Special Session II-E

Case Studies in Preventing Post-Death Administrative Nightmares

Litigation Series
Planning with Trusts Series

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The following hypotheticals are designed to illustrate the Estate and Trust administration difficulties that arise when the estate planner is faced with planning for and anticipating the conduct of difficult or problem beneficiaries. In each case, we start with the scenario facing the estate planner; we then list the outcome or administrative complication arising post-death; and finally propose planning solutions that would have avoided or mitigated the problematic outcome at death.

In many of these proposed planning solutions, we will refer back to the outline by Mr. Baker and Mr. Pharies from the plenary session, for additional legal authority, forms, and strategies described therein.

Scenario I: Multiple Disinheritances; Multiple Contests

You are planning for the Estate of a wealthy, elderly business owner with an estate worth millions of dollars. Your client has five children, all adults; he plans to leave the entire estate in trusts of equal shares for the three youngest children. He is intending to disinherit one child entirely and give another child a modest trust worth millions of dollars, but significantly less than the residuary trust for the three youngest children.

You draft that plan, and include a standard in terrorem clause which disqualifies any contestant.

Decedent dies two years later and the entire estate, worth in excess of $100 Million, passes through the testamentary document you drafted.

The Outcome

Within six months of the opening of the administration, the child who is completely disinherited files a Will Contest. The Contest is extensively litigated to the tune of millions of dollars in legal bills and is eventually settled for a payment substantially equal to the modest trust created for the second disinherited child.

Two months after you settle with the first contestant, the child with the modest trust files an intentional tort claim against the three children, individually, who inherited the majority of the estate, claiming that they tortiously interfered with the Decedent to bring about the Estate Plan. When the executor moves to intervene and defend the tort claim, his petition to intervene is denied; when the defendants submit their legal bills for their defense of the tort claim to be paid from the Estate, the Court disallows their fee petitions because the Estate is not a party to the action. Eventually, after additional legal fees are incurred a significant additional amount is placed in the trust for this child to settle the tort claim.

Planning Options

- Consider broader in-terrorem clause
- Consider directing defendant fee payment from trust or estate
- Consider bequests to all potential contestants

Scenario II: Financial Transactions between Spouses

You represent a wealthy individual, with adult children from a first marriage and a childless, long-time second marriage. Second spouse entered the marriage with relatively little property; your client was extremely wealthy at the time she married second spouse.

The second spouse and the children from the first marriage did not get along. The children have always stated that they consider their wealth to be a birthright, which is not to be shared with anybody outside the bloodlines and absolutely not to be shared with the second spouse.

Through a series of common investments during the term of their 25-year marriage, in which your client initially funded both her share and the paid for assets purchased by the second spouse, your client's net worth has grown considerably. However, second spouse has also acquired a considerable net worth of virtually equal value to hers.

There is no pre-nup or post-nup agreement; many of the common investments purchased by them were purchased so long ago that detailed records about the sourcing of the transactions and purchases do not exist.

Your client's plan says absolutely nothing about any of these matters, and creates a standard QTIP for the surviving spouse, if your client's second spouse outlives your client, and a broad special power that would allow the second spouse to appoint half of the marital trust to charity.

The Outcome

Your client dies first; the second spouse survives and states that he has exercised the power of appointment in his Will in favor of charity. The children from the first marriage file a lawsuit against the surviving spouse, demanding an accounting because throughout the marriage, each spouse has had broad property law powers of attorney for the other spouse, executed as a routine matter when the initial estate plans where signed.

The children from the first marriage claim that any net worth that the surviving spouse has is a direct result of some unspecified form of misappropriation or defalcation of the decedent's money in order to build his net worth, and seek to recover all of it into the Decedent's Estate using a citation, intermeddler, replevin or other statutory or common law recovery scheme against the surviving spouse.

The simple lack of records and the cost of the litigation results in a meaningful settlement by the surviving spouse, transferring some of his net worth back to the Decedent's Estate and his agreement to cut back on the extent of the exercise of his power of appointment over the QTIP marital trust.

Planning Options

- Consider express acknowledgement of prior spouse-estate enhancements in plan documents
- Consider direction to Executor/Trustee not to pursue claims against spouse
- Consider beefing up priority language in QTIP

Scenario III: Death-Bed Transfer; Skimpy Tax Clause

You represent a wealthy client who comes in to update his estate plan when he is quite old. He feels he has adequately provided for his children, grandchildren and stepchildren, and therefore establishes an estate plan that is almost entirely marital and charitable, with little transfer tax burden arising at death. After executing these documents, he returns months later, having been worked over by his children and stepchildren, and they have convinced him to establish a series of significant, multi-million dollar, inter-vivos commercial, inter-family transfers that all contain gift tax exposure. You implement these transfers but do not change the estate plan, which has a standard residuary tax clause of three sentences.

