ELECTRONICALLY REPRINTED FROM JUNE 2021
TRUSTS & ESTATES

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Drafting Trust Agreements With a Corporate Trustee in Mind

Proactively reassess boilerplate language

An elemental part of the trust creation process is selecting the trustee. Though many settlors initially consider appointing an individual, the benefits of a corporate trustee (CT) including significant experience, investment expertise, consistency, objectivity and a well-established back office to perform common administrative tasks are well known.[1] Banks and trust companies have the financial stability to make a trust whole in the event of an error, whereas individual trustees might not. In addition to these benefits, many settlors simply lack personal relationships with other individuals whom they unequivocally trust with the complexity or intimacy this arrangement requires.

On accepting the role, the trustee assumes fiduciary duties and the potential for liability to the trust and its beneficiaries. A trustee must rely on the trust agreement, as well as state statutory law and common law, to understand the full burden of the undertaking.[2] Provisions governing the trustee's role are often found in boilerplate language and tend to be tailored toward individual trustees. The drafting attorney should be mindful of the differences between individual trustees and CTs with respect to their capabilities and limitations and how those differences will likely play out in real world scenarios.

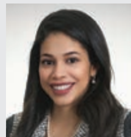
Certain trustee provisions may appear unproblematic, but for practical purposes pose a challenge for any trustee, especially a CT, to monitor and enforce. These provisions could be integral to the settlor's intent and, thus, exemplify the need for the attorney to consider the realistic outcome of certain boilerplate (and other) language and collaborate with the CT during the drafting stage prior to execution.

A significant advantage of CTs is that many have trust professionals who welcome the opportunity to provide feedback and who can share applied professional knowledge in this niche area. CTs devote significant resources to client services and often have seasoned trusts and estates attorneys on staff who partner with the drafting attorney to mitigate potential risk and ambiguities in the agreement.[3] A CT might be unable to serve due to certain trust provisions running afoul of its internal policies, requiring modification to align with those policies. The partnership between the drafting attorney and the CT at the onset of trust creation is therefore crucial to ensure a streamlined and cost-effective administration.

Let's address three common areas in which seemingly innocuous trustee provisions should be re-evaluated when using a CT: (1) subjective determinations of sobriety and incapacity; (2) litigation minimization clauses; and (3) funding and making gifts from the trust. Although we'll speak to general considerations, not every CT has identical preferences, requirements or policies. Some CTs offer comments and rely on the attorney's own personal drafting style to implement the requested changes, while others strongly suggest the use of certain form language prior to accepting a trust.

Subjective Determinations

Trust agreements often include provisions requiring a trustee to determine whether a party has substance abuse problems, can handle finances in a mature and sensible manner or has legal capacity.[4] These instructions to the trustee can be general and included as



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boilerplate, or the analysis can be quite extensive and specific. When using a corporate trustee, ensure that the trustee effectively can carry out the settlor's intent.

Sobriety clauses. Observing and supervising a beneficiary's actual or perceived substance abuse is a challenging job for any trustee, but is especially arduous for a trust officer. As already noted, provisions applicable to alcohol, drug and other substance abuse may be boilerplate, simply instructing the trustee to be wary of these situations and take action if necessary. In some situations, the beneficiary has a known dependence issue, and a fundamental purpose of the trust is for the trustee to try to protect the beneficiary from self-destructive actions. This situation may be problematic for both the CT and the beneficiary, depending on the specific CT selected. The CT is usually tasked with identifying erratic or unusual behavior or other tell-tale signs that a beneficiary may be in the throes of addiction. This is a subjective determination made by a trust officer who may have limited interaction with the beneficiary and a multitude of trust accounts in her book. Monitoring substance abuse presents further palpable challenges. To wit, the predictable tension with and pushback from the beneficiary, especially if the trustee withholds distributions, orders counseling and medical intervention or takes other drastic measures. Conversely, the CT faces potential liability if it fails to take "appropriate" action when it suspects, or has actual notice or knowledge of, a substance abuse problem.

Should the settlor desire substance abuse provisions or sobriety clauses in the trust, it's crucial to discuss these wishes with the CT team before the trust agreement is executed. Many trust companies routinely manage trusts with these provisions and serve for beneficiaries suffering from addiction and dependency problems. They can share valuable insights based on their experiences with similarly situated families, while realizing every family has a unique journey. Here are a few best practices to ensure that substance abuse provisions, or other "bad behavior" monitoring, in a trust agreement will have the best possible real world application.

