DRAFTING TO AVOID LITIGATION[1]

Angela M. Adams
Law Office of Wm. Fletcher Belcher
St. Petersburg, Florida
February 7, 2019

I. INTRODUCTION

A. "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."[2]

B. Issues arise when trust provisions are ambiguous, unclear, or do not address a situation that arises during administration. More thoughtful, careful drafting can reduce litigation between fiduciaries and beneficiaries, or the need for sometimes less adversarial (but still expensive) construction or modification proceedings.

C. Always remember: A litigator reads a trust instrument with different eyes than a drafter.

II. EXAMPLES OF TOPICS WHERE CAREFUL, THOUGHTFUL DRAFTING CAN PROVIDE GUIDANCE AND REDUCE THE NEED FOR LITIGATION

A. Trust Purpose

It is not unusual to see a trust provision making reference to the "purpose of this trust." Nor is it unusual for such a trust to fail to contain any statement of purpose, leaving the trustee, beneficiaries, and their respective counsel to opine on the settlor's intended purpose of the trust.

Additionally, several sections of the Florida Trust Code refer to the purpose or purposes of the trust, e.g., §736.736.0108 (Principal place of administration); §736.0404 (Trust purposes); §736.04113 (Judicial modification of irrevocable trust when modification is not inconsistent with settlor's purpose); §736.04115 (Judicial modification of irrevocable trust when modification is in best interests of beneficiaries); §736.0414 (Modification or termination of uneconomic trust); §736.0417 (Combination and division of trusts); §736.0703 (Cotrustees); §736.0706 (Removal of trustee); §736.0801 (Duty to administer trust); §736.0804 (Prudent

[1] The author greatly appreciates and acknowledges the use of some of the materials on this subject prepared by Michael Dribin, James R. George, and Jennifer Robinson.

[2] F.S. §736.1009

administration); §736.0805 (Expenses of administration); §736.0807 (Delegation by trustee); §736.0808 (Powers to direct); §736.0814 (Discretionary powers; tax savings); §736.1011 (Exculpation of trustee). Perhaps a short statement of the trust's purpose(s) would be useful.

B. Trustees and Successor Trustees

1. Power to remove and replace. While the ability to remove and replace an unreasonable or expensive trustee may avoid litigation, careful consideration should be given to the following: Who has the power? How is it exercised? How does successor step in? What happens to the power if the power holder dies or becomes incapacitated? If a beneficiary or group of beneficiaries is given the power to remove and replace the trustee, will there be a revolving door until the beneficiaries get a trustee that simply does whatever they demand?

2. *Dowdy v. Dowdy*, 182 So.3d 807 (Fla. 2d DCA 2016).

Husband and wife created the Dowdy Family Trust which contained the following provision regarding trustee succession:

> "In the event of the death of each of the initial trustees, Dennis R. Dowdy and Betty L. Dowdy, the settlors nominate and appoint Settlors' son and stepson to serve as co-trustees…".

Does the provision mean that both of the initial trustees must be dead before the successors step in, or does it mean that the death of either initial trustee triggers the appointment of the successors? The case turned on who the trustee(s) were or should be in the quoted provision, and the trust provision had to be construed up to the appellate court level. The Second District construed the provision as meaning upon the death of both of the initial trustees, which permitted the surviving spouse, as sole trustee and lifetime beneficiary, to sell trust property for her own benefit.

3. Incapacity triggering succession

How is incapacity defined?

Letter from physician

C. Revocability of Trust Upon the Death of the First of Multiple Settlors

It is not uncommon for spouses to be the settlors of a revocable trust, but do they intend for the trust to remain revocable and amendable after the death of the first spouse to die? What about upon the incapacity of one spouse? Take, for example, the language in the *Dowdy* case (above).

