

Trustees of Revocable Trusts May Owe Duties to Contingent Beneficiaries

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Revocable trusts are a ubiquitous part of modern US estate planning because they avoid the delay, cost and publicity inherent in probate administration and, in the international context, because of the certainty they provide in establishing the trust as a grantor trust. During the settlor's life, a revocable trust, in conjunction with a general power of attorney, allows for management of the settlor's US estate without a conservatorship or guardianship. Following the settlor's death, a revocable trust acts as a will substitute by disposing of the trust property without judicial involvement. Under US law, a settlor can achieve these advantages without sacrificing control over the trust property—or so many advisers thought.

IN DEPTH

Conversely, as a matter of English law (as well as the laws of the Crown Dependencies and British Overseas Territories), the trustee must owe enforceable obligations to the members of the beneficial class of a revocable trust from the moment the trust is settled. As a matter of English law, if the beneficiaries have no rights, then there is no trust. *Armitage v. Nurse* (1998). Except to the extent that a power has been expressly and appropriately reserved to the settlor, the trustee of even a revocable trust must not merely follow the instructions of the settlor. The trustee must possess an irreducible core of discretionary responsibilities—although the trustee should, in addition to the interests of the beneficial class, consider the settlor's wishes in exercising its discretion. While the power to revoke is clearly a personal power of the settlor, and the settlor may exercise it purely for her own benefit, for so long as the trust exists the trustee's obligations are to the beneficial class as a whole, and those obligations are fiduciary in nature and enforceable by the members of the beneficial class.

Offshore there is one notable exception to the general rule that a trust requires that the "objects" of the trust (the beneficiaries) have standing to police the trustee. That exception is trusts created under the Cayman Special Trusts Alternative Regime (STAR trusts), which delegates standing to enforce the obligations owed to the beneficiaries to an "enforcer." This statute was deeply controversial when introduced in 1997, but the STAR trusts have now become generally accepted as valid trusts. No

other common law jurisdiction, however, has adopted similar legislation taking away the beneficiaries' standing to police the trustee outside of the United States.

It would be a vast overstatement to suggest that these two very different visions of a revocable trust are converging. However, in at least some US states, contingent beneficiaries of a revocable trust may in some limited circumstances have standing to invoke the supervisory jurisdiction of the courts over the trust. As a recent case in Michigan illustrates, some US states now grant rights to contingent beneficiaries of revocable trusts when the settlor ceases to have capacity. Because it is often unclear whether a settlor lacks capacity, a trustee of a US revocable trust should proceed with caution before following an instruction from the settlor that is inconsistent with any duties the trustee may owe to the contingent beneficiaries.

In *In re Rhea Brody Living Trust* (2017), Robert and Rhea Brody, husband and wife, created separate revocable trusts to hold interests in two family businesses. Rhea subsequently became incapacitated and Robert began acting as successor trustee of Rhea's revocable trust. As the trustee of his trust and Rhea's trust, Robert sold all of the trusts' interests in the family businesses to Robert and Rhea's son, Jay. Rhea and Robert's daughter, Cathy, subsequently filed a petition challenging the sale price and seeking Robert's removal as successor trustee of Rhea's trust.

Robert and Jay both argued that Cathy, as a contingent beneficiary, did "not have standing to bring an action regarding the administration of a revocable trust." In support of their argument, Robert and Jay alleged that Rhea's trust remained revocable because (1) Rhea had not been declared "disabled" pursuant to the terms of the trust and (2) Robert, as Rhea's agent under a durable power of attorney, could exercise Rhea's power to revoke the trust. However, the Michigan Court of Appeals concluded that Cathy was an "interested person," as defined under Michigan law, and thus had standing to commence an action concerning Rhea's trust—whether or not the trust was revocable. In so holding, the court expressly rejected Robert and Jay's request "to adopt the approach of other jurisdictions in holding that a contingent beneficiary lacks standing to challenge the administration of a revocable trust," noting that their reliance on "the Uniform Trust Code and cases from other jurisdictions [was] misplaced" because Michigan had modified its version of the Uniform Trust Code.

