

The Crossroads of Estate, Ethics, and Special Needs Planning

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The Uniform Trust Code (“UTC”) was adopted in Kentucky on July 15, 2014 and with this adoption came a litany of questions from both attorneys and those who provide services to trust beneficiaries, mainly trustees. While the UTC was adopted to strengthen and more clearly define the rules applicable to trust administration, it will take some time before this outcome is fully realized. If, however, attorneys and trustees continue to work together to ensure that legal documents are properly drafted and their terms are enforced in an ethical and consistent manner, the UTC will become much more valuable.

First, however, before exploring the UTC and the duties it imposes upon trustees, it is important to define the scope of responsibilities trustees and attorneys owe to their clients/beneficiaries. In other words, who does the trustee and the attorney advising the trustee owe a duty? Answer - while trustees owe several duties to the beneficiaries of a trust, the attorney advising the trustee is only responsible for representing the trustee (the fiduciary) individually and not the beneficiaries of the trust.ⁱ This position was formally adopted by the Board of Governors of the Kentucky Bar Association in formal ethics opinion E-401. In this ethics opinion, the following conclusions were made:

1. In representing a fiduciary, the lawyer’s client is the fiduciary—not with the trust or estate, or with the beneficiaries of a trust or estate.
2. The fact that a fiduciary has obligations to the beneficiaries of the trust or estate does not in itself either expand or limit the lawyer’s obligations to the fiduciary under the Rules of Professional Conduct, nor impose on the lawyer obligations toward the beneficiaries that the lawyer would not have toward other third parties.
3. The lawyer’s obligation to preserve client’s confidences under Rule 1.6 is not altered by the circumstance that the client is a fiduciary.
4. A lawyer has a duty to advise multiple parties who are involved with a decedent’s estate or trust regarding the identity of the lawyer’s client and the lawyer’s obligations to that client. A lawyer should not imply that he or she represents the estate or trust or the beneficiaries of the estate or trust because of the probability of confusion. Further, in order to avoid such confusion, a lawyer should not use the term “lawyer for the estate” or the term “lawyer for the trust” on documents or correspondence or in other dealings with the fiduciary or the beneficiaries.
5. A lawyer may represent the fiduciary of a decedent’s estate or a trust and the beneficiaries of an estate or trust if the lawyer obtains the consent of the multiple

clients, and explains the limitations on the lawyer's actions in the event a conflict arises, and the consequences to the clients if a conflict occurs. Further, a lawyer may obtain the consent of multiple clients only after appropriate consultation with the multiple clients at the time of the commencement of the representation.

Example: An attorney is hired by a disabled person to help establish a first party special needs trust to preserve his eligibility for government benefits after the receipt of an inheritance. During the drafting process, a bank is engaged to provide corporate trustee services due to the disabled person's inability to serve as trustee of their own trust. Unfortunately, however, several legal issues arise during the administration of the trust, specifically issues that relate to the ability for the trust to pay family for the care provided to the disabled person. As a result, the trustee contacts the attorney who drafted the trust for legal guidance, but the trustee is informed that absent consent of all the parties, the attorney is ethically prohibited from providing counsel to the trustee due to a conflict of interest with the original client, the trust beneficiary. Fortunately, all parties executed a waiver of conflict and consent to mutual representation agreement allowing the attorney to proceed with providing the trustee with legal counsel.

Whenever an attorney represents a Trustee of a trust, said attorney must ensure the he or she is capable of diligently representing the Trustee (as defined in Kentucky Rule of Professional Conduct Rule 1.3); capable of competently representing the Trustee (as defined in Kentucky Rule of Professional Conduct Rule 1.1); and capable of communicating his or her knowledge about the relevant issues facing the Trustee. In lieu of Kentucky's recent adoption of the UTC, it is imperative that attorneys who focus on estate planning, specifically those advising Trustees, understand the duties required of trustees under the uniform code. Similar to the duties the Kentucky Bar Association established for attorneys, the UTC requires Trustees to perform certain duties in order to uphold their fiduciary responsibility to the beneficiaries of the trust being administered. By reviewing, studying, and hopefully understanding the remainder of this article, an attorney should be able to satisfy the above ethical responsibilities owed to a client who is a Trustee.

