

MAR 28, 2012 3:00 PM

Do We Need Protection from Trust Protectors?

Two experts offer different opinions

BY JOHN T. BROOKS, PARTNER IN THE CHICAGO OFFICE OF FOLEY & LARDNER LLP AND GREGORY F. MONDAY, PARTNER IN THE MADISON, WIS. OFFICE

This month, we take note of two articles that seem to take opposite sides on the issue of trust protectors. When read together, however, they illustrate why we're seeing a proliferation of the use of trust protectors and why we may see a corresponding emergence of legal claims against trust protectors if the role isn't used thoughtfully.

Both articles define a "trust protector" as a person (not the settlor, beneficiary or trustee) who is appointed to exercise one or more broad powers affecting the trust and the beneficiaries' interests. For example, a trust protector may remove and replace the trustee, direct investment decisions; change distribution terms or make distribution decisions or even modify or terminate the trust itself. About half of U.S. states have adopted statutes that either explicitly or impliedly recognizes trust protectors.

Positive View

The first article, "Why You May Need A 'Trust Protector,'" by Tatiana Serafin, in Barron's Penta (March 3, 2012), makes the case for trust protectors from the consumer's perspective. Serafin's piece emphasizes the flexibility that a trust protector can provide to pursue the trust settlor's intentions under changing circumstances, even in a dynasty trust that's continued in perpetuity. According to Serafin, "Deciding to appoint a trust protector is sometimes a no-brainer."

The discerning reader will wonder why the trust protector can affect a trust in ways that a trustee supposedly couldn't. Serafin's piece seems to imply that trust protectors are acting as agents of the settlor and, as such, they may be free of the fiduciary duties that apply to trustees. For example, she writes, "[A] trust protector focuses on the wishes of the grantor . . . The trust protector, unlike the trustee, doesn't typically have a fiduciary role to make the best investment decision."

Use Caution

The second article, “The Case Against the Trust Protector,” by Alexander A. Bove, Jr., in the ACTEC Law Journal (Summer 2011), cautions attorneys not to incorporate trust protectors into a settlor’s trust documents without a thoughtful discussion about imposing fiduciary duties on the trust protector and making the him accountable to the beneficiaries in some manner. Bove provides an insightful history of the emergence of trust protectors in U.S. domestic trusts, and, in doing so, supports his argument that they must fall within the well-established law of trust rights, interests and fiduciary duties.

For example, Bove argues that trust protectors can’t be agents of the settlor, because the settlor isn’t a party to a trust after it’s established. By process of elimination, Bove concludes that a trust protector must owe fiduciary duties to the beneficiaries, unless the power granted to the trust protector is a personal power (such as a general power of appointment that can be exercised for the benefit of the power holder) or the trust instrument or state statute exculpates the trust protector, which Bove thinks is a bad idea and may not be enforceable.

It’s easy to imagine, after reading Bove’s piece, that beneficiaries who suffer economic loss due to the incompetent, vindictive or self-serving actions of a trust protector would be tempted to argue that it’s against public policy to foreclose them from legal recourse against the trust protector. If a court were to agree, it might open the floodgates for similar claims, in which inattentive or naïve trust protectors may find themselves being held accountable for powers they weren’t “properly” exercising.

Middle Ground

The Serafin article is a nice introduction to the trust protector concept for consumers, and while generally positive on the concept, even she points out the “too many cooks in the kitchen” problem. Moreover, we agree with Bove that attorneys should be cautious and thorough when incorporating trust protectors into their clients’ trust agreements. Settlers should understand the concept of fiduciary duties and strike a balance between flexibility and accountability.

There’s a place for trust protectors. Corporate fiduciaries who are wary of litigation exposure don’t want to be given broad discretion to make decisions that can be second-guessed by beneficiaries in a courtroom. Many are glad to defer such discretion to an independent party. At the same time, trust settlors react to fears about litigation undermining their intentions with respect to trust investments and trust beneficiaries. Trust settlors want to appoint a

decision maker who can carry out the settlors' wishes without being influenced by threats of litigation or personal liability.

However, as Bove argues, we may have gone overboard with trust protectors who are completely exculpated, have no fiduciary duties and aren't answerable to anyone in any court. Bove, frankly, thinks that such arrangements, when litigated, will be unenforceable as against public policy. On the other hand, if trust protectors are given the same fiduciary duties as trustees, why would they accept the discretion and responsibilities that the trustees have wisely refused?

Fortunately, Bove points out a middle ground, in which a trust protector's fiduciary duty to the beneficiaries is recognized, but the trust protector is exculpated from simple negligence claims. Under this model, the trust protector is answerable to the beneficiaries only for gross negligence or willful breaches of fiduciary duties. Other ways to mute the threat of litigation against a trust protector might include the use of indemnification and advancement provisions and/or the use of penalty clauses and fee-shifting language to enforce alternative dispute resolution provisions.

In the final analysis, we can agree with both authors. Trust settlors should ask their attorneys about a trust protector, but attorneys should be clear and thoughtful about how a trust protector is incorporated into the settlor's trust agreement.