

# Advising Trustees Who Manage Closely -Held Business Interests

*Presented by*

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The Fiduciary Litigator provides important legal news, updates on recently decided and pending case precedent, and commentary to directors, officers, managers, in-house counsel, trust officers, and wealth advisors who work for financial institutions that serve in fiduciary roles, as well as attorneys and court personnel who provide legal services in the fiduciary area.



# Introduction

# Introduction

Settlors often place some or all of the ownership of a closely-held business in a trust.

A trustee managing a trust with an interest in a closely-held business has difficult management issues to address, and this often raises disputes.

This presentation will address how counsel can advise trustees who are administering trusts with closely-held business interests.

# Introduction

The presentation will include a discussion about:

Why a trust may own an interest in a closely-held business

Proper considerations that a trustee should undertake in managing a closely-held business interest

The differing fiduciary duties between a trustee and an officer/director of a closely-held business

The risks associated with holding both roles

Best practices for addressing conflicts of interest and avoiding breaches of fiduciary duties

Attorney-client issues

Disclosure obligations to beneficiaries regarding closely-held business interests

Directed trust issues for managing closely-held businesses

Co-trustee issues for managing closely-held businesses

Why a Trust May Own a Closely-Held  
Business Interest



# Why a Trust may Own a Closely-Held Business Interest

There are many reasons that a trust may own a minority or majority interest in a closely-held business.

The settlor may transfer such an interest into the trust as part of an estate plan or otherwise.

The trustee may create a closely-held business and transfer assets into the business.

The main reason to do so is risk avoidance.

Also, it may assist in limiting the duty to diversify and maintaining ownership of a family business.

# Issues to Consider Before Creating A Closely-Held Business

Creating a closely-held business will create new duties to properly manage the ownership interests.

This may create principal versus income issues that impact an income beneficiary.

May limit a trustee's ability to diversify assets.

Fractional ownership of business may devalue the asset, which may be good or bad depending on circumstances.

This may make termination of the trust easier.

This may have tax benefits.

This may make it easier to avoid probate if a co-owner dies.

Compensation issues for dual roles.

Considerations in Managing a  
Closely-Held Business Interest

# Managing an Interest

- The trustee shall administer the trust in good faith according to its terms.
- So, a trustee should carefully review the trust document to see what rights and limitations are in the document concerning the ownership of an interest.
- Trust Codes allow a trustee to own an interest in a closely-held business, but a trustee should be careful to avoid self-interested transactions concerning the trustee or the trustee's affiliate.
- For example, Texas Trust Code Section 113.053 provides: “[A] trustee shall not directly or indirectly buy or sell trust property from or to: (1) the trustee or an affiliate; (2) a director, officer, or employee of the trustee or an affiliate; (3) a relative of the trustee; or (4) the trustee's employer, partner, or other business associate.”
- “Affiliate” includes: (A) a person who directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person; or (B) any officer, director, partner, employee, or relative of a person, and *any corporation or partnership of which a person is an officer, director, or partner*.
- The conflict can be overcome if the trust document authorizes the transaction, the beneficiaries consent after full disclosure, the court approves the transaction, the transaction involves a contract entered into before the trustee became a trustee, or the statute of limitations for challenging the transaction expires.

# Managing an Interest

A trustee has a duty to manage the trust as a prudent person would do and maybe as an expert.

The business asset is an investment held by the trust.

Would application of the “Prudent Investor Rule” suggest that the business be sold, and the proceeds invested in other investments?

Uniform Prudent Investor Act § 2(a): “A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.”

# Managing an Interest

Uniform Prudent Investor Act § 2(c): Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

- (1) general economic conditions;
- (2) the possible effect of inflation or deflation;
- (3) the expected tax consequences of investment decisions or strategies;
- (4) *the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property* ;
- (5) the expected total return from income and the appreciation of capital;
- (6) other resources of the beneficiaries;
- (7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and
- (8) *an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries* .

# Protections To Maintain Interest

- Due to the duty to diversify and to avoid concentrations, a trustee may have pressure to sell some or all of a closely-held business interest.
- This may be contrary to the desire of the settlor or the beneficiaries.
- Here are some potential protections that may assist a trustee in maintaining the interest:
  - Directed trust language
  - Special business co-trustee
  - Delegation language
  - Retention clause/abrogate duty to diversify
  - Exculpation clause
  - Beneficiary consent/release agreement
  - Court order abrogating diversification as to the interest

# Managing an Interest

A trustee that has an interest in a closely-held business should consider:

Does the trust own a minority share or controlling share?

