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Commentary on *Discretionary Trusts: An Update* by Richard C. Ausness

*Alexander A. Bove, Jr.**

Writing an article on the exercise of a trustee's discretion takes a certain amount of courage, and at the very least, it is risky business, since the very essence of an act of exercising one's discretion calls for purely personal evaluations and decisions that are by their very nature subjective, and often reflect cognitive biases of the trustee. Despite that, they are presumptively justifiable.[1] Add to the mix the so-called standards of behavior by which a trustee is sometimes judged, such as "reasonableness," "impartiality," "good faith," and "loyalty," which are themselves vague and dependent on each set of facts, and in a hundred cases on the "reasonableness" of the exercise of the trustee's discretion, for example, we might see a hundred different results, even though the underlying facts were not that dissimilar. Unfortunately, there is no Trustee's Handbook with specific instructions to ensure consistency from case to case. Thus, the daunting task undertaken by Professor Richard Ausness in his article, "Discretionary Trusts: An Update," deserves the attention of practitioners and academics alike to determine what, if anything, has changed on the subject and whether any new light or insight is shed on the courts' attitude towards trustee's discretion. If not, does the article nevertheless provide insight into something that is critical for us practitioners to keep in mind? That is, with limited exception, the broader we draft the provisions for trustee's discretion, the more trouble we may be making for the trust and the beneficiaries.

Professor Ausness opens by paying homage to what he rightfully calls the "seminal" article on trustee's discretion by Dean Edward Halbach in the 1961 Columbia Law Review.[2] Citing Halbach's article was quite appropriate, as it should be mandatory study (not just reading) for every attorney who drafts trusts. One considerable difference

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[1] *See* Anderson v. Sams (*In re* Sams' Estate), 258 N.W.2d 682, 685 (Iowa 1935).

[2] Richard C. Ausness, *Discretionary Trusts: An Update*, 43 ACTEC. L.J. 231, 231 (2018) (referencing Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 COLUM. L. REV. 1425 (1961)).

between Halbach's work and Prof. Ausness' article is that Halbach offers an insightful discourse on the several issues involved in the question of trustee's discretion, while Prof. Ausness uses a combination of inductive and deductive reasoning by presenting numerous cases covering each of the relevant issues to illustrate how courts viewed the typical questions that arose on trustee's discretion. For example, on the issue of to what extent a trustee could or should apply its discretion in a "support" trust, Prof. Ausness discusses the facts of several cases where the courts held an abuse of discretion in some[3] and upheld the exercise of discretion in others,[4] leaving the reader to use her own discretion to decide whether she agreed with the court. Although interesting reading which could prove beneficial to inexperienced attorneys, I felt that Professor Ausness' own evaluation in these cases would have been instructional. I would have welcomed his personal observations on a "bad faith" versus "good faith" exercise by a trustee. For example, in a "spray" trust where the trustee has the sole discretion to distribute (or not) among a group of beneficiaries, is it "bad faith" or an abuse of discretion if the trustee decides to distribute nothing to a particular beneficiary over a period of years? The quick reaction to this is, shouldn't the answer depend on whether that beneficiary had his own outside source of funds? This of course leads in turn to the perennial question of whether the trustee is "required" to, or "may but need not" consider a beneficiary's outside resources. Prof. Ausness mentions this important issue but not in great detail, perhaps assuming that the several pages Halbach devoted to it were adequate. Nevertheless, it is an essential issue often overlooked by draftspersons and would have warranted further discussion.

Professor Ausness' coverage of the available cases seemed to be heavily weighted towards "support" trusts, both mandatory and discretionary. Although his discussion of support trusts is articulate and helpful, we were expecting an "update," and most of the cases cited did not offer that. In the area of trusts related to support, there have, in fact, been a number of developments. For example, many families have disabled children for whom they establish "Special Needs Trusts" or "Supplemental Needs Trusts," and elderly individuals are establishing so-called, "Medicaid Planning Trusts,"[5] each of which has been the subject of numerous developments and commentary over the past 2 or 3 de-

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3 Ausness, *supra* note 2, at 252-53 (citing *In re* Trusts for McDonald, 953 N.Y.S.2d 751, 753-54 (App. Div. 2012)).