I. Duty to Administer Trust

Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries.ⁱⁱ In other words, the UTC requires a trustee to manage the trust in good faith for the benefit of the beneficiaries, both current and successor beneficiaries, in accordance with the terms of the trust agreement. This requirement solidifies the long-held common law position that part of the general duty to administer trusts obligates trustees to treat the interests of all beneficiaries equally, to act with prudence, and to keep beneficiaries reasonably informed of trust matters.ⁱⁱⁱ

Not only is this duty the first duty set forth under the UTC, but also its broad scope establishes the framework for the remaining duties as well. By administering a trust in good faith, a trustee must make certain to perform many of the other duties set forth under the UTC, such as the duties of loyalty

and impartiality, and to inform and report beneficiaries of trust activities. Thus, this duty requires a trustee to consider the terms, purposes, distributional requirements, and other circumstances surrounding the trust and consider present as well as future beneficiaries in all matters involving its administration.^{iv} In short, consider this the catch all duty.

II. Duty of Loyalty

A trustee shall administer the trust solely in the interest of the beneficiaries.^v This duty identifies various scenarios a trustee should stay away from in order to avoid a conflict of interest with the beneficiaries of the trust.

For example, a transaction involving a conflict of interest between the trustee's fiduciary and personal interests is voidable by the beneficiary, unless:

- a. The transaction was authorized by the terms of the trust;*
- b. The transaction was approved by the court;*
- c. The beneficiary did not commence a judicial proceeding within the time allowed by KRS 386B.10-050 (1 or 5 years);*
- d. The beneficiary consented to the trustee's conduct, ratified the transaction, or released the trustee in compliance with KRS 386B.10-090 (beneficiary's consent, release or ratification); or*
- e. The transaction involves a contract entered into or claim acquired by the trustee before the person became or contemplated becoming trustee.^{vi}*

A sale, encumbrance, or other transaction involving the investment or management of trust property is presumed to be affected by a conflict between personal and fiduciary interests if it is entered into by the trustee with:

- a. The trustee's spouse;*
- b. The trustee's descendants, siblings, parents or their spouses;*
- c. An agent or attorney of the trustee; or*
- d. A corporation or other person or enterprise which the trustee, or a person that owns a significant interest in the trustee, has an interest that might affect the trustee's best judgement.^{vii}*

A transaction between a trustee and a beneficiary that does not concern trust property, but that occurs during the existence of the trust or while the trustee retains significant influence over the beneficiary and from which the trustee obtains an advantage, is voidable by the beneficiary unless the trustee establishes the transaction was fair to the beneficiary. In addition, a transaction concerning trust property in which the trustee engages in the trustee's individual capacity involves a conflict between personal and fiduciary interests if the transaction concerns an opportunity belonging to the trust.^{viii}

Example: trustees should not enter into a business in direct competition with a business owned by the trust or individually purchase an investment that the trustee was expected

to purchase for the trust.^{ix} Finally, this duty of loyalty does not preclude the following transactions, if fair to the beneficiaries:

- a. *An agreement between a trustee and a beneficiary relating to the appointment or compensation of the trustee;*
- b. *Payment of reasonable compensation to the trustee;*
- c. *A transaction between a trust and another trust, decedent's estate, or conservatorship of which the trustee is a fiduciary or in which a beneficiary has an interest;*
- d. *A deposit of trust money in a regulated financial institution operated by the trustee;*
- e. *An advance by the trustee of money for the protection of the trust; or*
- f. *Any transaction authorized by any other statute under the laws of the Commonwealth of Kentucky.*

III. Duty of Impartiality

This provision of the UTC requires that if a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing and distributing the trust property, giving due regard to the beneficiaries' respective interests.^x The UTC commentators recommend that a trustee pay particular attention to Kentucky's Principal and Income Act and be sensitive to the allocations of trust assets between principal and income.^{xi}

Example: There are often situations where the trust income is being distributed to one beneficiary and the principal is due to be distributed to a separate beneficiary upon the income beneficiary's death. In such a scenario, the trustee's obligations to both beneficiaries are slightly in conflict with one another as it is often difficult to maximize the income for one beneficiary, while at the same time, preserve and grow the principal for a remainder beneficiary. A trustee, however, is obligated to address the scenario as fairly and as impartially as possible.