What rights does the trustee have as an owner under the business documents (articles, by-laws, shareholder agreement, partnership agreement, etc.)?

Regularly review the business documents to be familiar with rights.

Enforce rights to information and books and records.



# Managing an Interest

A trustee that has an interest in a closely-held business should consider:

Enforce rights to have meetings and to participate in same.

Vote ownership percentage.

Enforce rights to buy-out and put options (diversification issues).

Enforce rights to avoid dilution.

Enforce rights to distributions/dividends.

Understand duties owed by directors/officers and have information regarding compliance.

Enforce rights to bring suits to police management (direct actions or derivative actions).

Consider proxy fights to obtain representation on board or control of management.

# Managing an Interest

- A trustee may have the ability to appoint (or remove) a beneficiary to (or from) a position in the business.
- If election of a beneficiary to a position within the company is not in the best interests of the trust, the trustee should not elect the beneficiary to the position (or allow the beneficiary to continue serving in that position), even though the beneficiary may wish to hold the position.
- A trustee cannot simply acquiesce to a beneficiary's wishes to hold a position in a company if the beneficiary is not qualified to hold the position or demonstrates an inability to properly perform the job.
- Same can be said for the trustee appointing or failing to remove himself or herself.

# Trustee vs. Officer/Director

# Trustee Fiduciary Duties

- A trustee is held to the highest fiduciary standard.
- Trustee duties:
  - Administer trust in good faith and in accordance with terms and purposes of trust
  - Administer trust in the interest of the beneficiaries
  - Loyalty
  - Impartiality
  - Care
    - Prudent administration
    - Exercise reasonable care, skill and caution
    - Use special skills or expertise
    - Make trust property productive
  - Keep books and records
  - Inform beneficiaries of material facts
- Potentially liable for even non-negligent mistakes

# Trustee Fiduciary Duties

- “A trustee must always act solely in the beneficiaries’ interest. If the trustee violates any duty owed to the beneficiaries, the trustee is liable for breach of trust..In a trust relationship, then, the benefits belong to the beneficiaries and the burdens to the trustee. The office of the trustee is thus by nature an onerous one, and the proper discharge of its duties necessitates great circumspection.”
- *Moeller v. Superior Court* , 16 Cal.4th 1124 (1997).

# Officer/Director vs. Trustee Duties

- Directors in most states also have duties of loyalty, care, and good faith.
- However, a trustee's duties are generally seen as more stringent than a director's duties.
  - *Paddock v. Siemoneit*, 218 S.W.2d 428 (Tex. 1949) (“Acts which might well be considered breaches of trust as to other fiduciaries have not always been so regarded in cases of corporate officers or directors.”).

# Officer/Director Duties

- Biggest difference between trustee's duties and officer/director's duties is the duty to act prudently.
- The business judgment rule is a standard of judicial review of corporate director conduct.
- It seeks to prevent courts from examining the wisdom of a corporate director's decision, instructing them instead to focus on the process by which the decision was reached.

# Officer/Director Duties

- The business judgment rule establishes a rebuttable presumption that a corporate director's decisions were made:
  - In good faith,
  - With the care that a reasonably prudent person would use, and
  - With the reasonable belief that he or she was acting in the best interest of the company.
- A plaintiff attacking a decision of a corporate director must provide evidence to rebut one or more of these three presumptions.
- This effectively precludes claims against directors that sound in ordinary negligence.
- That is a very different standard than a trustee's duties.



# Risks With Holding Both Trustee and Officer/Director Roles

# Risks of Dual Roles

- It is common for a trustee who owns a closely-held business interest to also act as a director or officer of the business.
- There are risks associated with this dual role:
  - Complaints by beneficiaries of the trust regarding the operation of the business or trust.
  - Complaints by owners of the business regarding the operation of the business.
  - Conflicts of interest.
  - Self-Interested transactions.
  - Legal advice and privilege issues.
  - Duty to disclose and duty to maintain records.
  - Differing standards for the duty of prudence.

# Risks of Dual Roles

- A person would not want their actions as a trustee to be judged by the trustee prudence standard vs. the business judgment rule.
- When a person acts in dual roles it can be confusing as to which standard applies to what conduct.
- A court must look to the capacity in which the person is acting: trustee role or officer/director role.
- What hat is the person wearing?

