FEATURE:
FIDUCIARY PROFESSIONS

ELECTRONICALLY REPRINTED FROM FEBRUARY 2016
TRUSTS & ESTATES
The WealthManagement.com journal for estate-planning professionals

By **Pamela Lucina** & **John T. Welsh**

That's Not What Mom or Dad Wanted

The role of settlor's intent on long-term trusts

Effectuating a settlor's intent is supposed to be a primary guiding principle of trust law. For centuries, courts have stated that their primary purpose in a trust case is to give effect to the "settlor's intent."[1] Yet, the settlor's intent isn't often articulated. Many trust creators never have a conversation about what they truly intend to accomplish with a trust. The subject often only arises when a beneficiary claims, "But that's not what Mom and Dad really wanted."

While a settlor's intent has always been important in trust law, it's increased in importance because of several recent trends:

1. **Longer term trusts.** Settlors often struggle with giving up control and creating long-term trusts whose provisions may change over time for beneficiaries they may never meet. However, the modern trend is toward allowing for the creation of longer term trusts, with at least 29 jurisdictions having eliminated or extended the common law rule against perpetuities;
2. **Larger trusts.** Larger trusts are being created thanks to the increased gift tax, estate tax and generation-skipping transfer (GST) tax exemptions, coupled with lower gift, estate and GST tax rates; and
3. **Statutes that allow for trust modification.** Many modern trust statutes, such as decanting, virtual representation and directed trusts, are allowing for trustees and beneficiaries to change the terms of trusts.

Because of these recent trends, how a court determines a settlor's intent, and a settlor's ability to influence that determination, is continuing to evolve.

Pamela Lucina is a family wealth strategist, and **John T. Welsh** is a vice president in the Global Insights Lab, both at BNY Mellon Wealth Management based in Chicago

Material Purpose and Settlor's Intent

Claflin v. Claflin[2] set the standard for requiring a court to consider a trust's "material purpose." In *Claflin*, the Massachusetts Supreme Court was asked to decide whether all of the beneficiaries of a trust could terminate the trust prior to the termination date specified in the trust agreement. The court held that the trust could be terminated early by voluntary consent only if: (1) the settlor consents, or (2) all of the beneficiaries and the court conclude that doing so won't frustrate a material purpose of the trust. This became known as the "*Claflin* doctrine." For decades, under this doctrine, many types of trusts were found to contain a material purpose and therefore held to be indestructible, even if the purpose was as simple as the trust including discretionary distributions or spendthrift provisions.[3] These provisions are now typical of most modern trusts.

Although the *Claflin* doctrine still stands today, there's an emerging rule in the Uniform Trust Code (UTC) and the *Restatement (Third) of Trusts* that allows a court to modify or disregard the terms of a trust if the court determines that those terms aren't in the beneficiaries' interests, even if those terms unambiguously express the settlor's intent (that is, the material purpose). This is known as the "benefit of the beneficiaries" rule. Proponents of this rule believe it prevents unreasonable restrictions on the use of trust property, even if the modification or termination is contrary to the settlor's intent.[4]

According to the rule, the material purpose may be disregarded if the beneficiaries all agree to the termination or modification, and a court determines the reasons behind a termination or modification outweigh the material purpose of the trust.[5] There's considerable debate as to how far courts should apply the benefit of the beneficiaries rule,[6] and some jurisdictions have clearly rejected it by amending portions of the UTC

for purposes of foreclosing any argument that the rule applies.[7] Along those same lines, most modern decanting statutes require the consideration of a trust's material purpose as a limit on the changes that may be made to an irrevocable trust.[8]

Determining Settlor's Intent

Occasionally, a settlor will clearly state a specific purpose is the "primary purpose or a material purpose of the trust," but otherwise, identification of a material purpose is "a relatively subjective process of interpretation and application of judgment to a particular situation."[9] Most state law dictates that a court should look to the four corners of a document to determine a settlor's intention.[10] This limitation prohibits courts from admitting any evidence extrinsic to a trust document that would contradict or add to the plain meaning of the trust's language, unless the language is found to be ambiguous. Accordingly, if a trust is capable of clear and unambiguous construction, the court must give effect to the trust's clear meaning without regard to the extrinsic evidence.