D. Family

1. Divorce

a. Failing to plan for divorce

Entrepreneur spouse ("E") develops successful business or patents the next great widget and makes tens of millions of dollars (or more). E wisely engages a skilled estate planning attorney to prepare an estate plan to provide for non-entrepreneur spouse ("S") and the children of E & S, as well as to minimize inheritance taxes. That estate plan includes one or more irrevocable trusts. At least one of the irrevocable trusts specifically authorizes the trustee to make discretionary distributions of principal and income to the beneficiaries who are S and the lineal descendants of E and S. That trust also names S (the non-entrepreneur spouse) as trustee and the oldest child as successor trustee.

E also creates a grantor trust of which E is trustee and S is a beneficiary. Everyone is rich and happy, and E never renders any accountings to the beneficiaries.

A few years down the road, S (the non-entrepreneur spouse) files a petition for dissolution of marriage.

Problems include:

- While the estate plan brilliantly minimized inheritance taxes and provided all the usual tax benefits, it failed to make any provisions in the event of separation, divorce, or the filing of petitions for such relief.

- The children take sides in the divorce and the child designated as successor trustee of the irrevocable trust sides with S.

- S sues E as trustee of the grantor trust for breach of trust based upon E's failure to account and seeks removal of E as trustee.

To avoid these and other problems, the attorney drafting an irrevocable trust must include provisions for what happens in the event of separation or divorce.

b. F.S. §732.507(2) and *Carroll v. Israelson, as Personal Representative*, 169 So. 3d 239 (Fla. 4th DCA 2015).

Section 732.507(2) protects divorced persons from their inattention to estate planning details or inability to change their estate plan. The statute provides:

> Any provision of a will executed by a married person that affects the spouse of that person shall become void upon the divorce of that person or upon the dissolution or annulment of the marriage. After the dissolution, divorce, or annulment, the will shall be administered and construed as if the former spouse had died at the time of the dissolution, divorce, or annulment of the marriage, unless the will or the dissolution or divorce judgment expressly provides otherwise.

In the *Carroll* case, the former husband's will left the residue of his estate to his ex-spouse's niece and nephew if the ex-spouse predeceased him. "The appellees contend that the second sentence of section 732.507(2) allowed the circuit court to treat [the ex-spouse] as if she died, so that her family's inheritance would proceed through her trust. This application of the statute would nullify the provision of the first sentence that, "upon divorce," renders "void" those will provisions that affect a former spouse."

2. Same-sex marriages. Although the law is now clear regarding the validity of same-sex marriages, what if the client does not wish to recognize same-sex marriage? Would a prohibition be unenforceable as against public policy?

3. Descendants

   a. Adoption

      How does the settlor want adopted children to be treated?

      Does it matter how old the "child" is at the time the adoption is effective?

      What about a child that is raised by a relative, but is never legally adopted? Is this person to be treated as a child of the relative?

      What if a person's biological child is adopted by another person?

b. Illegitimate children

"Approximately 24 percent of the nation's children are born to cohabiting couples, which means that more children are currently born to cohabiting couples than to single mothers."[3]

c. Assisted Reproductive Technology and Surrogates

Drafters should routinely consider including provisions dealing with the inheritance rights of children conceived through ART, especially if creating a long-term trust.

d. Generally, the rules that have developed in case law and the statutes to address the above and other questions can be overridden or changed by appropriate drafting estate planning documents, but the drafter must discuss these issues with the client. In considering these issues, remember that it is becoming more common for trusts to last for generations.

e. Undisclosed children

What if the client has a spouse, two children with the spouse and a child from a nonmarital relationship that neither his spouse or their children know about, and the client wants that information to remain confidential, but still provide for that third child? While the drafter can make separate arrangements for the third, undisclosed child, and arrangements for the spouse and other children, the drafter will have to be very careful in the documents to identify the beneficiaries, limit the term "descendants," avoid the use of the word "heirs" unless it is defined so as to exclude the third child.

E. Tangible Personal Property

Although there are those clients with items of tangible personal property having significant value (art, jewelry, antiques, collections, etc.), many estates and trusts include tangible personal property of modest or little value. Yet, it is this relatively worthless "stuff" that causes some of the biggest disputes among beneficiaries. Too many attorneys just include boiler plate tangible personal property clauses without giving much thought to these often troublesome assets.