4 *Id.* at 247 (citing *In re* Greenleaf's Estate, 225 P.2d 945 (Cal. Ct. App. 1951)).

5 *See generally* THOMAS D. BEGLEY, JR. & ANGELA E. CANELLOS, THE SPECIAL NEEDS TRUST HANDBOOK (Aspen 2017).

cades.[6] In all of these trusts the trustee is given a certain amount of discretion, but the breadth of that discretion must be very carefully delineated. This is because even a modicum of "excess" discretion could cause a total loss of public benefits to the beneficiary, even though the discretion is or was never exercised. A brief discussion of the precautions would be helpful in this regard, if for no other reason than to provide the reader with the full picture of the discretionary realm of the trustee and the risks of inattentive drafting.

Speaking further of developments, one of the most significant developments in trust law since Halbach has been the trend and practice towards trust decanting. Trust decanting is a term of art suggesting that a trustee with the discretionary authority to do so would transfer some or all of the assets from the present trust into a new (or different) trust,[7] sometimes called the receiving trust. Whether the receiving trust would have the same or different beneficiaries or the same or different dispositive provisions would in many cases depend on the extent of the trustee's discretion and the law governing the administration of the trusts. But the obvious question would be, if an existing beneficiary (of the first trust) were omitted from the receiving trust, would this be an abuse of the trustee's discretion? There have been a number of cases on decanting[8] as well as a number of states that have adopted laws permitting a decanting,[9] and the laws of those states vary widely, from allowing the omission of existing beneficiaries to disallowing such a change,[10] although none of those states appears to allow the addition of a new beneficiary to the receiving trust, unless otherwise expressly provided in the original trust.[11] Another area of law importantly connected with trustee's discretion that Professor Ausness covers clearly is creditor's rights to trust assets and the effect of trustee's discretion on the same, pointing out that where the discretion exists in a "support" trust, creditors (including the U.S. and state governments where public benefits are provided) who provide necessaries to the beneficiary have greater rights to recover from the trust.[12] We would have further benefited from a discussion of the trend for settlors to establish so-called "Medicaid Planning

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6 *See id.*

7 UNIF. TR. DECANTING ACT § 2(10) (UNIF. LAW COMM'N 2015).

8 *See, e.g.*, Ferri v. Powell-Ferri, 476 Mass. 651 (2017); Morse v. Kraft, 992 N.E.2d 1021 (Mass. 2013).

9 *See* LAW OFFICES OF OSHINS & ASSOCIATES, LLC, 5TH ANNUAL TRUSTS DECANTING STATE RANKING CHART (2018), https://docs.wixstatic.com/ugd/b211fb_e22a41932407481c8d324afe4c6e388a.pdf.

10 *Id.*

11 *See, e.g.*, Harrell v Badger, 171 So. 3d 764, 768 (Fla. Dist. Ct. App. 2015). *See also* UNIF. TR. DECANTING ACT § 11(C)(1).

12 Ausness, *supra* note 2, at 274-78.

Trust," referred to earlier, where a trustee's discretion to distribute principal may be directed to beneficiaries other than the settlor or her spouse.[13] We would have also benefited if the creditor's rights discussion addressed the huge movement over the past 20 years towards self-settled asset protection trusts in the U.S., which occurred three decades after Halbach's article.[14]