IV. Prudent Administration

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.^{xii} Much like with the duty to administer trusts, this provision of the UTC is very broad and captures the intent of several subsequent statutory provisions, such as trustee's skills under KRS §386B.8-060. A trustee must always maximize his or her knowledge and skills to administer a trust in conformity with its terms, or if necessary, delegate those services or duties to a more qualified individual or corporation in order to adhere to the fiduciary standard set forth under this provision.

V. Trustee's Skills

A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, shall use those special skills or expertise.^{xiii} Often times trustees are appointed due to a specific skill set he or she or the corporation possesses and the trust requires that specific skill set. This provision requires that whenever appointed on account of a specific skill or expertise, a trustee must administer the trust by maximizing that knowledge or ability in order to properly administer the trust on behalf of the beneficiaries.

Example 1: Special needs trusts, trusts established pursuant to 42 USC §1396p(d)(4)(A), require that a trustee be well versed in both Medicaid's and Social Security's rules and regulations and be able to understand how certain distributions can affect the disabled beneficiary of the trust. Furthermore, any failure on behalf of the trustee to improperly leverage that knowledge for the benefit of the disabled beneficiary could have negative and long-lasting consequences for the individual. Therefore, a trustee of a special needs trust or other unique or complicated trust should only accept an appointment of trustee when he, she or the corporation knows they are qualified to administer the trust properly.

Example 2: A single father of two daughters is a member of several LLCs, the majority shareholder of a corporation, and owns interests in several commercial real estate properties. Sadly, the father dies while his daughters are minors. Fortunately, however, the father made sure that all of his assets were to be held in two separate trusts, one for each daughter, until the trust beneficiary (a daughter) is age 35. While the father could have relied upon family to serve as trustee of each trust, the father recognized the complexity of his investments and business interests, and as a result, elected to appoint a trust company as the trustee of each trust, believing the trust company maintained the proper skills necessary to administer each trust. If the trustee accepted the responsibility of serving as trustee of these trusts knowing it did not possess the necessary skill set to administer them, the trustee would be in breach of its duty to the trust and, more importantly, would severely jeopardize each daughter's financial well-being.

VI. Delegation by Trustee

A trustee may delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill and caution in:

- a. Selecting an agent;
- b. Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and
- c. Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.^{xiv}

The ability to delegate certain duties and powers to an agent to act on behalf of the trustee is becoming more and more valuable as trusts become increasingly more complicated to administer. In addition, as corporations continue to raise the minimum dollar requirements for accepting the appointment as trustee of a trust, individual trustees are becoming more and more commonplace. That

said, however, the ability to delegate enables individuals to be appointed as trustee who may not otherwise possess the overall skills necessary to properly administer a trust. Such an appointment can be accepted with the knowledge that an expert in a specific field can and will be engaged to provide advice about the trust's administration or investment needs.

For example, an individual may accept the appointment as trustee knowing that the investment of the trust's assets will be delegated to a wealth manager, such as a bank, trust company or investment management company.

VII. Powers to Direct

If the terms of a trust confer upon a person, other than the settlor of a revocable trust, the power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.^{xv} This power is most often evident when a trust has advisors that are permitted to direct a trust about certain aspects of the trust's administration, such as the investment or distribution of trust assets. In short, even when a trust has advisors, a trustee cannot simply accept an advisors direction, rather a trustee must evaluate each direction so as to ensure the direction does not violate the terms of the trust. As always, a trustee must act in good faith even if this duty requires the trustee to question or decline the request of an advisor in order to protect the trust beneficiaries.

VIII. Prudent Investor

All trustees acting under the UTC with respect to investments shall have the authority and duties set forth in KRS §286.3-277.^{xvi} By adopting this rule, Kentucky eliminated the different investment standards individual and corporate trustees used to have by requiring that the "prudent investor" rule applies to all trustees. In order to satisfy the prudent investor rule, it is generally acknowledged that the following items should be considered for the beneficiaries of a trust:

- a. Financial institution;
- b. Current investment portfolio;
- c. Need for income;
- d. Tax status and bracket;
- e. Investment objective; and
- f. Risk tolerance.^{xvii}