[3] *See* Waggoner, "Marriage is on the Decline and Cohabitation is on the Rise: At What Point, If Ever, Should Unmarried Partners Acquire Marital Rights?", 50 Fam. L.Q. No. 2 (Summer 2016).

1. Suggestions to Avoid Problems with Tangible Property

- Talk to the client and inquire about their TPP. Ask them what types of TPP they own.

- Ask them who should receive the TPP.

- Ask them if they anticipate there being any problems or issues with that disposition.

- Inquire if there are certain pieces of TPP that more than one beneficiary may want. If so, inquire how the client would want such a dispute to be resolved.

- Encourage the client to complete a separate writing pursuant to F.S. §732.515 directing the disposition of TPP and explain to them what has to be included in order to have a valid separate writing.

- Find out what should happen to the TPP that no one wants? Can it be sold? Can it be donated?

- Discuss whether the estate/trust will pay to pack and ship items to beneficiaries? What if there are large pieces such as furniture? What about the cost of insurance?

- Thoughtful drafting.

2. Examples of "Standard Clauses" and Their Problems

a. **I devise certain items of my tangible personal property in accordance with a written statement which I shall have prepared prior to my death in conformity with Florida law. My Personal Representative may assume that no written statement exists if none is found within thirty (30) days after the issuance of Letters of Administration. Except as otherwise provided in the written statement, I devise the balance of my personal and household effects and other tangible personal property, together with any insurance policies thereon, to my children who survive me, in equal shares.**

How do you distribute TPP in equal shares? Is this based on monetary value? Will an appraisal be needed? Is equal value really what the testator intended? What about sentimental value? Does that factor in? If so, how?

b. **The division, if any, of my tangible personal property among my children shall be made in such manner as my children shall agree among themselves.**

What if they don't agree? If the drafting attorney uses an "agreement" clause, then he/she should also include a mechanism to resolve disagreements over TPP. For example, "if my beneficiaries cannot agree then. . . [one of the following solutions]":

- The property will be sold after XX days.
- Lovely Lucy is nominated to make a final decision (be sure to name a back-up person). Note that you could say the tie breaker will be the PR but often times the PR is a beneficiary and may be one of the parties arguing over TPP – should he/she get to decide the dispute?
- The competing beneficiaries shall submit a sealed bid on the item(s) and the highest bidder wins.
- Assign each beneficiary a position and allow each beneficiary to choose one item in that assigned order. Reverse the order and then the beneficiaries each get to choose another item. Repeat using the numbers in sequential order and then again the numbers in reverse, until all the TPP is selected.

F. Self-dealing (F.S. §736.0802)

This is a **critical** consideration when a trustee will be administering and making decisions with respect to a trust asset in which the trustee also has an interest. The entire problem can be avoided by authorizing what would otherwise be acts of self-dealing. However, authorizing self-dealing can be dangerous and should be given careful consideration.

G. Substance Abuse

1. These can be some of the most difficult provisions for a fiduciary to handle. Take, for example, the common provision directing the fiduciary not to make distributions to a beneficiary believed be abusing alcohol or drugs, but authorizing the fiduciary to make payments to third parties for the benefit of the beneficiary (e.g., pay the beneficiary's rent directly to the landlord, pay the mechanic for repairs to the beneficiary's car, etc.).

2. Problems:

- How is a corporate fiduciary supposed to know whether a beneficiary has a substance abuse problem?

- Beneficiaries find very creative ways to get around these provisions. For example, the beneficiary tells the trustee, "I need a new dishwasher, and I picked out this Samsung at Best Buy." Trustee pays for the dishwasher, and beneficiary returns it and pockets the cash. A more sad example, but true, the trustee is paying rent on the beneficiary's apartment pursuant to the terms of the trust, but to finance his habit, the beneficiary moves out and lets his dealer live in the apartment.

  Typically, the parent who asks for these restrictions to be included in his/her trust was enabling this child during the parent's life. Perhaps the drafter should ask the settlor how he/she handles the child's finances.

