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Wealth Management

Design Your Trust To Deter Disputes

Minimize potential for disagreements between beneficiaries and fiduciaries

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Administering a trust without conflict is rare. The good news is that many conflicts among fiduciaries and beneficiaries, between co-fiduciaries or among beneficiaries, can be resolved quickly and easily. Unfortunately, sometimes the disputes can be serious, driving parties to litigation and destroying relationships. It should go without saying that unambiguous language is the first step to reducing the potential for conflict. Whether beneficiaries are content with the settlor's decisions or not, well-constructed language clearly setting out the terms of the trust is less likely to cause disparate interpretations. On the opposite end of the spectrum, amorphous language simply stating that assets are to be held "in trust" without stating how the trust is to be administered is, at the very least, begging for a construction proceeding.

This article suggests some tech-

niques that can be useful in drafting trusts to avoid potential conflict, all of which require the client to consider how the trust will work in practice from the point of view of the beneficiaries and the trustee(s). Counseling a client regarding potential conflicts (and ways of reducing the chances of their occurrence) will give the settlor a realistic view as to how the plan will function in practice, which may help shape the substance of the instrument. Of course, certain types of trusts (including trusts intended to qualify for the marital or charitable contribution deductions) require certain terms that cannot be changed, and such trusts fall outside the scope of this article.

Choosing the right fiduciary (an executor or a trustee) is critical. A successful fiduciary must be able to execute the settlor's wishes (as expressed through the governing instrument) and communicate effectively with beneficiaries and perhaps to co-fiduciaries. As in many other contexts, conflicts can often be soothed or incited, depending on the personalities and communication skills of the players — here the fiduciary and his advisers. Importantly, the fiduciary must be able to recognize when to reach for professional investment, accounting and legal advice.

The number of fiduciaries can also

play a role. The simplest way to eliminate the possibility for conflict between co-fiduciaries is to appoint only one fiduciary to serve at any one time. While the fiduciary should feel free to consult with others close to the situation, with only one person serving there will be no battles between co-fiduciaries who might have opposite opinions on a variety of trust issues, such as appropriateness of distributions or whether a certain asset should be sold or retained. Appointing one fiduciary can not only reduce conflict, but can also reduce trust expenses and can simplify court proceedings (whether adversarial or otherwise). While many clients believe that their children will get along and cooperate as co-fiduciaries, the reality may often be different after the parents have passed away. When selecting fiduciaries, the settlor should be practical. While a settlor may not want to hurt anyone's feelings, she should remember that serving as a fiduciary is work, and assembling the wrong fiduciary "team" can lead to additional headaches, legal costs and delays, hurting everyone in the end. On the other hand, sometimes pairing two individuals or an individual and a financial institution can make for an extremely effective solution, and it is up to the settlor to make the right decision.

If a settlor is sure that more than one person or entity having power over the trust is advisable, he might instead consider including a nonfiduciary power of

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appointment over some or all of the trust assets. In this way, the power-holder can direct distributions among one or more individuals, but not be involved in day-to-day administration of the trust. Powers of appointment can be an important tool and are discussed in more detail below.

Inevitably, every human fiduciary will stop serving, whether due to death, incapacity or resignation. Thus, choosing a strong succession of fiduciaries can ease the administration process, circumvent disagreements when a group of beneficiaries is forced to choose a successor, and avoid the time and expense of involving the courts to appoint a new fiduciary. A settlor might consider naming a bank or trust company in the succession of fiduciaries, or as a fail safe if all other succession mechanisms are exhausted. When considering succession mechanisms, especially when a financial institution is to be appointed, the settlor should consider adding removal and replacement powers. For example, a settlor may be willing to give the primary beneficiary of the trust the power to remove a fiduciary (or co-fiduciary) and replace that party after the beneficiary reaches a certain age. When dealing with multigenerational trusts, this type of provision allows each generation input into trust administration so that fiduciaries and beneficiaries can work together to respond to existing circumstances and needs. Depending upon the situation, the mere existence of the removal power can also serve as a dispute deterrent, resolving conflicts before they ever arise, by empowering the beneficiary.

If a financial institution is to be appointed, a family member, representative or committee can be given the power to remove one institution and appoint a replacement. Such a power can be especially important as banks merge and change their array of services and fee structures, ensuring that there is an exit strategy for the beneficiaries that does not require reforming the instrument.

A settlor may want to include a non-fiduciary power of appointment in a trust

agreement as a way to provide flexibility, regulate behavior and avoid conflict among potential beneficiaries. Unlike the exercise of fiduciary discretion, a properly drawn power of appointment will not expose the power-holder to any liability from beneficiaries for the exercise or nonexercise of the power. Clients often like the idea of a "spray" or "one pot" trust, which puts all beneficiaries in a single pool. In theory, it is a wonderful idea, symbolic of a harmonious family where a large pot of money is available to provide for the needs of the settlor's descendants. While this type of trust does allow flexibility — a single group of assets can grow and be available for beneficiaries without regard to equality of distribution — differing priorities of the beneficiaries can result in conflict and damage otherwise cordial family relationships. A spray trust can easily serve as an incubator for litigation, and the trustees generally are well advised to establish a policy of equal distributions among the beneficiaries unless there is a compelling need for unequal distributions. In practice, spray trusts are often administered as if there were one trust for each beneficiary, either by an unyielding practice of distributing assets equally or stirpitaly among the beneficiaries, or by using separate accounts or subtrust accounting arrangements.

Instead, a settlor should consider narrowing the class of beneficiaries for each trust to one individual. For example, the settlor can create a separate trust for each of his children as opposed to one larger trust for all of his descendants. Each child can be granted a nonfiduciary special power of appointment in favor of the settlor's descendants (other than the child himself), adding flexibility without forcing a fiduciary to choose among numerous beneficiaries. Such powers can be a potent tool, permitting the child, if he decides it is appropriate, to move assets to continuing trusts for other members of the family, especially in a state like New Jersey that has emasculated its rule against perpetuities. The child can also use powers of

appointment to regulate behavior of her descendants without regard to fiduciary concerns. This type of trust design avoids competing interests among siblings as well as among generations, and the fiduciary will feel more comfortable exercising its discretionary power.

Using separate trusts also allows for dramatically different investment strategies to be utilized for each child's trust where appropriate, easing a primary source of tension when beneficiaries have disparate interests. For example, one sibling could have enough personal wealth to not need immediate access to the trust, which could be invested more for long-term growth with an eye to the remainder beneficiaries. On the other hand, her sister could have a great need for current income on a regular basis, while her brother may be a foreign citizen whose trust can take advantage of unique investment opportunities. If all three siblings were forced to share one trust, invariably the trustee would get caught in the middle. Thus, the best way to structure the planning to avoid such conflict is to have the settlor create three separate trusts for his three children. Although governed by one instrument, the trusts can be administered separately.

Almost every provision in a will or trust agreement can be a source of conflict, and space does not permit us to provide an exhaustive discussion of the myriad methods available for reducing that possibility. It is important for attorney and client to consider carefully the practical impact of the settlor's intentions with respect to disagreements that may arise between and among beneficiaries and fiduciaries. The attorney should educate the settlor about ways to avoid conflict, and counsel him to reach clear, informed decisions in harmony with his ultimate goals. The attorney will then ideally be in a position to draft unambiguous instruments that give the fiduciaries and beneficiaries tools to foster cordial fiduciary service and warm intra-family relationships. ■