

By **Anthony A. Froio** & **Manleen Singh**

## An Effective Strategy for Disputes With Beneficiaries

Testamentary trustees should seek court involvement early in the process

**A**dministration of a trust requiring distributions to more than one beneficiary can be fraught with disputes. The specific disputed issues can be anything, but the goal for the beneficiary raising the issue is, more often than not, the same—a larger share of the trust estate. In an effort to resolve disputes, the trustee, however, may need to spend trust assets, whether to negotiate a settlement or, if negotiations fail, to hire outside counsel and/or initiate legal proceedings. With the value of the trust estate reduced as a result, the trustee risks facing even more objections from beneficiaries that cause additional cost and delay in distributions. How can a trustee administer the trust and make distributions with minimal cost to the trust estate when faced with beneficiaries who continue to object? The answer may lie in proactively initiating a proceeding in a court with the relevant expertise and experience.

### Trustee's Duties and Roles

Before we explain what may seem to be a counterintuitive strategy, let's step back and review the role of a trustee in a testamentary trust. While administering the trust, a trustee must comply with several duties. One important duty is to administer the trust reasonably and in good faith. The trustee incurs this duty from the moment she accepts her appointment. Another equally important duty is of loyalty: A trustee is a fiduciary with duties of loyalty to all beneficiaries. In addition to prohibiting self-dealing by the trustee, the duty of

loyalty requires the trustee to treat all beneficiaries, and all classes or groups of beneficiaries, fairly and impartially. The trustee can't favor one beneficiary or class of beneficiaries over another. Other duties include: reporting to beneficiaries and providing them with a timely accounting of the trust estate; delegating responsibilities to a third party so long as it's reasonable to do so; and diversifying investments of trust assets pursuant to the prudent investor standard.

As mentioned above, a trust that provides for distributions to multiple beneficiaries is fertile ground for disputes. The trustee can minimize the opportunity for such disputes by communicating openly and regularly with beneficiaries, increasing transparency to beneficiaries with updated and timely accountings of the trust estate and keeping detailed and organized records of all trust activities. Ideally, the trustee can terminate the trust when all beneficiaries sign written assents to a final accounting and all distributions have been made.

### A Trustee Catch-22

But, what if these efforts aren't enough, and a beneficiary objects to an accounting and/or refuses to assent? Or, worse, what if the trustee, while acting reasonably, is accused of violating her duty of loyalty? Frequently, a trustee must make decisions on how to allocate trust costs; how she allocates such costs has a direct impact on the amount of distributions available to beneficiaries. This conundrum became clear to us in one matter we handled in which a trust had two classes of beneficiaries: Class A beneficiaries would receive the net proceeds from the sale of certain property on the death of the settlor, while Class B beneficiaries would receive any and all remaining trust assets after specific distributions and trust expenses had been paid. How should the costs associated with the sale of the property be allocated?

A trustee could reasonably decide to categorize such

**Anthony A. Froio** is managing partner, and **Manleen**



**Singh** is an associate, both at Robins Kaplan LLP in Boston



costs as general trust administration expenses because the trust required her to sell the property and distribute the net proceeds to Class A beneficiaries. In the matter we handled, the trustee did just that, and, as a result, the remainder of trust assets decreased, along with the amounts to be distributed to Class B beneficiaries. Conversely, a trustee may reasonably charge the costs associated with the sale of the property against proceeds received from that sale because the two are intertwined. The inevitable result is a reduction in the amount distributed to Class A beneficiaries. In either scenario, the trustee has a reasonable basis for making her decision

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regarding allocation of the costs associated with the sale of the property. And, in either scenario, one class of beneficiaries could accuse the trustee of violating her duty to act impartially by favoring the other class, as shown by the resulting negative impact on their distributions. The classic Catch-22. Indeed, in our matter, Class B beneficiaries did make such accusations and even brought a lawsuit against the trustee.

### A Seemingly Reasonable Solution

The trustee always has the option to pre-empt this issue outside of court. She could send a detailed letter to all beneficiaries in which she explains her cost allocation decisions and encloses what she believes to be the final trust accounting. In this letter, the trustee could request beneficiaries to review the accounting and, if they have no objection, to sign appropriate assents. At first blush, this may seem like the most reasonable, cost-efficient way to resolve the issue before it festers into disputes resulting in litigation. This method can be successful,

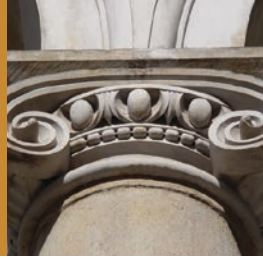
but its success remains wholly dependent on the beneficiaries and their goals. Calm, cool-minded beneficiaries can listen to and contemplate the trustee's reasoning and conclude that the trustee is administering the trust in good faith, reasonably and impartially.

For aggressive beneficiaries whose only focus is their bottom line, however, this letter may simply mark the beginning of a long and difficult journey of trust administration tangled with conflict and dispute. That journey could include multiple meetings requiring the trustee to explain each and every allocation, multiple revisions to trust accountings, multiple letters to beneficiaries explaining the changes to trust accountings and on and on. If still unsatisfied, such beneficiaries may quit settlement negotiations, refuse to assent and delay the orderly administration of the trust until the trustee takes formal action. Moreover, the beneficiary may seek relief in a court of general jurisdiction. Now, in addition to her responsibilities in administering the trust, the trustee has to defend herself in litigation, which often entails the retention of outside counsel.