Trust protector. A familiar option is to task a trust protector (TP) with making the triggering determination as defined in the trust agreement.[5] A TP can be an individual or a committee of individuals, personally familiar with the beneficiary, and given broad and malleable powers under the trust agreement. As long as the TP has personal and intimate knowledge of the beneficiary, the TP can be tasked with making this subjective determination. For example, in the case of a beneficiary who doesn't have a known substance abuse issue when the trust is created, a TP would be better situated to recognize changes in patterns of behavior of a beneficiary who begins abusing substances during the course of trust administration but is able to conceal such behavior during scheduled meetings with a trust officer.

The settlor should consider shielding the TP from liability so a family member or trusted friend can serve with less fear of litigation.

When using a TP in conjunction with a CT, an attorney should proactively consider including some often overlooked housekeeping items in the trust agreement. First, the agreement should clarify the role and responsibility of the TP, including how they interact with the trustee and whether they serve in a fiduciary capacity.[6] Second, the agreement should address resignation, removal and appointment of successor TPs. Commonly, an initial TP will be named, but the document will lack sufficient instructions if the named TP becomes unable to serve. Third, compensation provisions should be included to ensure transparency regarding the TP's fee. The term "reasonable compensation" is frequently used, but consider more concrete guidelines such as "as agreed upon" by the party who engages the TP (typically the settlor) or an hourly rate if the TP is a paid professional such as an attorney or accountant. Finally, the settlor should consider shielding the TP from liability so a family member or trusted friend can serve with less fear of litigation.

Actual knowledge or notice. CTs may have specific

requirements relating to substance abuse monitoring. For example, a CT may prefer the trustee take action only on acquisition of actual knowledge or notice of substance abuse. Various state statutes already use this standard, and it will generally be difficult for a CT to take anticipatory action. Consequently, drafters should consider indicating that the trustee is under no duty to inquire into a beneficiary's acts or conduct unless and until the trustee acquires that actual knowledge or notice.

Release and indemnification. Some CTs may also request, as a condition of agreeing to the substance abuse provisions, that a certain standard of care or evidentiary burden of proof be applied and that action (or inaction) on the part of the trustee be protected with release and indemnification provisions. A trust company may also request release and indemnity language for liability that results from action (or inaction) taken at the instruction of a TP, as well as protection for and from the TP's own actions (or inactions). Again, it makes sense for an attorney to partner with the CT to agree on language acceptable to the settlor and the trustee, so the trustee will accept the trust and administer it in a manner that best carries out the settlor's intent.

Incapacity. In a similar vein, requiring the CT to make determinations of a settlor's or beneficiary's incapacity is a provision that may appear straightforward but can create thorny practical issues. Generally, trust agreements may provide that: (1) the trustee alone makes the determination of incapacity; (2) the trustee may rely on the findings of one or more licensed physicians without a court adjudication; or (3) a court-adjudicated determination of incapacity is required. This is an important consideration for a settlor, and if they prefer to have the CT make this call, the attorney and CT should discuss how determinations of capacity would be handled.

Many CTs are wary of making an incapacity determination and prefer it be made solely by someone in a white coat or a black robe. Courts and physicians are considerably more qualified to judge an individual's capacity than a trust officer or corporate trust department. Besides, a CT would retain a physician or request declaratory action on capacity issues anyway. Accordingly, it makes sense to state in the trust agreement that capacity will be determined by a licensed physician or a court of competent jurisdiction. As a drafting note, when tasked with determining the capacity of the settlor, consider including language granting the trustee access to the grantor's health information otherwise protected under the Health Insurance Portability and Accountability Act of 1996 (HIPAA).

Financial mismanagement. Determination of a beneficiary's wherewithal and ability to properly manage finances and trust distributions is an equally tricky boilerplate provision. In simplistic language, the settlor usually instructs the trustee to withhold trust distributions if the beneficiary is ill equipped to manage wealth, squanders wealth or is generally not living up to the settlor's expectations.

Protecting beneficiaries from themselves is often the fundamental reason a trust is created. In situations in which the settlor and beneficiary have a personal and continuing relationship with the trust team, a CT might be better suited to fulfill the settlor's intent. In recent years, CT business models have included an increased focus on educating the next generation. Clients should ask their financial service providers about programs that could be helpful in alleviating concerns regarding a beneficiary's potential for financial mismanagement.

Notwithstanding financial educational programs, the best practice from a drafting perspective would be using a TP who personally understands the settlor's values and philosophy on wealth. Alternatively, implementing certain protections for a CT tasked with this responsibility would streamline a CT's decision-making process about whether to accept the trust. As with dependency issues, drafters should consider a provision requiring the trustee to have actual knowledge or notice of the frivolity, as well as release and indemnification for good faith actions.