For a couple of centuries, the law in the United States prohibited a person from protecting her assets by establishing a trust for her own benefit, even though the trust might be irrevocable, fully discretionary, and beyond the person's control. In such cases, the law allowed the settlor's creditors to reach the maximum amount that the trustee had discretion to pay her.[15] In 1997, however, Alaska passed the first domestic asset protection trust statute, followed the same year by Delaware, and followed through 2017 by fifteen additional states.[16] These new statutes provided that the assets of a trust settled in the particular state, regardless of the settlor's domicile, would not be reachable by the settlor's creditors if the trust met certain criteria, one of them being that any distributions to the settlor must be at the trustee's discretion, discretion being the keystone to the protection offered by the trust. Interestingly, however, to date all of the reported cases on such self-settled trusts have dealt with creditors' rights to the trust and not with a trustee's alleged abuse of discretion.[17]

On the question of abuse of discretion, which is unquestionably the more common issue where third party trusts are involved and the central issue of both Prof. Ausness' and Dean Halbach's articles, there is one factor, above all others, to which the courts invariably turn to get the answer – that is, the settlor's intent. Except for cases where there has been clear improper motive or willful misconduct, the settlor's intent has been repeatedly declared by the courts to be *the* most important factor in determining whether the trustee's exercise of discretion was proper. In Halbach's article, the one, central point he repeatedly stressed was not only how critical this is, but more importantly, how drafters of discretionary trusts have been continuously and notoriously negligent and lazy in drafting discretionary provisions in a trust.[18] In

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13 *See* BEGLEY & CANELLOS, *supra* note 5.

14 *See* Alexander A. Bove, Jr., *Offshore Asset Protection Trusts*, TR. & EST., Nov. 2010, at 67.

15 Paolozzi v. Comm'r, 23 T.C. 182 (1954); RESTATEMENT (SECOND) OF TRUSTS § 156(2) (1959) (AM. LAW INST. 2017).

16 TENTH ANNUAL ACTEC COMPARISON OF THE DOMESTIC ASSET PROTECTION TRUST STATUTES (David G. Shaftel, ed. 2016) http://www.shaftellaw.com/docs/tenth_annual_comparison_dapt_statutes_2016.pdf.

17 *See, e.g.*, *In re* Huber, 493 B.R. 798 (Bankr. W.D. Wash. 2013).

18 *See* Halbach, *supra* note 2, at 1457.

Halbach's own words, "formulation of the donor's intentions—is apparently one of the most neglected aspects of estate planning."[19] And in addressing the importance of the donor's intent in assessing an exercise of discretion, he says, "no trust involving dispositive discretion in a trustee should be drafted without providing at least a basic answer to this inevitable question."[20]

I actually spoke to Dean Halbach about this important point, and recently I spoke with Prof. Ausness. Both of them agreed with my suggestion that where the drafter was reluctant to draft a discretionary power that could cover three or four pages of details, many of which may not come into play, the settlor should be encouraged to prepare, perhaps with the assistance of the legal drafter, a non-binding letter of wishes to be held by the trustee administering the trust. The letter would contain a fairly detailed statement of the settlor's intentions insofar as discretionary distributions were concerned. It would contain examples of typical "parental" situations and explain what the settlor would decide in that case. Although the trustee would always be left to make the final decision, such a letter would give the trustee, and in pressing cases, the court, information and insight of the settlor's intent that they would otherwise never have.[21]

In closing his article, Prof. Ausness offers a few "Suggestions for Improvement."[22] One in particular which goes to the heart of his article is a proposal for a single standard of discretion to judge whether a trustee has abused its discretion. It would be applied if the court found that the trustee acted either "unreasonably" or in "bad faith,"[23] sort of a combination of the standards imposed by the Restatement (reasonableness)[24] and the Uniform Trust Code (good faith).[25] Seems like a sensible approach if applied with reasonable discretion.

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19 *Id.* at 1433.

20 *Id.* at 1442.

21 *See* Alexander A. Bove, Jr., *The Letter of Wishes: Can We Influence Discretion in Discretionary Trusts?*, 35 ACTEC J. 38, 43 (2009).

22 Ausness, *supra* note 2, at 281-82.

23 *Id.* at 281.

24 *Id.*

25 *Id.*