# Risks of Dual Roles

- In *Stegemeier v. Magness*, 728 A.2d 557, 562 (Del. 1999), the Delaware Supreme Court held that the standard of fiduciary duty for a corporate director was not that for a trustee.
- Self-dealing is virtually prohibited for trustees, but not directors (i.e., when a majority of disinterested directors approve the transaction).
- Directors can be protected by business judgment rule – but not trustees.
- Applicable standard based on the “legal form at the grantor chose to accomplish his purposes.”
- If the grantor chose a trust, “the stricter principles of trust law must apply to the challenged transaction.”

# Capacity Analysis

- For example, in *Rollins v. Rollins*, 338 Ga. App. 308 (2016), the Georgia Court of Appeals and the Supreme Court of Georgia clarify the competing duties of trustees also controlling a business.
- Two brothers acting as: trustees of certain trusts and individual partners of a partnership in which the trusts also are partners.
- Following the death of the trusts' settlor, the brothers amended the partnership agreement to: name themselves as managing partners, and change the partnership's distribution scheme to the purported detriment of the trusts' beneficiaries.
- One of the main issues the courts faced is what standard to use in judging the brothers' conduct.
- The Georgia Supreme Court ultimately applied different standards depending on the capacities the brothers occupied when taking certain actions.

# Capacity Analysis

- Amending the partnership agreement required the brothers to act in both their capacities as trustees of the trusts (which were partners) and their individual capacities as partners themselves.
  - In voting as trustees on behalf of the trust/partners, the brothers owed a duty to the trusts' beneficiaries, and therefore were held to a fiduciary duty standard.
  - On the other hand, in voting as individual partners, the brothers owed a duty to the other partners (i.e., the trusts themselves), and not to the beneficiaries of the trusts, and therefore were held to a partnership duty standard.

# Capacity Analysis

- When suing or defending a fiduciary who wears multiple hats, keep straight which duties tie to which hat.
- *Adam v. Harris* , 564 S.W.2d 162 (Tex. App.—Houston [14th Dist.] 1978, writ ref'd n.r.e.) shows this distinction:
  - Testamentary trust held controlling interest in trucking company.
  - Trustee was made director of company.
  - Company bought truck insurance from insurance company owned by trustee's brothers.
  - Beneficiaries sued trustee for self-dealing.
  - Trial court refused to award damages for self-dealing.

# Capacity Analysis

- Appellate court agreed there was no self-dealing:
  - “The flaw in [beneficiaries’] argument, however, is that whatever breach of fiduciary duty [trustee] committed was in his capacity as director of the truckline corporation and not in his capacity as trustee. [Trustee] did not self-deal with the trust property, the shares in the corporation, but rather with the corporation’s property, the monies used to purchase the insurance for the trucks. Section twelve of the Texas Trust Act directs that a “trustee shall not buy nor sell . . . any property owned by or belonging to the trust estate . . . from or to . . . a relative . . . .” Here, no property either entered or left the trust res; the trustee neither bought nor sold trust property.”



# Capacity Analysis

- Two approaches to avoiding the result in *Adam v. Harris* .
- Approach # 1: Breach of fiduciary duty suit against trustee.
  - Failure to act as controlling shareholder to supervise board of directors and vote out self-dealing board members.
  - Failure as controlling shareholder to bring shareholder derivative suit against breaching board members.
  - Failure as trustee to properly manage trust asset.
- Approach # 2: “Double derivative” suit against directors.
  - Sue derivatively on behalf of trust, since trustee will not sue himself.
  - On behalf of trust as shareholder, sue directors derivatively on behalf of corporation.

# Risk of Dual Roles

- Some jurisdictions hold that there is a clear distinction between the person as trustee and as director/officer only where the trust does not have a majority of the corporate stock and does not, therefore, have control over the company.
- So, in these jurisdictions, if the trust has control over the company, the person's conduct regarding the operations of the company may be imputed to the person in his or her capacity as trustee and as an officer/director.
- Similarly, if a trustee has control of the company, some jurisdictions hold that the trustee must disclose company information to a requesting beneficiary.
- An attorney should be very careful to research the law in the relevant jurisdiction as this can have a drastic impact on the person's liability.

Addressing Conflicts of Interests and  
Avoiding Breach of Fiduciary Duty Claims

# Addressing Conflicts of Interest

- Having a dual role can create conflicts of interests.
- A person can owe conflicting duties: duties to all of the trust beneficiaries and duties to the entity/owners.
- The beneficiaries and entity/owners may not be the exact same group and actions that benefit one may harm another.
- There can be conflicts between beneficiary classes (maximize income or reinvest for future).
- A trustee may also be a beneficiary and create conflicts.