However, there's a recent movement to allow for extrinsic evidence to be examined even if the document isn't proven to be ambiguous. The *Restatement Third of Property (Wills and Donative Transfers)* rejects the four corners rule altogether and proposes admitting extrinsic evidence to determine intent even absent an ambiguity.[11] The UTC follows suit by providing that the settlor's intent may be established by extrinsic evidence, assuming such evidence is "clear and convincing," to reform a trust.[12] Courts have been slow to adopt either approach.[13]

Reinforcing Settlor's Intent

A settlor who's concerned these recent changes and trends could lead to his wishes being set aside by some court in the future may want to consider clearly stating a material purpose. This can be accomplished in either a statement of intent (SOI) or a letter of wishes (LOW), as well as by using a trust protector who's familiar with the settlor's intent.

An SOI is a personal declaration of purpose, included in the trust document. It's an attempt to explain the why ("Here's what I'm thinking") and not the how ("Here's how to do your job") of a trust. Drafted correctly, it can lessen the potential for future controversy regarding the interpretation and administration of the trust. Because it's part of the trust document, it may establish a material purpose for decanting, modification or termination of a trust.

Alternatively, an LOW is less formal than an SOI and is separate from the trust document. It can be written or amended at any time and typically provides more detailed insight into the settlor's intent and aspirations for how the trust should be administered. The trustee can use it to set expectations regarding discretionary distributions and can "fill in the blanks" for terms such as "health, maintenance, and support." Because it isn't part of the trust document, it isn't legally binding and can't be used as evidence of the settlor's intent unless the trust document proves to be ambiguous.[14] However, as stated above, if you're in a jurisdiction that follows the UTC, extrinsic evidence may be allowed even if the trust document is unambiguous.

> Trust protectors can help ensure that trusts are administered as the settlor intended.

These are a few of the main differences. "A Comparison," p. 22, summarizes these and other major differences between the two.

Including an SOI within the four corners of a trust document may be more enforceable in those jurisdictions that follow the four corners rule in trust interpretation. Give careful consideration to providing a means for adapting to change because there may be a need for modification or even termination at some point in the future, especially in the case of multi-generational trusts. Consider these additional questions:

1. Could (or should) an SOI be used to authorize or prohibit decanting? Possibly. A Florida appellate court recently respected a "no modification clause" despite the trial court's ruling that such modification was in the "best interest of the beneficiaries."[15]

In addition, with increasing frequency, practitioners are including SOIs expressly authorizing decanting provisions in standard trust agreements.[16] Decanting may become so prevalent that a court in a jurisdiction that lacks a decanting statute may find that the absence of an SOI specifically granting a decanting indicates the intent of the settlor to preclude decanting.[17] In a recent

A Comparison

The differences between statements of intent and letters of wishes

Statements of Intent	Letters of Wishes
Part of trust document	Separate from trust document
Drafted concurrently with trust document	May be drafted at any time
Irrevocable once trust becomes irrevocable	May be amended at any time
Used as a personal declaration of purpose	Used as a personal letter from settlor to trustee
Typically a statement about the intended general purpose of trust	Typically more detailed with directions as to how trust should be administered
Legal implications in many jurisdictions	Non-binding in many jurisdictions
Usually shorter in length	Unlimited in length
More formal language used	More informal language used
Typically accessible by beneficiaries	Trustee may be able to keep confidential from beneficiaries in some jurisdictions

— Pamela Lucina and John T. Welsh

Massachusetts Supreme Court case, the court noted that: "[I]n light of the increased awareness, and indeed practice, of decanting, we expect that settlors in the future who wish to give trustees a decanting power will do so expressly. We will then consider whether the failure to expressly grant this power suggests an intent to preclude decanting."[18]

2. Could an SOI protect the trustee with a mandatory stock retention? If the settlor wishes for an asset to be retained in all circumstances, there should be clear, mandatory language included in the document. Modern fiduciary law draws a distinction between trust language that requires a trustee to invest in a certain manner and language that merely permits such conduct. Mandatory directions "are ordinarily binding on the trustee in managing the trust assets, thus often displacing the normal duty of prudence."[19] In contrast, a permissive or precatory provision "does not relieve the trustee of the fundamental duty to act with prudence."[20] Case law suggests that diversification either must be prohibited or it will be required.

