MODIFICATION AND TERMINATION OF TRUSTS

“Our goods, if we are so fortunate to have any, are not interred with our bones, but are left behind for others to enjoy. But we like to determine who shall enjoy them and how they shall be enjoyed. Shall we not do as we wish with our own?” Austin W. Scott, Control of Property by the Dead. I., 65 U. PA. L. REV. 527, 527 (1917)

Introduction:

The arguments started long before Generation X and irresponsible financial responsibility. Long before Medicaid trusts. GRITS GRATS and GRUTS. And 50 page trusts that are sold like blue light specials that will serve every client’s every need. The last being one of the causes for a need to discuss modifications of trusts. The former being the reason that brakes occasionally need to be applied to the notion that trust agreements are almost inherently in need of fixing after the fact. The purpose of this discussion is to address the need for the ability to modify trusts when appropriate but also to recognize that the creator of the trust has the right, even in death, to have the last say.

I extend thanks to my associate, Eric Schmitt, for some of the research prepared for the outline.

The Law:

Under the “Claflin doctrine,” [Claflin v. Claflin, 20 N.E. 454 (Mass. 1889)], the beneficiaries can compel termination or modification of a trust if and only if:

- All beneficiaries join in the request to the trustee or in the suit petitioning the court to modify or terminate the trust; and
- The proposed modification or the termination will not defeat a material purpose of the settlor in creating the trust.

633A.2202 Modification or termination by settlor and all beneficiaries.

1. An irrevocable trust may be modified or terminated upon the consent of the settlor and all of the beneficiaries.

2. Upon termination of the trust, the trustee shall distribute the trust property as agreed by the settlor and all beneficiaries, or in the absence of unanimous agreement, as ordered by the court.

3. For purposes of this section, the consent of a person who may bind a beneficiary or otherwise act on a beneficiary’s behalf is considered the consent of the beneficiary.

633A.2203 Termination of irrevocable trust or modification of dispositive provisions of irrevocable trust by court.

1. An irrevocable trust may be terminated or its dispositive provisions modified by the court with the consent of all of the beneficiaries if continuance of the trust on the same or different terms is not necessary to carry out a material purpose.
2. Upon termination of the trust, the court shall order the distribution of trust property in accordance with the probable intention of the settlor.

3. For purposes of this section, the consent of a person who may bind a beneficiary is considered the consent of the beneficiary.

4. For the purposes of this section, removal of the trustee or the addition of a provision to the trust instrument allowing a beneficiary or a group of beneficiaries to remove the trustee or to appoint a new trustee shall not be allowed as a modification under this section. This subsection shall not operate to limit the scope of dispositive provisions for the purposes of this section.

5. A spendthrift provision, or a provision giving the trustee discretion to distribute income or principal to a beneficiary or among beneficiaries, in the terms of the trust is presumed to constitute a material purpose of the trust.

633A.2204 Modification of administrative provisions by court for change of circumstances.

On petition by a trustee or beneficiary, the court may modify the administrative provisions of the trust, if, owing to circumstances not known to the settlor and not anticipated by the settlor, the continuation of the trust under its terms would defeat or substantially impair the accomplishment of the purposes of the trust. If necessary to carry out the purposes of the trust, the court may order the trustee to do acts that are not authorized or are forbidden by the trust instrument.

633A.2206 Reformation — tax objectives.

1. The court may reform the terms of the trust, even if unambiguous, to conform to the settlor’s intent if it is proved by clear and convincing evidence that the settlor’s intent and the terms of the trust were affected by a mistake of fact or law whether expressed or induced.

2. The terms of the trust may be construed or modified, in a manner that does not violate the settlor’s probable intent, to achieve the settlor’s tax objectives

633A.6304 Representation by holders of similar interests.

Unless otherwise represented, a minor or an incompetent, unborn, or unascertained person may be represented by and bound by another person having a substantially identical interest with respect to the fiduciary matter but only to the extent that the person’s interest is adequately represented.

The first questions to address when determining whether a trust can be modified or terminated:

1) Who are the interested parties?
   a) Minors or disabled?
   b) Unborn?
   c) Is our Settlor alive?
   d) Is the class open or closed?
e) Always remember that the Due Process clause controls no matter what a statute may say. Is there a person that may be deprived of a contractual right as a result of the proposed action?

2) What is the nature of the proposed change?
   a) Tax related.
   b) Administrative.
   c) Can you identify the material purpose for the trust?
   d) Cleary not anticipated by the settler?
   e) Is there an ambiguity (not actually a modification)?

3) Who do I represent?
   a) Assuming it is the Trustee, can they be sued?
   b) If it is a beneficiary, what rights am I giving up or gaining?
   c) Are there tax consequences for my client (if a beneficiary).