- Does the husband/wife really want to terminate distributions to the surviving spouse if he/she becomes addicted to alcohol?

H. Discretionary Distributions

1. "One of the most difficult tasks trustees face is how to exercise broad (and generic) discretion in the administration of trusts, whether the trust is fully discretionary, with no standards whatsoever, or discretionary subject to an ascertainable standard. **To the extent that the settlor's intent is expressed in the trust, it is much easier for the trustee to carry out that intent."**[4] (Emphasis added.)

2. "Enforcement and Construction of Discretionary Interests", Restatement Third, Trusts §50[5] (hereafter, "Restatement Trusts §50") is one of the longest sections of that Restatement.

   a. Subsection (1) of the Restatement Trusts §50 states:

      > A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee.

---

[4] Pruett, Benjamin H., "Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective", 35 ACTEC Journal, 331 (2010), 341

[5] The American Law Institute, 2003

b. Snippets from the Comments to subsection (1):

> The commentary that follows is concerned not only with the trustee's duties but also with the ability of beneficiaries of these discretionary interests to enforce their rights….
>
> A court will not interfere with a trustee's exercise of a discretionary power when that exercise is reasonable and not based on an unreasonable interpretation of the terms of the trust….On the other hand, a court will not permit abuse of discretion by the trustee. **What constitutes an abuse depends on the terms of the trust,** as well as on basic fiduciary duties and principles. (Emphasis added.)
>
> Court intervention may be obtained to rectify abuses resulting from bad faith or improper motive, and to **correct errors resulting from mistakes of interpretation**. (Emphasis added.)

c. Subsection 2 of the Restatement Trusts §50 addresses some of the issues associated with the construction of terms granting a trustee discretion to make distributions as follows:

> The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, **depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust.** (Emphasis added.)

d. Comment d(1) to subsection (2) includes the following:

> This Comment is concerned with the **construction of expressions** frequently used in the terms of discretionary powers, and particularly with the types of benefits likely to be encompassed by typical standards. Presumed meanings yield to findings of actual contrary intention and also may be affected by context and the more general purpose(s) of the trust and

the estate plan of which it is a part. (Emphasis added.)

e. What does "construction" mean in this context? Black's Law Dictionary defines "construction" as follows:

> The process, or the art, of determining the sense, real meaning, or proper **explanation** of **obscure or ambiguous terms or provisions in a statute, written instrument**, or oral agreement, or the application of such subject to the case in question, by reasoning in the light derived from extraneous connected circumstances or laws or writings bearing upon the same or a connected matter, or by seeking and applying the probable aim and purpose of the provision. It is to be noted that this term is properly distinguished from interpretation, although the two are often used synonymously. **In strictness, interpretation is limited to exploring the written text, while construction goes beyond and may call in the aid of extrinsic considerations, as above indicated.** (Emphasis added.)"[6]

3. Drafters often use the "HEMS" (health, education, maintenance, support) standards when authorizing discretionary distributions of principal, but the meaning of such terms becomes less obvious once administration begins.

a. Does "**health**" include the following:

Emergency medical treatment?
Psychiatric treatment?
Psychological treatment?
Routine health care examinations?
Dental care?
Eye care?
Eye glasses, contact lenses?
Elective cosmetic surgery?
Cosmetic dental work?
Lasik surgery?
Health insurance?
Dental insurance?
Vision insurance?

[6] Black's Law Dictionary (online version)

Unconventional, non-traditional medical treatment?
Home-health care, such as round the clock nurses?
Gym memberships?
Gold club memberships?
A day at the spa?
Extended vacations to relieve tension and stress?
A certain type of automobile with more comfortable seats to relieve back pain?[7]

b. Does "**education**" include the following:

Grammar, secondary and high-school tuition, fees, activity fee?

Post-graduate school?
Medical school, law school, and other professional school expenses?
Support of the beneficiary during the school year?
Support of the beneficiary between semesters and between school years?
What if beneficiary decides to "take a break" from education?
Extended post-graduate studies for the student who makes a career out of learning?
Technical school training?
Career training such as cooking school?
A year of college in Europe as part of a university program?
Traveling the world as part of studying world culture?[8]

c. At what **moment in time** is the standard to be applied?

