



# **Trust Administration and Conflicts of Interest: Drafting Policies for Sticky Situations**

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# Today's Agenda

## **I. Introduction**

- I. A (very) brief history of trusts
- II. Duties of a trustee
- III. The trustee's "duty of loyalty"

## **II. What constitutes a breach of the duty of loyalty?**

## **III. Challenges to the duty of loyalty in special needs trust administration**

## **IV. Legal defenses to allegations of a breach of the duty of loyalty**



# A (very) Brief History of Trusts

- The concept of a trust was developed in ancient Rome as a way of avoiding Roman inheritance laws. These laws prevented transfers to unmarried persons, childless couples, slaves, or foreigners.
- Basis of our trust law dates to medieval England during the Crusades (12<sup>th</sup> century). In order to fight in the Crusades, landowners entrusted their property to another person to manage during the landowner's absence. Upon their return, some landowners found that the people they'd trusted didn't want to return the trust property. Therefore, a legal system developed to recognize and enforce the original landowner's rights.





# Legal Background: Trusts

**Trusts are legal entities wherein the burdens of property ownership and management are separated from the enjoyment of the property.**

- Settlor: party creating the trust
- Trustee: party that bears the burdens of ownership and management of trust property and owes legal duties to the settlor and the beneficiary
- Beneficiary: Enjoys trust property. The party for whose benefit the trust is created.
- Trust corpus: the assets held in trust



# Legal Background: Trusts

## **The trustee's duties are determined by:**

- The trust instrument
- Statutes that codify trust law
- Long history of trust case law
- Treatises – Restatement 3d of Trusts
- Uniform laws – Uniform Trust Code

# Legal Duties of Trustees

## (from the Restatement 3d of Trusts)

### Trustees have the duty:

- To identify and segregate trust property
- To administer the trust in accordance with its terms and applicable law
- To provide information to beneficiaries
- Of prudence: exercising reasonable care
- Of loyalty: administering the trust for the benefit of the trust beneficiaries
- Of impartiality: not favoring one trust beneficiary over another\*



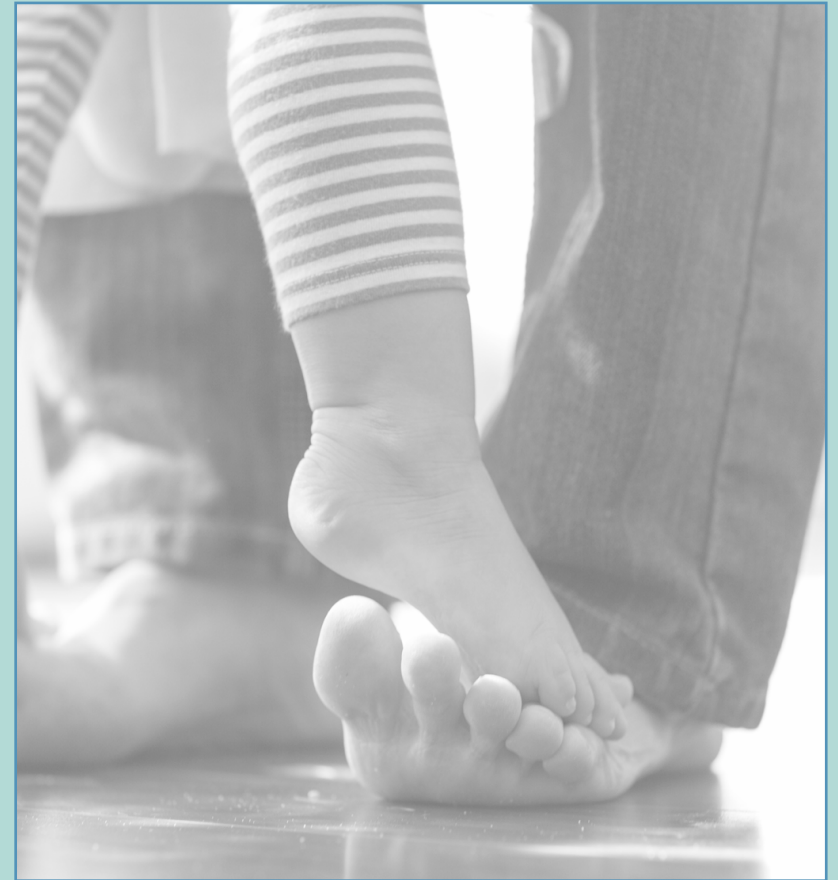
# The Duty of Loyalty

1. The trustee has a duty to administer the trust solely in the interests of the trust's beneficiaries
  - i. Beneficiaries > third parties
  - ii. Beneficiaries > trustee