The Outcome

Your client dies; an audit of all of the inter-vivos transfers results in those being characterized by the IRS as gifts, and significant gift tax liabilities are incurred. Your tax clause does not state where gift taxes incurred post-death are to be paid, and more importantly, it appears to place the primary burden of any taxes on the residue. This has the effect of doubling and tripling up the amount of the tax assessment, as eating into the marital and charitable deductions at death generates additional estate taxes on top of the gift taxes. As a consequence, everybody who touched this plan is eventually sued.

Planning Options

- Consider express abatement/ademption clause directly addressing the potential gift exposure
- Consider tax contribution agreements from recipients

Scenario IV: Lawyers in the Family

Estate planning client tells you that all of his children are lawyers, and all of them are litigious. She anticipates a fight upon her death regardless of how she distributes the property, since she does not intend to distribute it in precisely equal shares, and intends to have only one of the four children in control post-death. Your client is extremely privacy conscious, is a quasi-public figure, and feels the specter of the coming litigation at her death is as big a problem as is the potential to recast her estate plan and generate legal bills resolving the plan. Your client is not impressed with the prospect of an in terrorem clause, because she believes her litigious children will represent themselves so that there will be no independent lawyers to be scared off by the prospect of a malpractice threat.

You draft a fairly standard plan with an in terrorem clause and hope for the best.

The Outcome

Your client guessed right; all four of the children challenge some aspect of the plan and the litigation is time-consuming, expensive, and throws your deceased client into an unfavorable public light she sought to avoid. In short, every bad outcome that your client anticipated and wanted to avoid comes to pass.

Planning Options

- Consider use of ADR clauses in testamentary documents

Scenario V: Control Person

Your client is a successful business person with a significant estate, who has been both a CEO and COO of the business for many years that built his net worth. He has a spouse and three children, all of whom are likely to fight over both control of his business and asset allocations currently provided for under his testamentary documents. Since all are significant beneficiaries under the plan, you advise your client to place a broad-based in terrorem clause in the document and assure your client that should bring about compliance with his wishes.

The Outcome

Recognizing that the in terrorem clause could cost each of the children and the spouse their inheritance, the group gets together post-death and agrees through a non-judicial settlement agreement to substantially modify the Decedent's estate plan. Among the modifications they agreed to is conversion of the marital trust under the document to a total return trust of 5%, thereby significantly increasing what is likely to be distributed to the surviving spouse and requiring liquidation of closely-held assets your decedent did not want liquidated. They also agree to decant the trust to provide each of them with separate control over a fractional share of the trust and the investments, and allow them to make their separate share a directed trust which creates conflicting fiduciary appointments that eventually causes the sale and liquidation of the decedent's business.

Planning Options

- Consider document opt-out of various modification tools, such as decanting and total return conversion (*See "Don't Touch my Document Clause" included in the Plenary Session materials.)*

Scenario VI: Dueling Estate Plans

Your client is torn between two potential dispositions: one, under which he intends to leave his entire estate to a private foundation he has established, to be run by his lawyer and his business associates; the second, an outright bequest to a public charity and several family members in equal shares. Since he does not want his lawyers to be involved in talking him out of one or the other plan, he has two different sets of lawyers, and virtually every six months he goes to the first set and updates the foundation only plan, and six months later goes to the other lawyer and updates the outright plan. The main reason for his anxiety is that he is being pressured, on the one hand by his lawyers and his business associates, to disinherit his family and once he does so, he feels guilty and eventually goes to the second set of lawyers and again updates the outright plan.

The Outcome

While this could simply be a matter of which set of documents the client updates last, it turns out with the help of his business associates, that he has executed funding documents, placing all his assets in the declaration of trust which feeds the foundation-only plan. The back and forth between the dueling lawyers and the estate plans only stops when the client has a stroke that renders him incapable of making further changes. At that time, you, the lawyer for the outright plan, learn of the existence of the prior plan, and also learn that it has been pre-funded by assignment inter-vivos. Therefore you understand that even though your documents are the last ones in time, they are unlikely to operate because the prior plan has not been revoked and is fully funded. You tell the beneficiaries that, effectively, nothing can be done other than to await the client's death, at which time expensive litigation ensues between the beneficiaries under the two plans.

Planning Options

- Consider resort to guardianship estate planning for revocation of prior plan

- Consider routine revocation of all prior residuary plans upon execution of estate plan

Scenario VII: Share of Residue to Charity

Your Decedent is charitably inclined, and therefore has a mixed plan which leaves a straight percentage of her property to her children, and a percentage to her private foundation. The same fiduciaries of the estate plan and trust are the fiduciaries of the foundation.