Litigation Minimization Provisions

Mandatory arbitration. The use of mandatory arbitration clauses in trust agreements is a continuously developing area of trust law.[7] A common arbitration clause requires that for any dispute relating to the trust, all parties must use arbitration as the sole and exclusive remedy, with the result typically binding heirs and other successors to the parties subject to the arbitration as well. Several states permit some

form of arbitration provisions in trust agreements specifically by statute, while others have addressed it in court.[8] Some attorneys may include arbitration provisions in a trust agreement to hedge against risk of litigation regardless of whether the perceived benefits (for example, cost minimization, time minimization, increased privacy and a general litigation deterrence) are actually realized.[9] Arbitration clauses can be drafted either specifically for a settlor's family situation (anticipating that quarrelsome family members who are prone to litigate will do so against the trust or one another) or included as boilerplate and not discussed with the settlor.

When naming a CT, take certain additional considerations into account. For example, drafters should discuss the settlor's thoughts on dispute resolution and determine whether other avenues, such as using a TP or trust committee to initially resolve certain types of disagreements, can be pursued. It may also make sense to survey CTs to determine whether they've been involved in mandatory arbitration and whether the result met the settlor's intent regarding cost and time efficiency. Finally, if a mandatory arbitration clause must be included, drafters should ensure that the provision is carefully worded to be in accordance with both state law and best practices from reputable trade associations.[10]

No-contest provisions. No-contest (also known as "in terrorem") clauses have taken a prominent place in trust agreement boilerplate in recent years in states that permit their use.[11] These clauses are intended to compel compliance with the terms of the document by threatening disinheritance of the disgruntled party (and sometimes their heirs) if they challenge the terms of the trust agreement or the settlor's estate plan.[12]

Similar to drafting mandatory arbitration provisions, there are additional considerations when a CT is a trustee of a trust that contains a no-contest clause. In most cases, it's the trustee's responsibility to litigate trust claims, and the trustee is permitted to use trust assets to fund what could be costly litigation. This becomes especially problematic if the trustee is required to litigate issues involving not only the trust for which it serves but also those relating to the settlor's will, the estate or any other trusts applicable to the unsatisfied party (which may or may not include a similar no-contest provision). In this scenario, the CT is now the putative "defender" of the settlor's estate plan and could easily find itself in the difficult position of participating in litigation while balancing the needs of the other trust beneficiaries.

In many cases, no-contest clauses are strictly construed, narrowly enforced and may not be enforceable if a claim is brought in good faith and with probable cause. Yet, they can still serve a vital function in a settlor's estate plan. To that end, drafting attorneys should consider a few best practices. First, the settlor, attorney and CT should identify and discuss anticipated issues with heirs or other beneficiaries to determine whether a no-contest provision is appropriate. Second, the drafter should carefully review state law to ensure the provision is primed to withstand scrutiny and challenges and verify that its scope isn't unnecessarily broad. Third, the drafter should perform a holistic review of the estate plan and financial plan to ensure that provisions in other instruments don't undermine, but rather coordinate and complement, the no-contest clause.

Funding and Wealth Transfer

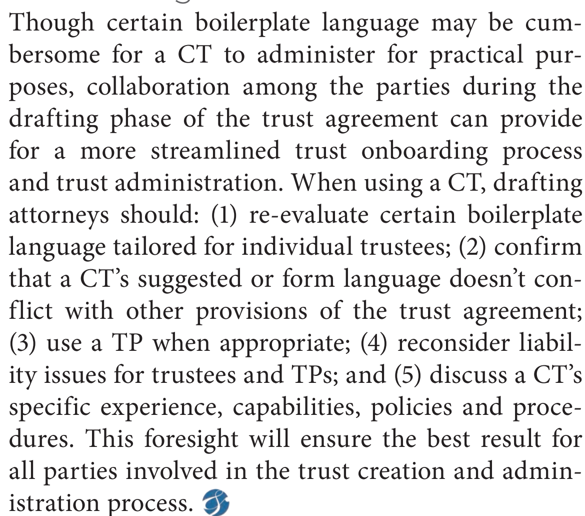
Funding. When using a CT, it makes sense to review which assets might create a problem from a practical administration perspective. In this context, the manner in which tangible personal property (TPP) will pass is often under scrutinized or addressed in boilerplate language. Many settlors will contribute TPP to a trust, but the CT has neither control nor custody of the property. This makes it challenging, if not impossible, for a trust company to track, insure and protect TPP until it can take custody, which generally occurs at the death or incapacity of the settlor/beneficiary. A way to solve for this reality is to distribute TPP outright or name the beneficiary with custody of the assets as a special trustee. A CT may also prefer that the trust agreement specifically state that any property added to the trust is subject to its acceptance and suggest a release for TPP not under its control.