# Conflict of Interest: Beneficiary vs. Third Parties

## Minor beneficiaries

- Typically, SNTs say that the trust's corpus trustee is required to supplement, and not supplant, goods and services available through other sources
- Every state imposes upon parents a duty to support their children, as they are able
- Paying expenses that a parent can or should assume for a minor trust beneficiary causes problems:
  - Trust's payments supplant the parents' support obligation
  - Payments from the trust in lieu of payments by parents primarily benefit the beneficiary's parents rather than the beneficiary



# Conflict of Interest: Beneficiary vs. Third Parties

## Minor beneficiaries

- **States use child support laws to determine each parent's specific support obligation**
  - May indicate what the amount is intended to cover
- **Factors include**
  - Each parent's income
  - Number of children being supported
  - [Division of custody as between the 2 parents]



# Conflict of Interest: Beneficiary vs. Third Parties

“The child support guidelines are based on the Income Shares Model developed by the Child Support Guidelines Project of the National Center for State Courts. ... A number of authoritative economic studies provide estimates of the average amount of household expenditures for children in intact households. These studies show that the proportion of household spending devoted to children is directly related to the level of household income and to the number and ages of the children. The basic support amounts reflected in the chart ... represent average marginal expenditures on children for food, housing, transportation, clothing and other miscellaneous items that are needed by children and provided by their parents, including the first \$250 of unreimbursed medical expenses incurred annually per child.” Explanatory comment to Pa. R.C.P. 1910.16-1.

# Conflict of Interest: Beneficiary vs. Third Parties

Combined net monthly income	One child	Two Children	Three Children	Four Children
950	232	291	325	348
1,400	336	489	578	638
3,100	676	977	1,150	1,271
6,200	1,092	1,571	1,840	2,033

# Conflict of Interest: Beneficiary vs. Third Parties

## Minor beneficiaries

- **Suggestion:** use state child support rules to determine how much beneficiary's parents are legally obligated to contribute, and what this amount is supposed to cover. Trust funds supplement this amount.
- **Downside:** requires intrusion into parents' finances.



# The Duty of Loyalty

1. The trustee has a duty to administer the trust solely in the interests of the trust's beneficiaries
  - i. Beneficiaries > third parties
  - ii. Beneficiaries > trustee
  
2. Except in some limited circumstances, the trustee is strictly prohibited from engaging in transactions that involve self-dealing, or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests
  - i. Transactions between trustee and trust
  - ii. Transactions between trust and firm/corporation in which trustee has an interest
  - iii. Trustee need not benefit from transaction to be held liable

# Conflict of Interest: Self-Dealing


**Self-dealing = transactions with trustee involving trust property or affecting its investment and management**

- “Flatly prohibited”, with limited exceptions
- “The policy of trust law is to prefer ... to remove altogether the occasions for temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses when a trustee has actually succumbed to temptation.” Restatement 3d. § 78



# **Conflict of Interest: Self-Dealing and the “No Further Inquiry” Principle**

**Self-dealing is a breach of trust, regardless of any of the following:**

- **Whether action was taken in good faith**
  - **Whether the terms were fair**
  - **Whether the trustee profited**
- 

**“A trustee, therefore, commits a breach of trust by purchasing trust property, even as the highest bidder at a public auction; otherwise the possibility of purchase by the trustee would create a temptation for the exercise of less than the trustee’s best efforts and business judgment on behalf of the trust to determine whether the sale was appropriate and to obtain the most favorable price and terms from others for the trust property.” Restatement 3d of Trusts § 78**

# Conflict of Interest: Self-Dealing

Can be an issue when the nonprofit serving as trustee also has direct service programs useful to beneficiary