# Addressing Conflicts of Interest

- A person can set themselves up in a conflict situation where an action in the business may benefit the person at the expense of the trust.
- Examples are:
  - Compensation, special fees, and overhead;
  - Diversification/Prudent Investor Rule;
  - Trustee individually owning interest in business; and
  - Characterization of distributions as income vs. principal.

# Addressing Conflicts of Interest

- A trustee should address conflict situations:
  - Disclose to the beneficiaries;
  - Disclosure will start limitations and may set up waiver/estoppel/ratification defense;
  - Have disinterested co-trustees approve transaction;
  - Obtain written consents;
  - Obtain written release on full knowledge;
  - File suit for judicial discharge or instruction; and
  - File suit to amend trust to provide exculpation and protection.

# Addressing Conflicts of Interests

- Otherwise, a trustee does have a duty to prudently manage trust assets.
- This duty may mean that a trustee has a duty to police the operation and management of the closely-held business interest.
- The trustee may have a duty to assert rights under the entity documents: obtain information, books and records, force buy-outs, and assert put options.
- A trustee may also have a duty to bring derivative actions.
- That may place the trustee in a very strange situation: suing itself!

# Addressing Conflicts of Interests

- A director/officer of a closely-held business should:
  - Try to diversify control.
  - Have a majority of directors that are disinterested.
  - Have the disinterested directors approve the action.
  - Appoint special committees to approve the action.
  - Appoint independent legal counsel to provide an opinion.
  - Disclose to all other directors/officers and owners.
  - Obtain consents and releases.



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# Attorney-Client Issues

# Attorney-Client Privilege

- Always be sure:
  - Who is the client?
  - What is the scope of the matter?
- A lawyer's communications with a fiduciary may not remain privileged.
- Possible ways to invade the attorney-client privilege:
  - Fiduciary exception
  - Successor fiduciaries
  - Change of corporate control
  - Joint privilege

# Fiduciary Exception

- Some states have a fiduciary exception to attorney-client privilege:
  - “Under [the fiduciary] exception, which courts have applied in the context of common-law trusts, a trustee who obtains legal advice related to the execution of fiduciary obligations is precluded from asserting the attorney-client privilege against beneficiaries of the trust.” *U.S. v. Jicarilla Apache Nation*, 564 U.S. 162 (2011).
- Rationale behind fiduciary exception:
  - Trustee obtains legal advice as representative of the beneficiaries because trustee has duty to act in beneficiaries’ best interest.
  - Fiduciary has duty of full disclosure of trust-related business to the beneficiaries.

# Fiduciary Exception

- When does the fiduciary exception apply?
  - When the advice was sought, no adversarial proceeding between trustee and beneficiaries was pending, and trustee had no reason to seek legal advice in personal rather than fiduciary capacity.
  - Advice sought only to benefit trust, not benefit trustee.
  - Advice paid for from trust funds.
- Advice paid for by the trustee for his own protection remains privileged, while advice paid for by trust for benefit of trust is not.
- Some courts have applied this exception to shareholder discovery of legal advice given to corporate management. *See, e.g., Garner v. Wolfinbarger* , 430 F.2d 1093 (5th Cir. 1970).
- Jurisdictions that apply this exception include Delaware, New York, Arizona, New Jersey, Washington.
- Jurisdictions that do not apply this exception include: California, Texas, Illinois, New Mexico, Massachusetts, and Oregon.

# Successor Trustees

- Some states require a predecessor trustee to disclose attorney-client communications concerning trust administration to the successor trustee:
  - Arizona. *In re Kipnis Section 3.4 Trust* , 329 P.3d 1055 (Ariz. Ct. App. 2014).
  - New Jersey. *In re Estate of Fedor* , 811 A.2d 970, 972 (N.J. Ch. Div. 2001).
- In California, successor trustees hold the predecessor's privilege as to communications about trust administration. *Moeller v. Superior Court* , 16 Cal. 4th 1124 (1997).
- So only successor trustees—not beneficiaries—can get the predecessor's attorney-client communications.
- Of course, successor trustees have a duty to bring claims against previous trustees.