Lifetime wealth transfer. Revocable trusts often provide the trustee the ability to make gifts on behalf of an incapacitated settlor. This may accomplish several goals, including tax-efficient wealth transfer and providing assistance to the settlor's loved ones. But even for an individual trustee without any perceived conflict of interest, this language can give rise

to numerous potential problems. The trustee could be placed in a situation in which individuals selfishly pressure the trustee to make gifts that might be contrary to the settlor's intent. For a CT, this is certainly fraught with peril because the trust officer would likely have difficulty determining who legitimately should receive distributions and who might otherwise be manipulating the situation to their improper advantage.

> When drafting a gifting provision, attorneys should consider limiting its scope.

When drafting a gifting provision, attorneys should consider limiting its scope. For example, allow gifts to spouses and minor children only, of specific maximum dollar amounts annually for others, to honor outstanding charitable pledges or to make new charitable donations in line with the settlor's historical pattern of giving. As always, the needs of the settlor should clearly take priority, and if distributions are to be made to others during the settlor's lifetime, consider making those other loved ones beneficiaries of the trust, if appropriate.



Final Thoughts

Though certain boilerplate language may be cumbersome for a CT to administer for practical purposes, collaboration among the parties during the drafting phase of the trust agreement can provide for a more streamlined trust onboarding process and trust administration. When using a CT, drafting attorneys should: (1) re-evaluate certain boilerplate language tailored for individual trustees; (2) confirm that a CT's suggested or form language doesn't conflict with other provisions of the trust agreement; (3) use a TP when appropriate; (4) reconsider liability issues for trustees and TPs; and (5) discuss a CT's specific experience, capabilities, policies and procedures. This foresight will ensure the best result for all parties involved in the trust creation and administration process.

Endnotes

1. For purposes of this article, the terms "corporate trustee" or "trust company" are used broadly and generally include any national or state bank or trust company having trust powers.
2. In addition to complying with state law, a trustee must ensure the trust complies with various federal laws.
3. Please consult with the specific corporate fiduciary. In most cases an attorney-client privileged relationship doesn't attach to the settlor, beneficiaries or trust, but the services are provided merely in a consulting and educational capacity.
4. Legal capacity is often defined by state law and isn't necessarily entirely a subjective analysis as many objective factors are taken into account under various state laws.
5. This article uses the name "trust protector," but this role can have any title. The trust protector carries out administrative and special tasks outlined in the trust agreement that aren't required of the trustee.
6. Whether a trust protector is a fiduciary is based on state law and the terms of the trust agreement and is beyond the scope of this article.
7. Mandatory arbitration clauses may appear in wills depending on state law, and a discussion of this topic is beyond the scope of this article.
8. As of the date of this article, a handful of states currently permit alternative dispute resolution provisions to be included in wills or trust agreements; *Rachal v. Reitz,* 403 S.W.3d 840 (Tex. 2013) (mandatory arbitration provision was enforceable by trustee who drafted the arbitration provision against a beneficiary); more recently, *see Kelly v. Giuliano et al.,* CL-2020-0007479 (Va. Cir. Ct. Sept. 21, 2020) (Fairfax County City Court held that a trust isn't a contract and thus, arbitration provision in trust agreement is unenforceable).
9. W. Cameron McCulloch and Michelle Rosenblatt, "Drafting & Enforcing Arbitration Clauses in Wills, Trusts & Settlement Agreements," *Estate Planning Journal,* Vol. 12, 103 (Issue 1, 2019), at p. 106.
10. *See* David L. Evans and India Johnson, "The Top Ten Ways to Make Arbitration Faster and More Cost Effective," American Arbitration Association (2013), *www.adr.org/sites/default/files/document_repository/the-top-10-ways-to-make-arbitration-faster-and-more-cost.pdf.*
11. Enforceability depends on the governing jurisdiction. This is a continuously developing area of trust and estate law. Many states won't enforce such clauses if the beneficiary had "probable cause" or acted in "good faith" in initiating an action. *See, e.g.,* Tex. Est. Code Section 254.005 (2019) (no-contest clauses will not be enforced when raised with just cause and in good faith).
12. In some cases, a no-contest clause will broadly cover all facets of an estate plan, including the will, the estate and other trusts.

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