4) What forum is appropriate?
   a) Inter vivos trust or testamentary (huge difference).
   b) Family settlement or court approval?
   c) Real estate or non-real estate?

What constitutes a material purpose?

Just about anything. There are limitations on what may be a trust purpose, based upon public policy, but that is about it. The question here is whether a material purpose remains to be served by the continuation of the trust or whether a modification would do an injustice to the Settlor’s material purpose. It has been suggested that every trust should contain a statement as to what its material purpose is. One of the more interesting issues on the subject arose in an Iowa case.

In The Matter Of Trust Under The Last Will And Testament Of Weitzel, No. 9-929/09-0447 (Iowa Ct. of Appl. 2009). The Court discussed whether a spendthrift provision in, and of itself, constituted a material purpose. Despite the opinion being respectfully detailed, the court declined to adopt as law that a spendthrift provision is presumptively a material purpose. The court looked to the facts of the case as a whole and the settlor’s intent was clear that there were material purposes remaining to be served. However, ambiguity in this question has been resolved by the legislature.

Iowa Code Section 633A.2203(5) was adopted in 2012 and states “a spendthrift provision, or a provision giving the trustee discretion to distribute income or principal to a beneficiary or among beneficiaries, in the terms of the trust is presumed to constitute a material purpose of the trust.” Therefore, any attempt to terminate a spendthrift trust early must show that the spendthrift provision is not material. At the same time it appears that other states are moving away from this type of provision both legislatively and judicially. See In re Pike Family Trusts, 2012 ME 8 (2012).

The UTC Section 411(c) specifically states that there is no presumption that a spendthrift clause is a material purpose. See Richard C. Ausness, Sherlock Holmes and the Problem of the Dead Hand: The Modification and Termination of "Irrevocable" Trusts, 28 Quinnipiac Pro. L.J. 237,
264 (2015). Furthermore, the UTC Section 411(e) allows a court to terminate a trust even if some of the beneficiaries don’t agree if “(1) the court could terminate the trust if all of the beneficiaries could consent, and (2) the interests of non-consenting beneficiaries are adequately protected.” Id.

**Inroads being made in both the planning stage and post-mortem:**

The Trust Protector

A trust protector is not a trustee. *Ruce*, “The Trustee and the Trust Protector: A Question of Fiduciary Power. Should a Trust Protector Be Held To a Fiduciary Standard?” Drake L. R. Vol 59 67, 68 (2011). Instead a trust protector has powers granted by the trust which supersede some of the powers of a trustee. Id. The protector holds no title to property, but instead serves to represent the settlor’s interests. Id.

The trust protector can also be used to “referee” between the trustee and beneficiaries, through power to arbitrate disputes, change the trustee, add beneficiaries, or change the entire instrument. *Marshall*, “Trust Protectors- Increasing Trust Flexibility and Security While Decreasing

History of Trust Protectors.

Overseas history

The office of trust protector can trace its roots back to the late 19th Century. See *Ausness*, “When is a Trust Protector a Fiduciary?” Quinnipiac Probate L. Journal Vol 27, n. 3 277, 278. The earliest statute I have seen dates to the Bahamas Trustee Act in 1893 which allowed a settlor to give a non-trustee power over the trust. Id. However, the term “protector” would not be used for nearly 100 years later.

In 1989 the Cook Islands International Trusts Amendment Act expressly provided for trust protectors. Id. Here, the protector was described as “the holder of a power which whom invoked is capable of directing the trustee in matters relating to the trust and in respect of which matters the trustee has discretion and includes a person who is the holder of a power of appointment or dismissal of trustees.” Id. Other Commonwealth nations followed and statutes drafted allowed the protectors to have even more power. Id. at 279.

What can trust protectors do?

- Protector power can originate from the trust or from a state statute creating trust protectors. Frolik at 273.
  - Should a state lack a statute authorizing, the settlor can presumably still have a protector. Id. See also *Minassian v. Rachings* Fl. Ct. Ap. No. 4D13-2241 (2014).
- Most important powers of trust protectors encountered:
  - Oversee trustee and supervise
  - Advise trustee on investments
  - Act as mediator between trustee and beneficiaries
- Modify trust without need for judicial intervention. See Ausness 282-3.

- **Examples of powers**
  - **South Dakota:**
    - Modify or amend trust instrument for tax benefit
    - Change beneficiary interest
    - Modify power of appointment
    - Remove and replace trustee
    - Terminate the trust
    - Veto or direct trust distributions
    - Change situs of trust or governing law
    - Appoint successor trust protector
    - Interpret trust instrument
    - Amend trust instrument to take advantage of laws governing restraints on alienation
    - Provide direction regarding notification of qualified beneficiaries See S.D. Code 55-1B-6

- **Consensus among states varies**
  - All state statutes recognize that the trust instrument controls the protector’s power and existence. Id. at 1145.
  - Therefore, it can be assumed from the commentators researched that a protector can likely always be created, but a poorly drafted trust instrument in a state without statutory guidance could result in ambiguity on what a protector can do and the protector’s liability.

