann. § 35-15-201; Tex. Prob. Code Ann. § 115.001; S.C. Code Ann. § 15-53-50; S.D. Codified Laws § 55-13A-105; Va. Code Ann. § 64.2-710; Wash. Rev. Code § 11.96.070; W. Va. Code §§ 44-6-3, 44-6-4.; Wis. Stat. Ann. § 701.0201; Wyo. Stat. Ann. § 1-37-105.; Unif. Trust Code § 201. The Uniform Trust Code has been enacted by Alabama, Arizona, Arkansas, Florida, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Pennsylvania, Tennessee, Utah, Virginia, West Virginia, Wisconsin and Wyoming.

[67] *See, e.g.*, Cal. Prob. Code § 17203 (persons entitled to notice); Fla. Stat. § 736.0109(4) ; N.Y. Surr. Ct. Proc. Act § 1420 (this section is applicable to trusts by virtue of N.Y. Surr. Ct. Proc. Act § 1501(1)(c)).

[68] *See Estate of Campbell*, 38 Haw. 573 (Haw. 1950); *Nairn v. Stemmler*, 309 N.E.2d 237 (Ill. App. Ct. 1974).

69 *See Anderson v. Dimick*, 77 So. 2d 867 (Fla. 1955).

70 *See In re Smith*, 47 A.2d 521 (Conn. 1946); *In re Clement Trust*, 679 N.W.2d 31, 39 (Iowa 2004); *McEntee v. Halloran*, 391 S.W.2d 266 (Mo. 1965); *City Bank Farmers Trust Co. v. Smith*, 189 N.E.222 (N.Y. 1934); *In re Revmann's Estate*, 12 A.2d 350 (Pa. 1940); *Benadom v. Colby*, 567 A.2d 463 (Md. Ct. Spec. App. 1989).

71 Warren's Heaton on Surrogate's Court Practice § 2.26 [6] (7th ed. 2014), *citing In re Ostendorg,* 349 N.Y.S.2d 275 (N.Y. Surr. Ct. 1973).

72 *See* Ariz. Rev. Stat. § 14-7431; Cal. Prob. Code § 16500, *et seq.*; Colo. Rev. Stat. § 15-1-405; Haw. Rev. Stat. § 557A-105; Idaho Code § 68-10-105; Ind. Code 30-2-14-16; Mont. Code Ann. 72-38-130, *et seq.*; Neb. Rev. Stat. § 30-3121; Nev. Rev. Stat. 164.725; Or. Rev. Stat. § 130.733; Tenn. Code Ann. § 35-6-105; Utah Code Ann. 1953 § 22-3-107; W. Va. Code § 44B-1-105; Wis. Stat. 701.1105; Wyo. Stat. Ann. § 2-3-805.

73 Many states allow interested persons to submit a nonjudicial settlement agreement to the Court for approval and, in some cases, entry as a court order. *See* Ala. Code § 19-3B-111; Ariz. Rev. Stat. § 14-10111; Ark. Code Ann. § 28-73-111; Cal. Prob. Code § 17200; 12 Del. C. § 3388; D.C. Code § 19-1301.11; Fla. Stat. § 736.0111; Idaho Code Ann. §§ 15-8-303, 15-8-304; Iowa Code Ann. § 633A.6308; Kan. Stat. Ann. 58a-111; Ky. Rev. Stat. Ann. § 386B.1-090; Me. Rev. Stat. Ann. tit. 18-B, § 111; Mich. Comp. Laws 700.7111; Minn. Stat. Ann. § 501C.0111; Miss. Code Ann. § 91-8-111; Mo. Rev. Stat. 456.1-111; Mont. Code Ann. 72-38-111; Neb. Rev. Stat. § 30-3811; N.H. Rev. Stat. § 564-B:1-111; N.M. Stat. Ann. § 46A-1-111; N.D. Cent. Code 59-09-11; Or. Rev. Stat. § 130.045; 20 Pa. Cons. Stat. § 7710.1; S.C. Code Ann. § 62-7-111; Tenn. Code Ann. § 35-15-111; Utah Code Ann. 1953 § 75-7-110; Vt. Stat. Ann. tit. 14A, § 111; Va. Code Ann. § 64.2-709; W.Va. Code § 44D-1-111; Wash. Rev. Code § 11.96A.230; Wis. Stat. 701.0111; Wyo. Stat. Ann. § 4-10-111; Unif. Trust Code § 111.

74 *See* Ariz. Rev. Stat. § 14-10205; Fla. Stat. § 731.401; Mo. Rev. Stat. 456.2-205; N.H. Rev. Stat. § 564-B:1-111A; S.D. Codified Laws § 55-1-54; *Rachal v. Reitz*, 403 S.W.3d 840 (Tex. 2013) (holding arbitration clause in trust instrument binding on beneficiaries); *but see, In re Calomiris*, 894 A.2d 408 (D.C. Ct. App. 2006) (holding arbitration clause in trust instrument not binding on beneficiaries). In California, a decision of the Court of Appeal finding an arbitration clause in a trust instrument not binding on the beneficiaries was vacated by the Supreme Court and remanded for reconsideration, but the case was settled before any further decision was entered. *See Diaz v. Bukey*, 125 Cal. Rptr. 3d 610 (Cal. Dist. Ct. App.), *vacated and remanded*, 287 P.3d 67 (Cal. 2012). A later decision of the Court of Appeal declined to enforce a trust arbitration clause against the beneficiaries. *McArthur v. McArthur*, 168 Cal. Rptr. 3d 651 (Cal. Dist. Ct. App. 2014). While New York courts have long held that arbitration of disputes pertaining to the distribution of a decedent's estate violates public policy, *see In re Berger*, 81 A.D.2d 584 (N.Y. App. Div. 1981); *Swislocki v. Spiewak*, 273 A.D. 768 (N.Y. App. Div. 1947); *Bauer v. Bauer*, 2014 WL 3360106, at *1 (N.Y. Sup. Ct. July 3, 2014); *Milnes v. Salomon Smith Barney, Inc.*, 2002 WL 31940718 (N.Y. Surr. Ct. Oct. 11, 2002); *In re Will of Jacobowitz*, 58 Misc.2d 330 (N.Y. Surr. Ct. 1968), the rationales of these cases would not preclude the enforceability of