# Successor Corporate Management

- When an attorney represents an entity, the client is the entity, not the individuals who manage the entity. See ABA Model R. Prof'l Conduct 1.13.
- “[W]hen control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well.” *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 349 (1985).
- In a corporate acquisition, “where efforts are made to run the pre-existing business entity and manage its affairs, successor management stands in the shoes of prior management and controls the attorney-client privilege with respect to matters concerning the company's operations.” *Tekni-Plex, Inc. v. Meyner and Landis*, 89 N.Y.2d 123 (1996).
- So, management and attorney should be aware of this potential ramification when management is transferred.

# Joint Privilege

- Attorney-client privilege does not apply when communication is:
  - Offered in action between joint clients.
  - Made between any of the clients and the lawyer.
  - Relevant to matter of common interest.
- Uniform Rules of Evidence 502(d)(6)
- Courts vary on how broadly they interpret “relevant” and “matter of common interest.”



# Conflict Situation

- One person/entity may need separate counsel in different capacities.
- For example, a trustee sued for breach of fiduciary duty may need two attorneys:
  - One to advise trustee on trust administration and management of closely-held business.
  - One to defend breach of fiduciary duty suit.
- Separate representations help keep trustee's defense privilege intact in states that apply fiduciary exception.

# Avoiding Privilege Problems

- Know who your client is.
- Have a written fee agreement or engagement letter.
- Limit the scope of the engagement in the fee agreement.
- Watch out for “mission creep.”
- Update the fee agreement or enter a new one for new matters.
- Avoid representing the same person in multiple capacities.
- If you do, consider conflicts both before and during the representation.
- Include a conflict waiver and a conflict-withdrawal provision in the fee agreement.

# Communications with Non-Clients

- Attorneys often need to communicate with other parties with whom they are aligned.
- This can be in transactions or in disputes.
- Many jurisdictions acknowledge that where parties have a “common interest” their communications will remain privileged.
- However, some jurisdictions (including Texas) hold that the common interest privilege only attaches after litigation has been filed.
- So, attorneys should be very careful to analyze the application of a common interest privilege before communicating with third parties.

# Communications with Non-Clients

- Courts hold that an attorney can create an attorney/client relationship inadvertently.
- Don't describe yourself as the lawyer for "the trust," particularly in states that do not follow the entity theory of trusts.
  - Beneficiaries may think you represent them.
- Similarly, owners or directors/officers may think that you represent them when you only represent the business.
- Describe your role precisely.
- Tell non-clients early and often that you do not represent them.
- Follow up with emails or correspondence to document.

# Payment of Fees

- Fiduciary may be entitled to reimbursement for their attorneys' fees.
- For acts as officer or director, look for indemnity provisions in bylaws or state statutes, which may include advancement rights.
- Also look for D&O coverage.
- For acts as trustee, trustee may be able to defend with trust assets.
- A trustee is entitled to be reimbursed out of the trust property, with interest as appropriate, for:
  - expenses that were properly incurred in the administration of the trust; and
  - to the extent necessary to prevent unjust enrichment of the trust, expenses that were not properly incurred in the administration of the trust.
- Uniform Trust Code § 709(a).

# Payment of Fees

- Trustees that lose typically are not entitled to reimbursement for fees.
- Trustees that win are typically allowed reimbursement for fees.
- A court may have discretion to award fees and expenses against any party or against the trust estate, regardless of who prevails:
  - “[W]hether a trustee should be awarded an attorney’s fee for defending a suit involving his administration of the trust depends upon equitable considerations, ...that the success or failure of the trustee in the litigation may be a matter to be considered but does not necessarily determine the trustee’s right to the fee, and that the trustee’s good faith and the reasonableness of his actions are matters to be considered ...” *American Nat’l Bank of Beaumont v. Biggs* , 274 S.W.2d 209, 222 (Tex. Civ. App.—Beaumont 1954, writ ref’d n.r.e.)

# Payment of Fees

- Courts have held that a trustee is not entitled to trust assets to pay for his or her defense until the underlying merits are decided.
- Consider a request for interlocutory or similar relief precluding use of trust assets to prosecute or defend case.
  - Uniform Trust Code § 1001: Court can remedy a “breach of trust that has occurred or may occur” with a laundry list of potential remedies.
  - May have to make a meaningful preliminary showing that there is a likelihood that the beneficiary will prevail.
- May be able to do by motion without TRO/TI.



# Disclosure Obligations



# Duty to Disclose

- There are four independent sources for a duty to disclose: the trust document, state statutory law, common law, and litigation rules.
- A settlor may limit disclosure obligations in a revocable trust – the settlor can always revoke it or change beneficiaries.
- In an irrevocable trust, statutes generally limit what a settlor can do regarding limiting the duty of disclosure.
- At common law, “trustees and executors have a fiduciary duty of full disclosure of all material facts known to them that might affect [the beneficiaries’] rights.” *Huie v. DeShazo* , 922 S.W.2d 920 (Tex. 1996).
- Affirmative duty to disclose or only upon request?

