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Those Crazy Lay Fiduciaries

What to Watch for When Working with Them

Cover Story

Oh, Those Crazy Lay Fiduciaries!

What Professionals Should Watch When Working With Them

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Your company is the trustee and the deceased grantor's doddering husband is the co-trustee. Or your company is the directed trustee, with Uncle Louie—self-styled venture capitalist and legend in his own mind—as the investment advisor. Or your company is the sole trustee, but the grantor's daughter, ever-fickle, was the questionable choice as trust protector.

But, you and your company are professionals, and you know how to cope with these situations. The trust's governing instrument looked solid to you and your colleagues after careful review, when your company agreed to serve as trustee. Plus, you've got many Delaware statutes aligning with the governing instrument to protect you. You're all set, right?

Yes, legally—but maybe not practically speaking. There are at least two reasons for this. The first is that not only are lay fiduciaries not "professional," but also they often have some personal interest in the trust or a relationship to one or more of its beneficiaries. The second reason is the old wisdom about lawsuits: you can't prevent people from filing them, but you can do your best to minimize that possibility, and to minimize the plaintiffs' possibility of success if they do. One way to do that is to watch out for the foibles of the very human lay fiduciaries who may play a role in the trust your company is administering. Several cases from Delaware and other jurisdictions over the last decade illustrate this.

At first glance, the task might seem easy—just prevent the greedy lay fiduciary from looting the trust. One can only wish there had been a professional fiduciary somewhere in the picture in the tragic *Hardy* case.[1] A sexual abuse victim placed a large cash settlement in trust, naming his sister and nephew as trustee. From an original settlement amount of about $345,000 in late

October 2011, by the end of that November about $160,000 remained in the trust; by the end of December about $98,000 remained; by the end of February 2012 (when suit was filed) about $34,000 remained; and by the end of March 2012, about $3,000 remained. In addition to squandering the trust assets under their charge (spending it on themselves, particularly for cars and various real estate investments), the lay trustees also (among other actions) had the reliant beneficiary sign broad unconscionable prospective waivers, and manufactured records after discovery requests were made.

In our little state alone, though, recent cases illustrate that it isn't just simple greed (as in *Hardy*) that you, the professional fiduciary, should watch out for in your lay counterparts. Their motives can vary as much as human beings themselves. In the *Paradee* case,[2] the decedent's second spouse did her level best to badger the lay fiduciary (her insurance broker) to terminate—and when that didn't work, to render valueless through large loans against the underlying insurance policy's cash value—an insurance trust for the benefit of the decedent's grandson by the decedent's first spouse. After the broker died, she became the trustee. The court found that she "consciously, intentionally, and vengefully refused to take any action to protect or preserve the [underlying insurance policy] because she did not want [the grandson] to benefit." The tricky element here was that she didn't want or need the money she was siphoning out of the trust. In other words, there was no obvious "greed" motive on the part of the lay fiduciary that a professional fiduciary (had one been involved) could have readily spotted. Instead, she simply disliked her husband's grandson, and resented the existence of a trust that would provide financial benefits to him.

As another example, consider the individual trustee in the *Mennen* decision,[3] whose aims the Master in Chancery described thusly:

> [M]ost of the transactions were motivated by something far more amorphous, but much more pervasive: pride. That is, because most of the trustee's personal fortune was out-of-reach in his own trust, the trustee turned to his brother's trust as a piggy bank he readily opened to fund a few private companies in which the trustee had invested his time and on which he had staked a claim that he was uniquely skilled at selecting and advising small fledgling companies that he could turn into the "next big thing." Certain that fortune and acclaim were around the bend, the trustee eschewed the interests of the beneficiaries in favor of subsidizing his self-aggrandized standing as a financier.

Here again, the "deadly sin" involved wasn't greed—it was pride.

Two recent decanting cases from New England have received national attention, and they're also instructive for professionals regarding lay fiduciary motivations. In the *Hodges* case out of New Hampshire,[4] the lay fiduciary (an employee of the grantor's company) would "hop off" as co-trustee so that the grantor's lawyer could "hop on" in his place to perform the decanting, after which the grantor's lawyer would "hop off" and the lay fiduciary would "hop back on" again. This happened twice. It's a little unclear whether the other usual trustee (who was also a lawyer) should be considered "lay" or "professional" here. Regardless, there was abundant evidence that the grantor (whose feelings about certain beneficiaries had changed over the years) masterminded the decantings, and that all of the fiduciaries simply rolled over to allow them to happen. Similarly to *Paradee*, the motivation was the grantor's dislike of the beneficiaries. And the twist here is that the lay fiduciaries' collective foible was an inappropriate level of loyalty to the grantor (rather than some negative emotion directed at one or more beneficiaries).