When the will or trust was signed?
On the testator's/grantor's date of death?
When the trust becomes irrevocable?
Currently, *i.e.,* at the time the distribution is being considered?[9]

d. What **other resources** are to be considered, if any?

(1) "No trust involving dispositive discretion in the trustee should be drafted without providing at least a basic answer to this inevitable question".[10]

---

7 Kiziah, Trent S., "Practical Issues Arising During Trust Administration", p. 14
8 Kiziah, Trent S., "Practical Issues Arising During Trust Administration", p. 16
9 Kiziah, Trent S., "Practical Issues Arising During Trust Administration", p. 35
10 Halbach, Jr., Edward C., 61 Colum.L.Rev.1425 at 1442 (1961)

(2) If the trustee **must consider** the beneficiary's other means of support, what should be considered?

- Is the trustee only to consider the beneficiary's income producing assets?
- Should the trustee consider the beneficiary's marketable securities that could easily be sold or converted into assets producing more income?
- Should the beneficiary be required to sell assets before the trust is invaded?
- Should the trustee consider that the beneficiary is employable but simply refusing to work?
- Should the trustee consider the beneficiary's spouse's financial resources or the beneficiary's parent's legal obligation of support?
- What documentation can the trustee rely upon from the beneficiary and what information must be gathered?

  Income tax returns?
  Financial statements? (Sworn, unsworn)
  Budget?

- Is "income" to be defined in terms of the Internal Revenue Code, Principal and Income Act, or mere receipts?

(3) If the beneficiary's other resources **may be considered**, then under what circumstances should they be considered?[11] (Emphasis added.) If the trustee may consider a beneficiary's other resources, will it be a breach of duty if the trustee automatically does not consider other resources? Does the use of the word "may" imply or suggest that there may be circumstances when the trustee should consider other resources? Does the phrase "may, but need not" give the trustee more protection from not considering other resources?

(4) "If the beneficiary's other resources **are not to be considered**, then is the trustee to consider how the

[11] Kiziah, *supra,* at p.33

beneficiary is using distributions the trust has already made to the beneficiary? For example, if the trust mandates income be distributed to the beneficiary, permits invasion of principal for the beneficiary's health, education, maintenance and support, and specifically provides the beneficiary's other resources are not to be considered, then is the trustee required to consider whether the mandatory income is sufficient to maintain the beneficiary's standard of living?"[12] (Emphasis added.)

4. To address some of these issues, consider using a statement of intent when broad grant of discretion is given.

> **It is the Settlor's intent that this trust be used to enhance the beneficiaries quality of life, including (without limitation) travel, purchase of a home, cultural appreciation and enjoyment (music, arts, etc.), and education. In addition, the Settlor would like this trust to provide a source of funds in the event that a beneficiary, through accident or misfortune, does not have sufficient sources of income to provide for his or her own support. The Settlor expects his [her] descendants to support themselves independently and to be productive members of their communities and not to become dependent upon distributions from the trusts to the extent that they lose their ambition or incentive. Where a beneficiary is able to be gainfully employed and is not actively engaged in raising his or her children, income and principal of a trust established hereunder should not be used to replace the beneficiary's own effort to work and accumulate financial security. However, it is not the Settlor's intent to force a parent to work outside the home when he or she has determined that it is important to stay at home to raise a family. In addition, the Settlor does not intend that the trustee place undue emphasis on the amount a beneficiary earns if he or she is actively engagement in a worthwhile pursuit including working as an unpaid volunteer for charitable purposes.**[13]

---

[12] Kiziah, *supra*, at p.33-34

[13] Pruett, Benjamin H., "Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective", 35 ACTEC Journal, 331 (2010), 343

5. The duty of impartiality[14]

a. How should the general duty of impartiality influence trustee consideration of discretionary distributions to current beneficiaries, at the cost of remainder beneficiaries? How should the same duty of impartiality come into play in making decisions to make distributions to some, but not all of a group of current beneficiaries?