# Duty to Disclose

- A trustee may not have a duty to disclose:
  - Non-material facts;
  - Facts about a trustee's non-trust related activities;
  - Negotiations concerning the purchase or sale of trust assets (if disclosed, possible cure is a confidentiality agreement);
  - Private information (financial, medical, etc.) about other beneficiaries; and
  - Attorney/client communications.

# Duty to Disclose

- A duty to disclose is generally only about trust-related assets.
- Where a trust owns stock in a closely-held business, is the beneficiary limited to information about that stock or may the beneficiary delve deeper and obtain access to the business's information?
- Does the trustee have a duty to obtain information from the business and provide to the beneficiary or just what is in their possession, custody or control?
- If the business is wholly owned by the trust?
- If the business is only partly owned by the trust?
- May set up a conflict situation for the trustee – duty to business versus duty to beneficiaries.

# Duty to Disclose

- As explained by Bogert's, "many cases have held that beneficiaries of the trust are entitled to information about the business entity, especially when the trustee is an officer or director of the entity or, with the trust's interests, controls the entity, while other cases have held beneficiaries are not entitled to such information or have limited their right to receive it."
- Potential protection: nondisclosure agreement before production.



# Directed Trust Issues

# Directed Trusts

- One way to limit risk as a trustee is to have a directed trust where the third party is in charge of the closely-held business interest.
- If a trust instrument grants any person, including the trustor, an advisory or investment committee, or one or more co-trustees, authority to direct the making or retention of an investment or to perform any other act of management or administration of the trust to the exclusion of the other co-trustees, the excluded trustee(s) are generally not liable for a loss resulting from the exercise of that authority.
- The trustee generally does not have the duty to:
  - (1) monitor the conduct of the advisor;
  - (2) provide advice to the advisor or consult with the advisor; or
  - (3) communicate with or warn or apprise any beneficiary or third party concerning instances in which the trustee would or might have exercised the trustee's own discretion in a manner different from the manner directed by the advisor.

# Directed Trusts

- A trustee who acts in accordance with the direction of an advisor, as prescribed by the trust terms, is not liable, except in cases of willful misconduct on the part of the trustee so directed, for any loss resulting directly or indirectly from that act.
- If the trust terms provide that a trustee must make decisions with the consent of an advisor, the trustee is not liable, except in cases of willful misconduct or gross negligence on the part of the trustee, for any loss resulting directly or indirectly from any act taken or not taken as a result of the advisor's failure to provide the required consent after having been requested to do so by the trustee.
- So, in a directed trust, the trustee may be protected from diversification issues or the failure to monitor and police the management of the closely-held business.



# Co-Trustee Issues



# Co-Trustee Issues

- Settlers may set up trusts with two or more trustees.
- Each co-trustee owes fiduciary duties.
- Each co-trustee has a duty to monitor and manage the trust.
- They make decisions by majority decision unless the document states otherwise.
- Unless the document states otherwise and absent delegation, co-trustees must act together.
- A co-trustee cannot act singularly (even if he/she has the power) and breaches a duty if they do so.
- Co-trustees have a duty to cooperate with each other.
- A co-trustee can be removed if he or she is hostile and that affects the administration of the trust.
- Co-trustees have a duty to disclose to each other.

# Co-Trustee Issues

- Co-trustee can seek an accounting.
- Co-trustee compensation.
- Co-trustee has a duty to police each other and bring suit for material breaches.
- Co-trustees can be liable for each other's conduct.
- Deadlock and potential resolution:
  - Trust document solution (tie-breaker provisions)
  - Go to court and seek instruction
  - Go to court and seek additional trustees
  - Go to court and remove trustee(s)
  - Go to court and seek a receiver
  - Go to court and seek order/injunction or "order for other appropriate relief"



# Conclusion

# Conclusion

- There are many good reasons for a trustee to hold an interest (all or a portion) of a closely-held business.
- This asset does complicate trust administration.
- Further complications arise when the trustee takes a position in the entity as a director or officer.
- This presentation was intended to give general guidance on these interesting issues.
- A trustee should seek counsel in the relevant jurisdiction to assist with these thorny issues.

# QUESTION & ANSWER