The other recent decanting opinion from east of the Hudson is the *Ferri* decision,[5] involving a Massachusetts decanting amidst a Connecticut divorce. The lay fiduciary (brother and business partner of the beneficiary) decanted his brother's trust when he learned of the brother's pending divorce—even though the beneficiary-brother could withdraw 75%, and later all 100%, of the trust at the time. In upholding the decanting, the Massachusetts high court depended on the Connecticut high court's recitation of (in turn) the Connecticut divorce court's finding that the beneficiary-brother hadn't consented to (or even been informed of) the lay fiduciary's decision to decant. Despite the Connecticut divorce court's "non-collusion" finding, the lay fiduciary's motivation—similar to that in *Hodges*—was loyalty (in this case, to the beneficiary rather than to the grantor). The Massachusetts high court upheld the decanting, but imagine the hesitation a professional fiduciary might have had were it involved in this case in some way.

These cases also demonstrate that often, trust instruments and statutes can only be as protective as those who are implementing them are inclined to be. Institutional limits of professional fiduciaries—regulatory, inherent checks-and-balances of more than one decision-maker, etc.—will usually supply key controls against the mis-exercise of fiduciary powers. But a lay fiduciary won't have those sorts of controls, and therefore might be more susceptible to ignoring fiduciary duties and abusing fiduciary powers.

The most basic example is a fiduciary's simple legal authority over assets. If the sole fiduciary of a trust withdraws money from the trust account, there is nobody to tell him what he can or can't do with the money before the fact. Before malfeasance occurs, one can only hope that the grantor selected the right fiduciary, one who understands her moral and legal obligations. Only after an act has occurred can a beneficiary or a court react. Other authority that a faithless fiduciary might abuse include providing information to beneficiaries, sale and investment powers, and distribution authority. The "hop-on, hop-off" decantings in *Hodges* immediately come to mind. Realizing the scope of the raw power held by a lay fiduciary should give pause to the professionals who are working with that lay fiduciary.

Once on higher alert as to what lay fiduciaries might do and why they might do it, the professional trustee should monitor acts or proposed courses of action of a lay fiduciary that may raise suspicions. Even though a directed trustee, for example, has no obligation to second-guess direction or to monitor or warn beneficiaries,[6] the directed trustee may still sound the alarm if warranted. More succinctly, "has no duty" or "isn't liable" does not mean "shall not."

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Some might argue that the duty of a directed trustee to follow investment direction might provide the "shall not." But if you, as a professional trustee, have the deepest concerns about a lay fiduciary's proposed or apparent behavior, should you really stand idly by? There could be situations whereby, in this writer's view, your company's risk of not following direction is surpassed by the risk to the beneficiaries and to your company of following direction. If your team thinks whistleblowing—whether to beneficiaries, a Trust Protector, or even a court—is the best way to protect your company or the beneficiaries, speak up. And don't forget the Delaware statute that is one of a professional fiduciary's best friends, yet isn't even found in Title 12—the petition for instructions statute (10 Del. C. § 6504).[7] Use it to your advantage if you have to. And in the meantime, keep an eye on those lay fiduciaries.

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Notes:
1- *Hardy v. Hardy*, 2014 WL 3736331 (Del. Ch. July 29, 2014).
2- *Paradee v. Paradee*, 2010 WL 3959604 (Del. Ch. Oct. 5, 2010).
3- *Mennen v. Wilmington Trust Co.*, 2015 WL 1914599 (Del. Ch., April 24, 2015).
4- *Hodges v. Johnson*, 177 A.3d 86 (N.H. 2017).
5- *Ferri v. Powell-Ferri*, 72 N.E.3d 541 (Mass. 2017).
6- *See, e.g.*, 12 *Del.* C. § 3313.
7- *See In re Trust u/a McKinley*, 2002 WL 31934411, at *4 (Del. Ch. Dec. 31, 2002) ("Manifestly, a trustee is entitled to seek judicial instructions on issues that concern the administration of the trust," *citing Scott, The Law of Trusts* § 188.4, n.12).