In short order, the general trust administration costs mushroom exponentially with the incurring of attorneys' fees and other litigation costs and expenses on top of the previous costs associated with out-of-court settlement negotiations. In their quest for larger distributions, these beneficiaries may not appreciate that their efforts also can simultaneously reduce their distributions because of the cumulative effect of increasing general trust administration costs that erode the trust assets. At the conclusion of litigation, all beneficiaries, objecting or not, may have been adversely impacted, and no one is satisfied.

### Go to Court Early

One strategic alternative for a trustee to consider is seeking instruction from the court early on in the administration process. Promptly on the death of a decedent, the testamentary trustee should open the lines of communication with all beneficiaries to keep them apprised of the assets of the trust and the progress of the trust administration process, as well as to establish a relationship of trust and credibility. While open communication increases transparency for beneficiaries, it also allows the trustee to learn about the personalities and goals of each beneficiary. If the trustee foresees a dilemma akin to the one described above, or any other scenario that




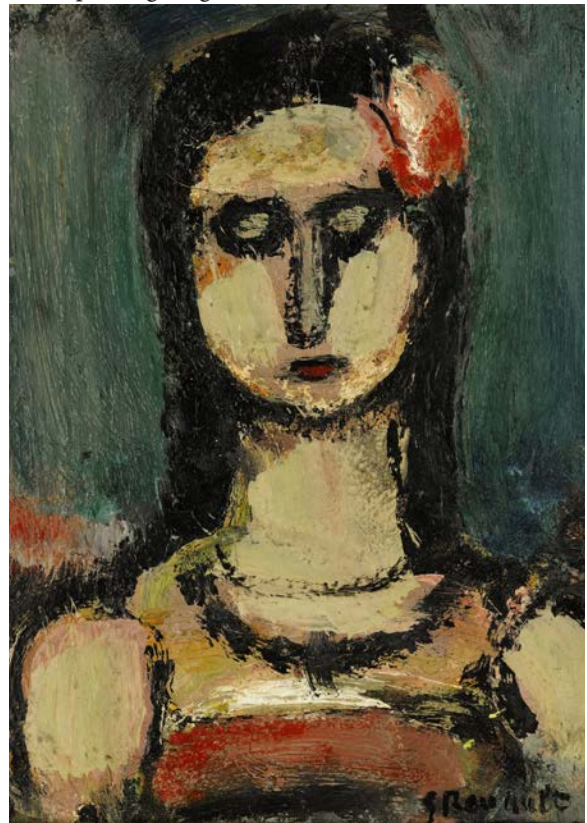
similarly places the trustee in a Catch-22, and the trustee has learned that at least one beneficiary (or class of beneficiaries) is unlikely to assent and may have a tendency to object, the trustee should file a petition for instructions with the probate court, or other court specially designated to hear trust disputes, as soon as possible.

The advantages of filing a petition for instructions sooner rather than later are many. First, the act of filing the petition with the probate court effects jurisdiction over the trust with a court that has an intimate understanding of trust administration and the associated duties of a trustee. This forecloses the opportunity for an objecting beneficiary to initiate a proceeding in a court of general jurisdiction where experience and expertise in matters regarding trust administration may not be as robust. Second, the trustee transfers her decision-making power regarding the disputed issue over to the court via the petition for instructions. With the court order in hand that dictates how the disputed issue must be resolved, the trustee has authority to proceed without fear of being accused of violating a fiduciary duty. Third, a court order conclusively determines the rights of all interested parties, absent fraud to the beneficiaries. And fourth, early resolution of disputed issues by a court order allows the trustee to minimize general trust administration costs that she may have had to incur as a result of negotiating with an objecting beneficiary before ultimately going to, or being dragged into, court. Of course, every jurisdiction is different, and practitioners should confirm the proper procedure to seek instructions from a court of appropriate subject matter jurisdiction.

Even though the advantages of going to court early are plentiful, a trustee must also ensure that she's not taking such formal action prematurely. Legal fees and costs, especially attorneys' fees, can grow quickly. While a trust typically covers such expenses, that coverage is only available so long as the trustee is acting reasonably. If a trustee seeks a court order before a dispute exists or before a trustee learns more about the beneficiaries and their likelihood to assent (or object), she risks facing an objection to the incurred legal expenses and losing that coverage. The trustee can reduce that risk by ensuring there's a reasonable need to seek instructions from the court. One way to show reasonableness is by documenting all communications between a trustee and all benefi-

ciaries. That way, if communications become adversarial and a trustee decides to go to court, she can show the court what led her to that decision.

A trustee may feel as if she's in a no-win situation when administering a trust with continuously objecting beneficiaries. In such cases, seeking instructions from a court with the relevant area of expertise may be the best strategy to accomplish the goal of administering the trust to its closure, with minimal risk of liability and, ultimately, accomplishing the goals and wishes of the settlor. 



## SPOT LIGHT

### Lady in Red

"Fleurs Du Mal," by Georges Rouault, sold for \$49,174 at Sotheby's Impressionist & Modern Art Day Sale in London on Feb. 4, 2016. Rouault's early work was influenced by his fascination with medieval art. In the later years of his career, he transitioned to predominantly painting religious figures, incorporating the vibrant colors reminiscent of medieval stained glass windows into the works.