Following the decision of the Michigan Court of Appeals, Robert applied for leave to appeal to the Michigan Supreme Court. In lieu of granting leave, the Michigan Supreme Court remanded the case to the Michigan Court of Appeals "for reconsideration of its standing analysis." On remand, the Michigan Court of Appeals again concluded that Cathy had standing to enforce the terms of Rhea's trust, but on grounds more consistent with the peculiarities of Michigan law. The final decision in this case was reached on June 14, 2019. In lieu of granting a second application for leave to appeal, the Michigan Supreme Court vacated a portion of the Michigan Court of Appeal's second opinion, but did not disturb the conclusion that Cathy had standing to enforce Rhea's revocable trust.

In its second opinion, the Michigan Court of Appeals determined that Cathy, as contingent beneficiary, had standing pursuant to Section 603 of the Uniform Trust Code (UTC) as enacted in Michigan. Section 603(b) of the UTC provides that:

To the extent a trust is revocable [*and the settlor has capacity to revoke the trust*], rights of the beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor.

The phrase "and the settlor has capacity to revoke the trust" was not bracketed in the version of the

UTC originally recommended for adoption in 2000. However, the comments to the UTC explain that this language was controversial, in part, because it may be difficult for trustees “to determine whether the settlor ha[d] become incapacitated and the settlor’s control of the beneficiary’s rights have ceased.” To address this concern, the Uniform Law Commission amended the UTC in 2004 to make the bracket language optional.

Michigan’s version of the UTC does not include Section 603(b) or its optional bracketed language. However, Michigan’s version of the UTC includes an alternative provision that, as applied by the Michigan Court of Appeals in *Brody*, has the same effect as the bracketed language in Section 603(b).

In Michigan, and in states that have enacted the UTC with the bracketed language from the Section 603(b), the trustee of a revocable trust owes duties exclusively to the settlor while the settlor has capacity. If the settlor loses capacity, then the “qualified beneficiaries,” which include presumptive remainder beneficiaries, acquire the right to receive information regarding the trust and standing to enforce the trustee’s duties.

In UTC states that have not adopted the bracketed language from Section 603(b) of the model act, beneficiaries (other than the settlor or the settlor’s agent) generally do not have rights in or standing to enforce a revocable trust upon the settlor’s incapacity. See *Manon v. Orr* (2014). However, the precise approach varies from jurisdiction to jurisdiction. For example, in enacting the UTC, Florida declined to adopt the bracketed language from Section 603(b), but allows contingent remainder beneficiaries to sue the trustee of a revocable trust, after the settlor’s death, for a breach of duty owed to the settlor. *Hilgendorf v. Estate of Coleman* (2016) (citing *Brundage v. Bank of America* (2008)). The same rule exists in Texas, a state that has not adopted the UTC. *Moon v. Lesikar* (2007).

Pending gubernatorial approval, Illinois will become the 34th state to enact the UTC, effective as of January 1, 2020. Consistent with its common law, Illinois’ version of the UTC includes the bracketed language from Section 603 of the model act. See *In re Estate of Michalak* (2010). Thus, in Illinois, contingent remainder beneficiaries of revocable trusts will continue to acquire standing to enforce the trust upon the settlor’s incapacity.

The lessons here are as follows:

- Trustees of revocable trusts should exercise caution before following an instruction given by a settlor or the settlor’s agent that may be contrary to the terms of the trust. If the settlor’s capacity is diminished or otherwise questionable, the trustee should review applicable law to determine the rights of the contingent remainder beneficiaries before following the instruction. A trust instrument may eliminate any rights the contingent remainder beneficiaries may have upon the settlor’s incapacity. Therefore, if the default provisions of applicable law grant rights to the contingent remainder beneficiaries upon the settlor’s incapacity, the trustee should determine whether the trust instrument eliminates such rights. Lastly, if such rights are not eliminated, the trustee should obtain a release from the contingent remainder beneficiaries or refuse to follow the instruction.
- Conversely, a trustee of a foreign revocable trust owes enforceable obligations to the objects (beneficiaries) of the trust forthwith regardless of the settlor’s capacity. Trustees of even revocable trusts must have an irreducible core of discretionary obligations, and while they should consider the wishes of the settlor, they cannot merely follow her instructions. In the absence of these obligations enforceable by the beneficiaries (except Cayman STAR trusts)

there is no trust, and there may be innumerable complications arising from whatever form of legal relationship the court will impose on the structure.

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