Settlors often hesitate to tie the trustee's hands by requiring the trustee to hold an asset in its current form at all costs. In some jurisdictions, boilerplate precatory language hasn't even established a middle ground.[21] To bolster the protection for the fiduciary, the trust should have customized language that captures the settlor's clear intent, reference the diversification provisions of the jurisdiction's Prudent Investor Act and explicitly direct that they shouldn't apply. The trust should also reference a concentrated holding by name and explain and defend the settlor's rationale (such as avoiding capital gains taxes, the desire to retain a family business or residence, access to superior information about a specific company or business or investment philosophies).

Professional trustees are often left holding concentrated assets in old trusts that contain general permissive retention clauses. In many instances, the beneficiaries may be better served by converting these trusts to directed trusts. In some jurisdictions, this may be difficult to do through a traditional modification proceeding. A recent Delaware case held that, despite arguments that the beneficiaries may be better served by a directed trust, the trust was drafted in such a way that led the court to believe that it was the settlor's intent to have professional management of the assets and that the *Claflin* doctrine prohibited a modification contrary to this intent.[22] Perhaps there would have been a stronger argument that the settlor's intent would be preserved if the retention clause had been more specific or there was some indication that the beneficiaries could control the investments.

3. Could an SOI help ensure that loans to beneficiaries will be considered? A trustee may consider making a loan to a beneficiary instead of making a distribution to the beneficiary. There may be estate tax advantages (loans don't increase estates), creditor benefits (keeps assets in the trust) and non-financial benefits, such as requiring that the beneficiary has "skin in the game" for a purchase rather than making an outright distribution. However, loans to beneficiaries can be tricky for a trustee to execute, as they're evaluated as an investment of the trust and, as such, have to satisfy prudent investment requirements, as well as the trustee's duty to act impartially to all beneficiaries. A well-crafted SOI, which provides that making loans to beneficiaries isn't only permissible but is a material purpose of the trust, may grant the trustee more discretion to make loans without running afoul of its fiduciary duties.

Using Trust Protectors

In addition to SOIs and LOWs, a settlor may want to appoint a trust protector to help beneficiaries determine the settlor's intent if there's a dispute or to aid in the interpretation of administration. Trust protectors can help ensure that trusts are administered as the settlor intended.

A settlor may want to consider someone who's familiar with the family and the settlor's values to act as trust protector rather than as trustee.[23] The advantages of using a trust protector are: (1) the powers may be narrower than that of a trustee (could be called on to act only in certain instances when the settlor's intent is in question), and (2) depending on how the trust is drafted and the jurisdiction, the trust protector may be able to act in a nonfiduciary capacity.

In a recent Florida case, the trust protector, who was the drafting attorney, used his trust protector powers to modify ambiguous terms that were at the center of litigation between the trustee and beneficiaries.[24] The trust in question granted the trust protector the power to determine the settlor's intent to correct ambiguities and drafting errors that may defeat such intent. A Florida appellate court held that the modified provisions were ambiguous, and because the trust protector had these powers, the modification was valid. The court highlighted the trust protector's conversations with the settlor as uncontradicted evidence of the settlor's intent.

As this case demonstrates, a trust protector who knows the settlor personally and has had conversations as to the settlor's intent may be a logical choice to help the trustee interpret ambiguous provisions or make judgment calls on discretionary distributions. However, issues arise when trying to appoint a successor trust protector who doesn't have actual knowledge of the settlor's intent. Because a trust protector has no default powers, the procedure for appointing successors must be fully set forth in the trust agreement to be effective. One way to help resolve this issue may be to include an LOW.