> "Where there are multiple beneficiaries of the trust, meaning either concurrent beneficiaries or successive beneficiaries (current and remainder), a trustee needs guidance as to how to exercise that discretion with respect to the various competing interests, given the trustee's duty of impartiality among trust beneficiaries.
>
> "Is the trust primarily for the benefit of current beneficiaries, with remainder beneficiaries being entitled only to that amount, if any, that is left over after the current beneficiary's death, or is the intent to preserve assets for later generations?
>
> "As to current beneficiaries, should the trustee give priority to the interests of one beneficiary over another?"[15]

b. Sample provision:

> "**The trustee may distribute to or for the benefit of the beneficiary and/or the beneficiary's descendants, so much or all of the net income and principal of this trust as the trustee deems desirable to provide for the health, support, education and welfare of the beneficiary and/or such descendants. Making a distribution to one beneficiary under this subparagraph does not require making a distribution to any other beneficiary. . . .**
>
> **"Distributions for a beneficiary's (or his or her descendants') welfare may include, but are not limited to, distributions to enable the person to (i) make a down payment on the purchase of a home**

[14] "If a trust has two or more beneficiaries, the trustee shall act impartially in administering the trust property, giving due regard to the beneficiaries' respective interests." F.S.§736.0803.

[15] Pruett, Benjamin H., "Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective", 35 ACTEC Journal, 331 (2010), 342

consistent with such beneficiary's standard of living; (ii) invest a reasonable amount in business enterprises in which the beneficiary would be an active participant, including the purchase by the trustee of such enterprises as investments of the trust; and (iii) pay for a wedding and honeymoon, or other special trip at any time. I may provide the trustee with additional guidance by letter or memorandum to assist the trustee in ascertaining my intent, but any such writing would be non-binding."[16]

I. Tax Apportionment

1. Retirement benefits, insurance, survivorship accounts, and other assets that pass by operation of law are representing a greater and greater percentage of estates. What if tax apportionment clause directs apportionment to residue solely?

2. Estate of Tom Clancy

Tom Clancy created two family trusts; one for the benefit of his children of first marriage, one for benefit of surviving wife and daughter from second marriage. The issue was whether estate taxes were to be apportioned to this second family trust. The Wife argued that taxes ($11.8 million) should only be paid from first family trust, and the court agreed. Portions of the will, when read in isolation, offered "some evidence" that Clancy intended for both family trusts to jointly shoulder the tax burden; however, the plain language of the will, as a whole, which the judge deemed the clearest and the predominant evidence of Clancy's intent, did not require the second family trust to pay taxes.

J. Business valuation

Assume that a valuable, closely-held business is a principal asset of husband/wife's estates. One of three children is active in the business and is the logical choice to receive shares as part of her distribution. The other children are not likely to have a problem with the one child receiving the shares of the business, and the parents want the equivalent value to go to other children. At the parents' deaths, how is the business (shares) to be valued? Is that question to be left to the successor trustees? What if the child receiving the business shares is one of successor trustees? Sole successor trustee? A clearly drafted plan for valuing the shares of the business will eliminate or reduce disputes over valuation.

16 *Id.*

K. Investments - Diversification and Retention of Assets

1. General Investment Duty of a Trustee

a. Florida Statute §736.0804 states: “A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.” Additionally, a trustee who has special skills or expertise has a duty to use those special skills.[17]

b. Similarly, Florida Statute §518.11(1)(a) states “a fiduciary has a duty to invest and manage investments as a prudent investor would considering the purposes, terms, distribution requirements, and other circumstances of the trust.”