**Who wants a trust protector?**

- The main answer is a settlor who might desire to change the trustee.
- A court has the power to remove a trustee. UTC Section 706 includes reasons such as “unfitness, unwillingness, or persistent failure…to administrate the trust effectively that removal of the trustee best serves the interests of the beneficiaries.” UTC Section 706(b).
  - While these are broad grounds, proof is still required that the trustee has done something wrong. See Frolik at 279.
  - Settlors may want to avoid public spectacle, court costs, or just leave decision making up to someone other than an unknown judge. Id. 279-80.

**Who can be a protector?**
unless there is a state statute limiting appointments of protectors, the settlor is free to decide. Frolik at 282.

- Example: Idaho Code Section 26-3204(1) requires that any protector serving a fiduciary function to be a chartered bank or alternatively an attorney or accountant with a preexisting professional relationship with the settlor.

- Beware conflicts of interest! Professionals who act as protectors cannot have a conflict of interest. In Estate of Wimberley, Np. 31757-9-III, 2015 WL 410340, at 11-23 (WA Ct. App. 2015) the protector (an attorney) was removed for filing motions and petitions against a beneficiary.

- Corporate entities can also be protectors and don’t have the problem of retirement or dying like individuals (Frolik at 283-4).

- Successor protector can be provided for by the settlor, the preceding protector, or trustee/beneficiaries. Alternatively a court could be empowered to decide on a successor. Frolik at 287-8.

**Does a trust protector owe a fiduciary duty?**

- Some states mandate that a protector is a fiduciary. For example, North Carolina, Vermont, Virginia, and Wyoming. See Frolik at 289.

  - In respect to the power that are fiduciary in nature some states make protectors fiduciaries when they exercise those powers. See Miss. Code Sec. 91-8-808.

  - Therefore, it can be assumed in some states (like Mississippi) that a protector with fiduciary like powers is a fiduciary no matter what the trust document says.

- Other states require that fiduciary responsibilities be enumerated in the trust instrument before a court will impose said duties on a protector, such as Alaska’s statute. See Ausness at 294.

  - South Dakota and a few other states go farther and states a protector is not presumed a fiduciary absent enumeration in the trust instrument. S.D. Codified Laws Section 55-1B-1 (2011).

- The UTC Section 808 (by implication through the comment section) states that a person (other than a beneficiary) who has “power to direct is presumably a fiduciary.” UTC 808 cmt at 142.

  - In the absence of statutory guidance on other protector powers it would be ambiguous whether or not the protector is a fiduciary.

- In the absence of a statute, one must look at the settlor’s intent. See Bove, “The Case Against the Trust Protector” ACTEC Law Journal Vol 37:77, 82 (2011).

- Commentators have pointed out the difference between personal power v. fiduciary power

  - Personal powers do not require fiduciary considerations. See Ruce, 80-81.

  - Only duty with personal power is to follow the direction of the settlor and ensure no terms of the trust are violated.

  - A fiduciary duty assigned to a protector goes beyond the trust instrument. Id.

    - Protector must assure the action does not violate a fiduciary duty. Id.
- Restatement of Trusts 2nd supports this proposition and Indiana Code Sec. 30-4-3-9(b)(1) also concurs. Id.

- Foreign jurisdictions have considerable authority for considering protectors to be fiduciaries. See Ausness at 302.
  - In Skeats v. Evans, 42 Ch. D. 522 (1889) the English Chancery Court decided that some limits are required for a trust protector (or trust advisor) otherwise the protector would have the ability to abuse their office for their own gain.

Minimal standard of good faith.

- Should a trust fail to mention a standard of care, the standard of care will be good faith. Frolik at 291. This can be traced back to the UTC, which permits the trust instrument to prevail except in a limited number of causes, including allowing a trustee (or protector) to act in bad faith. Id.
- Settlor can still define what “good faith” is so as to limit protector liability, but still would need to avoid bad faith acts. Id.
- As good faith is the minimal requirement, the protector will have some affirmative duties if good faith is to have any meaning. See Id. at 294.
  - Powers to change the trust to take advantage of tax changes logically necessitate a good faith effort to keep track of tax changes and make said changes.
  - Similarly, a power to remove the trustee would necessitate some monitoring of the trust by the protector. Id.
  - To avoid ambiguity, the trust instrument should include the protector’s detailed responsibilities to act in good faith. Id.
- Some foreign courts have found fiduciary duties only for an affirmative act.
  - Royal Court of Jersey in Centre Trustees Ltd. & Langry Trust Co. Ltd. v. Pabst, 2009 JLR 202 (Royal Ct. of Jersey, 2009), found a refusal to act was not a breach of fiduciary duty. However, if the protector was to act they would have to act as a fiduciary.
- Exception: When the trust protector is also the beneficiary, especially when they are the only beneficiary. Ausness, at 304.
  - Ausness suggests that if there are other beneficiaries the protector/beneficiary will owe some duties just as a trustee/beneficiary would. Id.