arbitration clauses against trust beneficiaries. *See also* N.Y. C.P.L.R. 7512 (executor bound by arbitration clause signed by decedent); *but see* N.Y. C.P.L.R. 1209 (prohibiting arbitration of matters involving infants or incapacitated persons except upon court order).

[75] *See* Wills and Trusts Arbitration Rules & Mediation Procedures, available online at www.adr.org/commercial.

[76] *Petition of Bronner*, 2012-2271 (NYLJ 1202750375154, at *1 (N.Y. Surr. Ct., January 15, 2016).

[77] *See* Ala. Code § 19-3B-709; Alaska Stat. § 13.36.078; Ariz. Rev. Stat. § 14-10709; Ark. Code Ann. § 28-73-709; Cal. Prob. Code §§ 15684, 15685; 12 Del. C. § 3325(6); D.C. Code § 19-1307.09; Fla. Stat. § 736.0709; Ind. Code 30-4-5-16; Kan. Stat. Ann. 58a-709; Ky. Rev. Stat. § 386B.7-090; Me. Rev. Stat. Ann. tit. 18-B, § 709; Md. Code Ann., Est. & Trusts § 14.5-709; Mass. Gen. Laws ch. 203E § 709; Mich. Comp. Laws Ann. 700.7709; Minn. Stat. Ann. § 501C.0709; Miss. Code Ann. § 91-8-709; Mo. Rev. Stat. 456.7-709; Mont. Code Ann. 72-38-709; Neb. Rev. Stat. § 30-3865; N.H. Rev. Stat. § 564-B:7-709; N.M. Stat. Ann. § 46A-7-709; N.Y. Surr. Ct. Proc. Act § 2110(2); N.C. Gen. Stat. Ann. § 32-58; N.D. Cent. Code 59-15-09; Ohio Rev. Code Ann. § 5807.09; 20 Pa. Cons. Stat. § 7769; S.C. Code Ann. § 62-7-709; Tenn. Code Ann. § 35-15-709; Tex. Prop. Code Ann. § 114.063; Utah Code Ann. 1953 § 75-7-709; 14A Vt. Stat. Ann. § 709; Va. Code Ann. § 64.2-762; W. Va. Code § 44D-7-709; Wis. Stat. 701.0709; Wyo. Stat. Ann. § 4-10-709; Unif. Trust Code § 709. *See In re Hart's Will*, 43 N.Y.S.2d 488, 493 (N.Y. Surr. Ct. 1937) (holding under New York law trustee entitled to lien against estate for amounts advanced for attorneys' fees).

[78] *Id.*

[79] Restatement (Third) of Trusts § 38, cmt. b ("Before distributing income or principal of the trust, the trustee may withhold funds for such reimbursement or for appropriate compensation); Bogert, The Law of Trusts and Trustees § 718 (explaining that "the word 'lien' is used because the trustee is entitled to retain possession of trust property until he or she has been paid the amount due for advances").

[80] Fla. Stat. § 736.0802(10).

[81] *See* Cal. Prob. Code § 17211(b) (providing for payment of beneficiary's fees by trustee individually where court finds trustee's opposition to beneficiary's challenge to trustees' account was made in bad faith); Fla. Stat. § 736.0802(10)(b) (authorizing court to enter order prohibiting payment of trustee's attorney fees from trust assets where the trustee engaged in a breach of trust).

[82] *See* Fla. Stat. §§ 736.0206 (authorizing court to review trustee's retention of outside professionals and reasonableness of fees paid to them), 736.1007(6) (authorizing court to review compensation paid or to be paid to trustee's attorney); N.Y. Surr. Ct. Proc. Act § 2110(1) (authorizing court at any time to fix and determine compensation of an attorney for services rendered to a fiduciary).

[83] *See Brigham v. Brigham*, 934 So. 2d 544 (Fla. Dist. Ct. App. 2006) (holding burden is on trustee to demonstrate that fees were spent for the benefit of the trust, rather than trustee individually); *Graddick v. First Farmers & Merchs. Nat'l Bank of Troy*, 453 So.2d 1305, 1311-12 (Ala. 1984) (vacating award of fees from trust assets and remanding so trustee could demonstrate the fees were for the benefit of the trust); *see also In re Bacharach*, 211 N.Y.S. 2d 230 (N.Y. App. Div. 1961) (where attorney's services benefitted only the contestants, the contestants, not the estate, were held to be responsible for attorneys' fees).