- Bill-paying
- Residential, day, or other programs
- Case management



# Conflict of Interest: Exceptions to Prohibition on Self-Dealing

1. Court approval
2. Authorization in terms of trust
3. Consent of beneficiaries
4. Trustee's compensation (for serving as trustee)
5. Certain self-employment (e.g., trustee who is attorney or real estate agent, "when it is advantageous to the trust that the trustee rather than another perform these services")
6. Advancements and loans needed for proper administration of trust estate, when funds are not available from others on same or better terms
7. Transactions with other trusts and estates, even when the trustee is the fiduciary for the other party
8. [applicable to larger banks and other custodians]

# Conflict of Interest: Exceptions to Prohibition on Self-Dealing

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# Conflict of Interest: Exceptions for Self-Dealing Authorized by Trust



## Conflict of interest provision in MTA

- Informs beneficiary of existence of affiliate relationships
- Expressly permits trustee to make distributions from beneficiary subaccounts for services provided to beneficiary by affiliate
- Trustee shall not be liable to settlor, beneficiary, or any other third party for any act of self-dealing or conflict of interest by reason of contracting with affiliates
  - Include bounding terms

# Conflict of Interest: Exceptions for Self-Dealing Authorized by Trust



## Bounding terms for use of vendor who otherwise would constitute conflict of interest:

- Trust may provide services when other provider(s) not available or willing to do so
- Services charged by trustee must be comparable to those charged by other providers in the same geographic area
- Notice to settlor, trust protector, or beneficiary/beneficiary's representative
- Outside review of fee-for-service bills
- Periodic review to ensure service is in beneficiary's best interest

# Conflict of Interest: Exceptions for Self-Dealing Authorized by Trust



**Section in JA to allow grantor to opt-in to specific direct services to be provided by nonprofit**

- Solicit guidance from grantor:
  - Goals for additional services?
  - Limits to/budget for additional services?
  - As the trustee, in exercise of its discretion, believes necessary to accomplish the purposes of the trust

# Conflict of Interest: Exceptions for Self-Dealing Authorized by Trust



**As with any distribution and vendor, trustee should keep good records regarding why it believed the distribution was needed and why this particular vendor was a good choice.**

# Conflict of Interest: Exceptions for Self-Dealing w/ Beneficiary Consent



## Consent of beneficiaries

- May include remainder beneficiaries, depending on how trust addresses postmortem remainder, and directs the trustee to weigh interests among beneficiaries
  - Consent is only as effective as it is informed
  - In writing, with adequate time under the circumstances
  - Suggested title: "Beneficiary Consent to Conflict of Interest Transaction"
  - Should contain all material facts
  - Not effective unless returned

# Conflict of Interest: Exceptions for Self-Dealing w/ Court Approval



## Court approval

- Best if prospective rather than retroactive (i.e., *nunc pro tunc*)
- No pro forma petitions – provide your reasoning and background facts to show the distribution is reasonable and in beneficiary's interest
- Ask your attorney if the petition can provide a budget for a period of time, rather than requesting approval of one expense which may need to be repeated

# Conflict of Interest: Exceptions for Self-Dealing for Self-Employment



## Self-employment

- An exception with limited utility?
- Comment mentions it may be most appropriate where there are clear standards for fees (such as statutory fee structures)

# Conflict of Interest: Self-Dealing

## Compensation of executives

- With significant control over the nonprofit
- Generate a record of how fair compensation was determined
- See Family Trust of Mass. cases from yesterday's session



# The Duty of Loyalty

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  - i. Transactions between trustee and trust
  - ii. Transactions between trust and firm/corporation in which trustee has an interest
  - iii. Trustee need not benefit from transaction to be held liable
3. Whether or not acting as a trustee, the trustee has a duty to deal fairly with the beneficiary, and to communicate all material facts the trustee knows/should know

# Conflict of Interest: Self-Dealing

## Duty to deal fairly w beneficiary

- Applies regardless of whether trustee is acting as trustee in the deal at hand
- Written communication with beneficiaries (including summaries of meetings or phone calls) provides best record
- Must disclose facts that weigh against you – but do so with caution (and maybe legal advice)





# Summary

- **As trustees, you are tapping into an ancient body of law with hundreds of years of judicial and statutory refinement.**
- **A trustee's fiduciary duty requires that it serve only the interests of the trust's beneficiaries, rather than any other party**
- **Self-dealing is per se a breach of trust, unless the transaction fits into one of the exceptions provided in common law (or one provided by statute)**
- **Strategically, organizations may wish to seek counsel when considering business practices which could be seen as self-dealing.**

# Thanks friends!!

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