American case law is extremely sparse on whether a trust protector is subject to any fiduciary duty. A recent law review article from the University Of Pittsburgh School Of Law in March 2016 had only found one case dealing directly with this question. See Frolik, Trust Protectors: Why They Have Become “The Next Big Thing” (March 2016). Sadly Robert T. MClean Irrevocable Trust v. Davis, 283 SW 3d 786 (MO Ct. App. 2009) and the subsequent case in 2011 failed to address the fiduciary duties in anything but dicta. However, Missouri has adopted a statute since the case that states protectors are fiduciaries absent a trust provision.
TRUST DECANTING ACT

Prefatory Note
The Uniform Trust Decanting Act is promulgated in the midst of a rising tide of state decanting statutes. These statutes represent one of several recent innovations in trust law that seek to make trusts more flexible so that the settlor’s material purposes can best be carried out under current circumstances. A decanting statute provides flexibility by statutorily expanding discretion already granted to the trustee to permit the trustee to modify the trust either directly or by distributing its assets to another trust. While some trusts expressly grant the trustee or another person a power to modify or decant the trust, a statutory provision can better describe the power granted, impose limits on the power to protect the beneficiaries and the settlor’s intent, protect against inadvertent tax consequences, provide procedural rules for exercising the power and provide for appropriate remedies. While decanting may be permitted in some situations under common law in some states, in many states it is unclear whether common law decanting is permitted, and if it is, the circumstances in which it is permitted and the parameters within which it may be exercised.

The act makes clear that the power to decant is a fiduciary power that must be exercised in accordance with the fiduciary duties of the authorized fiduciary. A fiduciary must administer a trust in good faith, in accordance with its terms (subject to the decanting power) and purposes, and in the interests of the beneficiaries. An exercise of decanting power must be in accordance with the purposes of the first trust. The purpose of decanting is not to disregard the settlor’s intent but to modify the trust to better effectuate the settlor’s broader purposes or the settlor’s probable intent if the settlor had anticipated the circumstances at the time of decanting.

One interesting possibility with regard to the decanting statute is a possible legislative solution to In re: Barkema.

Section 13
“(b) A special needs fiduciary may exercise the decanting power under Section 11 over the principal of a first trust as if the fiduciary had authority to distribute principal to a beneficiary with a disability subject to expanded discretion if:
(1) a second trust is a special needs trust that benefits the beneficiary with a disability; and
(2) the special needs fiduciary determines that exercise of the decanting power will further the purposes of the first trust.”

Comment:
Section 13 permits an authorized fiduciary to exercise the decanting power over a trust that has a beneficiary with a disability to create a special needs trust that governmental benefits programs will not consider a “resource” for purposes of the eligibility of the beneficiary with a disability for those benefits. Many governmental benefit programs restrict eligibility for those programs to only persons of limited resources. These resources may include any assets from which the beneficiary with a disability has the right to compel a distribution or a withdrawal. Special needs trusts are drafted so as to limit the distribution rights of the beneficiary with a disability and thus better permit the beneficiary with a disability to qualify for governmental benefits. Under Section 13 the authorized fiduciary may modify the dispositive provisions for the beneficiary with a disability even if the authorized fiduciary has no discretion to make distributions.
This is offered only for the purpose of adding humor to an otherwise horribly dry topic.

SECTION 23. TRUST FOR CARE OF ANIMAL.
(a) In this section:
(1) “Animal trust” means a trust or an interest in a trust created to provide for the care of one or more animals.
(2) “Protector” means a person appointed in an animal trust to enforce the trust on behalf of the animal or, if no such person is appointed in the animal trust, a person appointed by the court for that purpose.
(b) The decanting power may be exercised over an animal trust that has a protector to the extent the trust could be decanted under this [act] as if each animal that benefits from the trust were an individual, if the protector consents in a signed record to the exercise of the decanting power.
(c) A protector for an animal has the rights under this [act] of a qualified beneficiary.

Comment: Section 408 of the Uniform Trust Code permits a trust to be created for one or more animals who are alive during the settlor’s lifetime. In this section, the term “animal” should be construed to mean nonhuman animals, including pets and domesticated animals.

A few thoughts that will hopefully make this talk a little more useful:

1) Better drafting will often avoid the need for a modification or termination.
2) Better drafting begins with better planning.
3) Add flexibility whenever possible.
4) Recognize the limitation on accountability that use of a revocable trust creates.