IX. Duty to Inform and Report

Except as otherwise provided in the terms of the trust, a trustee shall keep the qualified beneficiaries (current beneficiaries eligible to receive distributions, successor beneficiaries and remainder beneficiaries who will receive the trust property upon the trust's termination) reasonably informed about the administration of the trust. Unless unreasonable under the circumstances, a trustee shall promptly respond to a qualified beneficiary's request for information related to the administration of the trust.^{xviii}

Further, this provision requires a trustee, within 60 days of its acceptance of the trust, to notify qualified beneficiaries of the trustee's acceptance of the appointment of trustee as well as the trustee's name, address and telephone number. In addition, whenever a trustee acquires knowledge of the creation of an irrevocable trust or of a revocable trust becoming irrevocable, a trustee, within 60 days of acquiring such knowledge, must notify the qualified beneficiaries of the trust's existence, the identity of the settlor or settlors, and about the right to request a copy of the trust instrument and the right to a trustee's report. Finally, this provision of the UTC establishes a mandatory duty to notify and report to at least one qualified beneficiary (age 25 or older) of:

- a. The existence of the trust;
- b. The identity and contact information for the trustee; and
- c. The qualified beneficiary's right to request reports.^{xix}

Example: The parents of three children die tragically in an accident. Prior to death, the parents established a single pot trust for the benefit of their three children ages 25, 20 and 16. The trust remains a pot trust until the youngest of the three children's turns 22 years old at which time the trust is divided into three individual trusts, one for each beneficiary. During the pot trust's existence, the trustee must keep all three beneficiaries reasonably informed about the administration of the trust, which is satisfied through the delivery of monthly statements of investment and disbursement related activity. If, however, after receiving a monthly statement, one of the beneficiaries makes a direct inquiry to trustee about a specific distribution, the trustee is obligated to promptly respond to the beneficiary's request for information. In the end, no beneficiary should maintain an expectation of privacy about their requests for distributions until such time that the pot trust is terminated and divided into three separate trusts.

Conclusion

As stated above, it will take some time before attorneys and service providers become fully comfortable with the UTC. Fortunately, however, the more people work together to satisfy their respective ethical and fiduciary duties, the better the results will be from the UTC's implementation. Change is always inevitable, and it is incumbent that everyone not only adopt the changes presented by the UTC, but embrace them so that the administration of trusts becomes easier for all interested parties. In the end, reading, studying and reviewing the new UTC provisions and how they affect the administration of the trusts is the only way to ensure that all fiduciary and ethical duties are satisfied. Much like when growing up, the more you study the better the final grade—or outcome.

ⁱ See KBA Ethics Opinion KBA E-401 (1997). In this opinion Kentucky adopted the majority view set forth in ABA Formal Ethics Opinion 94-380. For more information about how state's interpret the duties an attorneys owes to the beneficiaries of a trust whenever advising a Trustee, see *Blurred Lines: Analyzing an Attorney's duties to a Fiduciary-Client's Beneficiaries*, Washington and Lee Law Review, Daniel R. Nappier (September 1, 2014).

ii KRS §386B.8-010

iii *Fundamental Duties of a Trustee, a Guide for Trustees in a Post-Uniform Trust Code World*, Edward Jones Trust Company, October 2008

iv *Id.*

v KRS §386B-8.020

vi *Id.*

vii *Id.*

viii *Id.*

ix *The Kentucky Uniform Trust Code: Selected Kentucky Uniform Trust Code Provisions*, Linda W. Clark, 41st Annual Midwest-Midsouth Estate Planning Institute, July 2014

x KRS §386B.8-030

xi *Fundamental Duties of a Trustee, a Guide for Trustees in a Post-Uniform Trust Code World*, Edward Jones Trust Company, October 2008

xii KRS §386B-8-040

xiii KRS §386B-060

xiv KRS §386B-070

xv KRS §386B-080

xvi KRS §386B.9-010

xvii *The Kentucky Uniform Trust Code: Selected Kentucky Uniform Trust Code Provisions*, Linda W. Clark, 41st Annual Midwest-Midsouth Estate Planning Institute, July 2014

xviii KRS §386B.9-130

xix *The Kentucky Uniform Trust Code: Selected Kentucky Uniform Trust Code Provisions*, Linda W. Clark, 41st Annual Midwest-Midsouth Estate Planning Institute, July 2014