This standard is to be applied to investments not in isolation, but in the context of the investment portfolio as a whole and as a part of an overall investment strategy that should incorporate risk and return objectives reasonably suitable to the trust, guardianship, or probate estate. (Modern Portfolio Theory)

2. Duty to Diversify

a. A **fiduciary** has a duty to diversify unless, under the circumstances, the fiduciary believes reasonably that it is in the interests of the beneficiaries, and furthers the purposes of the trust, guardianship, or estate, not to diversify.[18]

b. The duty to diversify is viewed to be a separate duty and is in addition to the duty to use care, skill, and caution.

c. A waiver of the duty of loyalty is not a waiver of the duty to diversify.

d. Does it make a difference if the assets were the assets that originally funded the trust, guardianship, estate?

Unless the trust instrument states otherwise, the duty to diversify applies to all assets, regardless of who contributed or purchased the assets, except life insurance if the trust instrument references §736.0902 or the trustee gives the

[17] F.S. §736.806
[18] F.S. §518.11(1)(c)

beneficiaries notice. (Note: There are a handful of states that have modified the duty to diversify with regard to assets that originally funded the trust.)

3. Circumstances that may authorize the retention of a concentration

   a. The trustee reasonably determines that the purposes of the trust would be better served without diversifying, then retention of the concentration may be warranted. However, trustees should analyze and document the decision to not diversify regularly.

   b. Examples of circumstances that may justify retention

      - Income Tax Gain – Recognition of gain outweighs the advantages of diversification.

      - Estate Tax Issues – Due to the settlor's age or medical status, the assets would receive a "step up" at death.

      - Special Relationship – The special relationship that the asset has to the purpose of the trust may be a "special circumstance" which may justify the retention, e.g., family farm or business, family real estate such as a vacation home, residence occupied by settlor or a beneficiary; certain tangible personal property such as art or collections of coins, stamps, guns, cars, etc.

4. Waiving the Duty to Diversify

   a. Some courts have held that a retention clause does not waive or modify the duty to diversify.[19] Accordingly, if a settlor authorizes or directs retention or a concentration of assets, the document should also waive the duty to diversify, at least with respect to those retained assets.

---

[19] *E.g., see Wood v. U.S. Bank, N.A.,* 828 N.E. 2d 1072 (Ohio App. 2005).
The retention clause in this trust provided that the trustee was empowered **"to retain any securities in the same form as when received including shares of the corporate trustee, even though all of such securities are not of the class of investments a trustee may be permitted by law."** The clause did not make specific reference to the stock or waive the duty to diversify. At the time of the grantor's death, 82% of the stock was made up of stock of the corporate trustee and 18% was held in stock of Cincinnati Financial. The issue before the court was whether a trustee has a duty to diversify the assets of the trust when the language of the trust authorized retention. The court held that even if the trust allows the trustee to retain assets that would normally not be suitable trust assets, the duty to diversify remains, unless there are special circumstances. "The retention clause merely served to circumvent the rule of undivided loyalty. The trust did not say anything about diversification. And the retention language smacked of the standard boilerplate that was intended merely to circumvent the rule of undivided loyalty – no more, no less. . . . We hold that the language of a trust does not alter a trustee's duty to diversify unless the instrument creating the trust indicates an intention to do so."

b. At least one other court found an implied waiver of the duty to diversify when the document was silent based upon the settlor's insistence (while alive) that the concentration be retained.[20] However, after the settlor dies, courts may view the circumstances as "changed."

5. Can a retention clause and waiver of the duty to diversify trump the duty of a trustee to act prudently?

Matter of the Testamentary Trust established under the Will of Charles G. Dumont, deceased, 2004 NY Slip Op 50647U, (June 25, 2004), on appeal, 809 NYS 2d 360 (N.Y. App. Div. 2006) (reversing the judgment on other grounds)

Mr. Dumont's testamentary trust contained the following statement:

> It is my desire and hope that said stock will be held by my . . . said Trustee to be distributed to the ultimate beneficiaries under this Will, and neither my Executors nor my said Trustee shall dispose of such stock for the purpose of diversification of investment and neither they [n]or it shall be held liable for any diminution in value in the stock . . .[T]he foregoing shall not prevent my said . . . Trustee from disposing of all or any part of such stock of [Kodak] in case there shall be some compelling reason other than diversification of investment for doing so.