The Decedent has hard to value assets, special assets that are likely to be fought over by beneficiaries who each receive a fraction of the estate, and assets that may well be purchased by one or more of the non-charitable beneficiaries.

You draft a conventional fractional share estate plan, giving the fiduciaries broad powers to sell assets and fund assets non-pro-rata among the fractional shares.

The Outcome

The Attorney General of the state files an appearance and becomes directly involved in administration, in part because the fractional share to charity means that each and every dollar expended on administration effectively reduces the charitable share, and in part because there is a complete overlap between the fiduciaries of the foundation and the fiduciaries of the estate and trust, so those fiduciaries have conflicts and cannot be deemed to be protecting the interests of charity.

Anticipated fights over valuation, fiduciary sale of assets, and asset allocation all arise, and significant fees and expenses are generated, and then objected to by the Attorney General, which is extremely fee sensitive and seeks to have virtually all expenses either disallowed or allocated specially against the non-charitable beneficiaries. As a consequence, the attorneys are paid a small fraction of their actual fees and costs, certain inter-party sales are set aside and litigation essentially transforms the estate administration.

Planning Options

- Consider only pecuniary bequests to charity

- Consider specific bequests of unique or desired assets

Scenario VIII: Favored Fiduciary

Your client has a business associate that he wants to serve as his executor and trustee. He is a trusted business associate with sophistication, significant net worth, good judgment, and better things to do. Therefore, your client is concerned that there may be no incentive for this person to act, and in particular, is concerned that any potential threat of litigation or controversy will cause the favored fiduciary to decline to act.

The decedent's family has been litigious in the past, and your client believes it is not impossible that they would actually sue the executor simply to get leverage over preferred administration outcomes.

You place broad exoneration language for the fiduciary in the document, and advise your client that it should be enforceable and will therefore protect and incentivize the favored fiduciary.

The Outcome

While many jurisdictions will enforce exoneration clauses, at least in UTC (37) jurisdictions where the exoneration does not go beyond reckless disregard for the rights of the beneficiaries, alleged self-dealing and other inappropriate behavior will often take the potential exoneration clause out of full operation, and therefore these clauses can never be viewed as a complete shield to fiduciary liability. In fact, claims are made and the favored fiduciary ends up resigning in settlement before significant decisions are made that the decedent hoped would be implemented by his favored fiduciary.

Planning Options

- Consider contingent bequest to fiduciary in amount of personal exposure

Scenario IX: Children Battling Over the Business

Your client owns and operates a significant real estate company with holdings in various states. She has two grown children who have not seen eye to eye since they were young. Both children are equally sophisticated and have received lifetime gifts of various real estate interests, some of which they own jointly. For many years, Son was deeply involved in the family real estate business, and Daughter kept her distance because of potential conflicts with Son. After a failed transaction that your client believes to be the fault of Son, your client asked Son to step aside from the business in favor of Daughter. This infuriates Son and causes an irreparable rift between Son and Daughter. After several years of Daughter's involvement, the business is thriving and your client has come to depend on Daughter for effective management of the business. Despite the rift between Son and Daughter, your client insists on naming Daughter as trustee for the post-mortem administration so she can continue to manage the business and instructs you to protect Daughter against actions by Son.

You draft a standard estate plan that distributes the trust to your client's issue by right of representation. In order to protect Daughter, you include a broad exoneration clause in favor of Daughter while serving as trustee.

The Outcome

After your client's death, Son begins a campaign of harassment through litigation by which he challenges virtually every action taken by Daughter as trustee. He seeks to compel distribution of the trust after six months of administration, he challenges the accountings rendered by Daughter, he challenges Daughter's ability to use trust assets to pay her attorneys, and he seeks her removal as trustee as well as surcharge for damages he claims she caused by her actions.

Planning Options

- Separate the business management from the trust administration by placing the business interests in one or more entities

- Select a forum for the entities that allows a modification of fiduciary duties, exoneration of managers, and indemnification

- Structure Son's gift as a specific gift of an interest in the entities while giving the residue to Daughter, ensuring that each gift bears its share of the estate tax

- Tie Son's specific gift to a broad in terrorem clause, and include provisions in the trust that allow the trustee to withhold distribution until estate tax issues are resolved

- Consider a corporate or third-party trustee in order to avoid the argument that Daughter, as trustee, might be bound by the stricter trust-level fiduciary duties

- Consider employing the lifetime pre-validation procedure for trusts available under Delaware law to deal with a potential contest by Son