The trust document should also clarify the fiduciary responsibilities of successor trust protectors. It may not be possible to designate a power bestowed on a successor trust protector as a personal power because the settlor likely wouldn't have had a personal relationship with the power holder. It may still be possible, however, to provide that some powers are deemed to be held in a nonfiduciary capacity.

Articulate Settlor's Intent

Given the various ways that trusts can be modified under modern trust laws, it's best if trustees and courts are guided by the settlor's intent as clearly as possible. Modern statutes are loosening the grip on a settlor's dead hand control and taking into account the best interests of the beneficiaries, while still attempting to account for the material purpose of the trust as a constraint on modifications. Without a clear articulation of the settlor's intent, interpreting the material purpose is subjective and may sometimes rely on extrinsic evidence. It may be beneficial for settlors to plan for such interpretation of the settlor's intent through an SOI, LOW or appointment of a trust protector.

Without a clear articulation of the settlor's intent, interpreting the material purpose is subjective and may sometimes rely on extrinsic evidence.

—This article is developed from a presentation originally given by Pamela Lucina and Barbara Grayson at the 2015 Notre Dame Tax and Estate Planning Institute. The statements in this article reflect the views of the authors and don't reflect the opinion or views of BNY Mellon Wealth Management or The Bank of New York Mellon Corporation.

Endnotes

1. *See, e.g., Hauck v. Second Nat'l Bank of Richmond*, 286 N.E.2d 852, 861 (Ind. Ct. App. 1972); *Eckels v. Davis*, 111 S.W.3d 687, 694 (Tex. Ct. App. 2003); *Estate of Irvine v. Oaas*, 309 P.3d 986, 990 (Mont. 2013) (concerning reformation of life insurance contracts); *First Nat'l Bank of Chi. v. Canton Council of Campfire Girls, Inc.*, 426 N.E.2d 1198 (Ill. 1981); *Univ. of S. Ind. Found. v. Baker*, 843 N.E.2d 528, 532 (Ind. 2006); *Bank of America v. Judevine*, 26 N.E.3d 555, 561 (Ill. App. Ct. 2015); *Kristoff v. Centier Bank*, 985 N.E.2d 20, 23 (Ind. Ct. App. 2013); *In re Moulton's Estate*, 46 N.W.2d 667 (Minn. 1951); *Nw. Nat'l. Bank of Minneapolis v. Simons*, 242 N.W.2d 78 (Minn. 1976).
2. *Claflin v. Claflin*, 20 N.E. 454 (Mass 1889).

3. Austin Wakeman Scott et al., *Scott and Ascher on Trusts (Scott and Ascher)* Section 34.1.4 n.1 (5th ed. 2008).
4. Uniform Trust Code (UTC) Section 404 (2010).
5. *Restatement (Third) of Trusts (Restatement Third)* Section 65(2) (2003): "if a termination or modification of the trust desired by all of the beneficiaries would be inconsistent with the material purpose of the trust, the beneficiaries cannot compel its termination or modification except with the consent of the settlor or, after the settlor's death, with authorization of the court if it determines that the reason(s) for termination or modification outweigh the material purpose."
6. *See, e.g.,* Jeffrey A. Cooper, "Shades of Gray: Applying the Benefit-of-Beneficiaries Rule to Trust Investment Directives," 90 *B.U. L. Rev.* 2383-401 (2010).
7. New Hampshire added the requirement that a trust and the terms of that trust be for the benefit of its beneficiaries as their interests are defined under the terms of the trust. N.H. Rev. Stat. Ann. Sections 564-B:1-105(b)(3), 564-B:4-404 (2004). In addition, Massachusetts eliminated the benefit to the beneficiary rule altogether because, according to the comment to Mass. Unif. Trust Code Section 404, "trusts are an interrelationship between the settlor, the beneficiaries and the trustee." Mass. Gen. Laws ch. 203E Section 404 (2012).
8. The draft Uniform Decanting Statute proposes that an exercise of decanting power should be in accordance with the purposes of the first trust. The reason for requiring the consideration of the purpose of the first trust is explained: "the purpose of decanting is not to disregard the settlor's intent but to modify the trust to effectuate better the settlor's broader purposes or the settlor's probable intent if the settlor had anticipated the circumstances at the time of decanting."
9. *Restatement Third* Section 65(2) (2003).
10. *See, e.g., Peck v. Drennan*, 103 N.E.2d 63, 66 (Ill. 1951) (holding that the court was without jurisdiction to construe will that was clear and certain and stating that the: "court never acquires jurisdiction to construe a will merely by allegation that a question requiring construction exists, when the record shows there is no such question"); *Bartlett v. Mutual Ben. Life Ins. Co.*, 193 N.E. 501 (Ill. 1934); and *Jusko v. Grigas*, 186 N.E.2d 34, 37 (Ill. 1962) ("The court does not acquire jurisdiction to construe a will merely because the complaint contains an allegation that a question requiring construction exists where the record shows no such question exists").
11. It provides:

    > The so-called plain-meaning rule is disapproved to the extent that that rule purports to exclude extrinsic evidence of the donor's intention. The plain meaning, Wigmore noted, 'is simply the meaning of the people who did not write the document.' The objective of the plain-meaning rule, to prevent giving effect mistaken or fraudulent testimony, is sufficiently served by subjecting extrinsic evidence that contradicts what appears to be the plain meaning of the text to a higher than normal standard of proof, the clear-and-convincing-evidence standard.

12. UTC Section 415 (2010).
13. *See, e.g., Bank of America v. Judevine*, 26 N.E.3d 555; *Kristoff v. Centier Bank*, 985 N.E. 2d 20; *Eckels v. Davis*, 14 S.W.3d 687; *Matter of Cohorn's Estate*, 622 S.W.2d 486; *Kelly v. Estate of Johnson*, 788 N.E.2d 933; *Dennis v. Kline*, 120 So.3d 11 (Fla. Dist. Ct. App. 2013); *Clairmont v. Larson*, 831 N.W.2d 388.
14. *Scott on Trusts* Section 38 (original ed. 1939); *See also Restatement Third* Section 21(2); *Scott and Ascher, supra* note 3, Section 4.5.
15. *Bellamy v. Langfitt*, 86 So.3d 1170 (Fla. Ct. App. 2012).
16. Diana S.C. Zeydel and Jonathan G. Blattmachr, "Tax Effects of Decanting—Obtaining and Preserving the Benefits," 111 *J. Tax'n* 288 (2009).
17. *Phipps v. Palm Beach Trust Co.*, 196 So. 299 (Fla. 1940).
18. *Morse v. Kraft*, 992 N.E.2d 1021 (Mass. 2013).
19. *Restatement Third* Section 228e (2003).
20. *Ibid.*, Section 228f (2003).
21. *See, e.g., In re Estate of Rowe*, 712 N.Y.S.2d 662 (App. Div. 2000) (IBM Stock); *Estate of Saxton*, 712 N.Y.S.2d 225 (App. Div. 2000) (IBM stock); *In re Estate of Dumont*, 4 Misc.3d 1003(A) (N.Y. Surr. Ct. 2004); 809 N.Y.S.2d 360 (App. Div. 2006) (Kodak stock); *Wood v. U.S. Bank*, 828 N.E.2d 1072 (Ohio Ct. App. 2005) (Firstar stock); *Cf. Americans for the Arts v. Ruth Lilly Charitable Remainder Annuity Trust*, 855 N.E.2d 592 (Ind. Ct. App. 2006).
22. *In re Trust Under Will of Flint for the Benefit of Shadek*, 118 A.3d 182 (2015).
23. To avoid retaining a power that could cause estate tax inclusion under Internal Revenue Code Section 2036, the settlor shouldn't appoint a person who's related or subordinate to the settlor under IRC Section 672(c); *See* Revenue Ruling 95-58.
24. *Minassian v. Rachins*, WL 6775269 (Fla. 4th DCA Dec. 3, 2014).