The appellate court did not contradict the lower court's reasoning that:

> "The permissive retention clause cannot trump the legal duty of the trustee to act prudently. The trustee must listen to (a) the grantor's intent, (b) the beneficiary's needs, and (c) the market's financial realities. . . . . "The risk presented by the concentration itself may not have been a compelling reason for sale but the actual substantial loss and the lack of viable hope of long term gain was.""

The *Dumont* case suggests that if retaining assets will cause harm to the trust, the trustee may have a duty to seek judicial relief from the retention provision if the trustee feels it is prudent to sell the concentration.

[20] *W.A.K., II, a Minor v. Wachovia Bank, N.A.,* 712 F.Supp.2d 476 (E.D. Va. 2010).

6. Examples of types of assets that should trigger alarm bells for the drafting attorney:

   - Family business
   - Closely-held stock
   - Commercial or residential real estate
   - Concentration of stocks
   - Collections of art, guns, cars, etc.
   - Other unusual assets – timberland, farmland

7. Suggestions for the drafting attorney

   - Discuss your client's assets in detail and inquire!
   - Include detailed language regarding the retention of specific assets or concentrations, including specifically identifying the asset and stating that there is a concentration or could be a concentration in the future.
   - Elaborate in the document if there is a special relationship to the asset and describe the special relationship in detail.
   - Specifically direct retention (including whether the direction to retain is permissive or mandatory) and waive the duty to diversify with respect to that asset.
   - If the retained or concentrated asset is stock, specify whether a change of status such as a merger should alter any directions to retain or sell.
   - Consider including directed trustee language so that a third party (i.e., a family member) can direct the trustee to retain the asset and can direct the trustee.
   - Include language that shows the settlor acknowledges and recognizes that by holding the specific asset(s), the account will lack diversification.

L. Irrevocable Trusts

Are irrevocable trusts really irrevocable given the current modification statutes? Any drafter preparing an irrevocable trust should discuss this with the client and consider identifying "the material purposes" of the trust.

M. Coordination among various estate planning documents

Often an estate plan consists of several documents, will, trust, power of attorney, designation of health care surrogate, etc. It can be easy to overlook a subtle lack of coordination between or among the various estate planning documents. For example, the power of attorney may permit the agent to amend a revocable trust, but the revocable trust may prohibit amendments by a guardian, legal representative, or an agent acting under a power of attorney.

N. Distributions from trust to guardians of minor beneficiary of trust to pay for home improvements and other expenses incurred as a result of taking on responsibility of serving as guardian

Sample provision:

> **Distributions to Guardians. The trustee is specifically authorized in its sole discretion, to make distributions of income or corpus directly to the guardian of any beneficiary of this trust for expenses incurred by the guardian because of his or her care for such beneficiary. Such expenses are to include, by way of illustration and not limitation, the guardian's reasonable travel expenses in visiting the beneficiary, the reasonable cost of additions or improvements to the guardian's home, and the reasonable cost of additional household help or appliances in the guardian's home, providing such expenditures are necessary in the judgement of the trustee to enable the guardian to care for such beneficiary. It is my intention that such expenses be paid even though such payments may directly or indirectly benefit the guardian or the guardian's family. To the extent that such expenditures do not frustrate the primary purpose of this trust, I direct the trustee to be generous in making such distributions to guardians, and direct that whenever feasible, doubts should be resolved in favor of the guardian. Notwithstanding any provisions in this paragraph to the contrary, however, if a guardian is also serving as trustee of this trust, and there is no corporate or other disinterested co-trustee, then no payment for the benefit of the guardian may be made pursuant to this section.**[21]

[21] Pruett, Benjamin H., "Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective", 35 ACTEC Journal, 331 (2010), 343.

III. TRAPS

A. Technology

1. Using prior documents as a template

- Risk of failing to make all necessary changes
- Risk of including unnecessary provisions that may create confusion
- Risk of failing to include or address matters that are specific to the current client

2. Document assembly software

B. Being rushed or in a hurry