

Protecting trustees from blame (and liability) in COVID-19's new world order

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The total fallout from the ongoing and evolving COVID-19 pandemic on the global economy, including the long-term impact on the real estate markets and business sectors, is yet to be seen. The economic recovery from COVID-19 is likely to take many years and previously successful financial management strategies may find new challenges in the resulting changed world. Past economic downturns have shown that successful people negatively impacted by portfolio losses, market volatility, and business struggles often scrutinize the actions and inactions of the people managing their assets. This happened following the economic recession in 2008, for example, and led to significant litigation.

Beneficiaries of trusts holding significant assets are no exception. And while there is little precedent to guide fiduciaries navigating a global economy grappling with COVID-19's impact, trustees must be proactive and diligent in taking steps to put themselves in the best position to defend against future claims of mismanagement or breach of trust.

As fiduciaries, trustees are typically guided by the responsibilities and obligations imposed on them under the law and/or pursuant to a contract or trust instrument. In litigation, courts typically focus more on the sufficiency of the trustee's asset management process and administrative approach than investment portfolio results. It is important, therefore, that a trustee focus on the review process and reevaluate all aspects of the administration.

Trustee protection strategies in a COVID-19 world and its aftermath

Here are a few important approaches and considerations to guide that process in a manner to help avoid or defend against potential future claims.

- **Step Back and Thoroughly Evaluate Risks and Needs.** The first important step for trustees facing any significant change is to carefully evaluate the assets under administration, researching and analyzing current and future risks. Trustees should speak to investment managers, business officers, banks, trust lawyers, and other knowledgeable advisors or contacts about the facts relating to the trust's interests. Trustees should identify actual or potential risks and explore potential plans to minimize the negative impact or to take advantage of new opportunities. Risk assessment should occur not only relating to the assets themselves, but also risks facing beneficiaries who are dependent upon trust distributions. Beneficiaries and trust-held businesses may have greater or different needs than what was necessary pre-pandemic, and those evolving needs must be considered in planning. Proactive evaluation may include budgeting, trend analysis, and scrutinizing the performance of other fiduciaries managing interests impacting the trust. This may also be an environment where maintaining cash is important, so evaluating cash needs and access to cash may be of greater importance in a COVID-19 environment. In addition to identifying risks, this may also be a time to consider opportunities, including refinancing loans or investing in crisis-priced assets.
- **Document Your Due Diligence.** Passive trustees make for easy targets. Trustees should not rely on past beneficiary satisfaction with established approaches to be an indicator of future approval. The turbulent COVID-19 environment requires constant diligence regarding financial performance and constant review of investment choices. The trustee process for evaluating assets should be deliberate and regular. To protect the trustee, the process should be sufficiently documented to show the standard of care used to protect the investments. If the trustee considered and rejected alternate strategies, the process that led to that decision should be documented as well. A clear and detailed record of the considered steps that led the trustee to make a change may help defend the decision, even if it turns about to be the wrong decision. In litigation, it is easier for the court to find that the trustee's actions were reasonable under the circumstances, even if the performance was unsuccessful, when the trustee's investment diligence and administrative processes are competently and clearly documented. This includes documenting the advice received from advisors and lawyers, as well as information received from beneficiaries and third parties. With trustees facing increased scrutiny for their decisions

during the COVID pandemic, documenting every step of the decision-making process is imperative.

- **Communication Is Key.** Trustees have a duty to keep beneficiaries reasonably informed regarding the trust and its administration. This remains true even when the future of the trust and its investment are unclear. Trustees should communicate early and often about how COVID is impacting the trust, its assets, and any decision that goes beyond the day-to-day administration of the trust. Trustees should also regularly open the lines of communications with beneficiaries and the individuals running any business interests held by the trust to understand how COVID-19 is impacting them. Frequent communication in uncertain times and periods of stress will help trustees and their advisors spot trouble spots that, if left unaddressed, could lead to litigation.
- **Scrutinize Expenses.** If your diligence uncovers an increase in beneficiary distribution need or a likely decrease in available cash, you may need to prepare for tightening the belt. Historical financial management or real estate related expenses may no longer make sense in a global pandemic marketplace. It may be the right time to renegotiate rates with consultants, brokers, and property managers. If the trustee is taking a significant fee, the trustee should take care to document administrative and investigative efforts so that there is an evidentiary record supporting the value provided in exchange for that fee.
- **Consider Judicial Options.** There are certain statutory mechanisms that trustees can use to protect themselves from potential beneficiary attack and/or to adapt the governing instrument to a changed world. Trustees may be advised to consider these judicial tools in situations now even though they may not have considered using them in the past. Among other options, trustees should consider whether to petition the court for instruction, utilize a notice of proposed action, or even seek to modify the trust due to changed circumstances where appropriate.
- **Petition for Instructions.** A petition for instructions is a mechanism available to a trustee that seeks guidance or direction from the court on whether or how to take a particular action concerning the trust's assets. A court order instructing a trustee can help protect a trustee from liability for following those instructions. And since courts evaluate a trustee's act based on the process undertaken and the information available to the trustee at the time, seeking instruction from the court beforehand by presenting this information is better than having the court consider the same decision on a claim for breach of trust, when the court may be influenced by the negative result of that decision.
- **Notice of Proposed Action.** A trustee may give notice of any proposed action that the trust instrument authorizes the trustee to take, and includes a course of action or decision not to take action. Like a petition for instructions, a notice of proposed action gives beneficiaries forewarning that the trustee is going to take a certain act relating to the trust assets. If a trustee provides written notice of the anticipated act, and no beneficiary objects, then the trustee is likely protected from liability as to beneficiaries that received the written notice.
- **Changing or Ending the Trust.** Under certain scenarios, a trustee may petition the court to modify an irrevocable trust when there is a change in circumstances that was not anticipated by the settlor, and these changes would defeat the accomplishment of the purpose of the trust. There may also be other ways to change the trust structure to protect the beneficiaries, such as decanting, utilizing powers under tax savings clauses, or, in the most extreme of circumstances, terminating the trust.

These tools are not available or advisable under all circumstances, so a trustee should consult a lawyer familiar with these items to see if these are potential options for the trustee's particular situation and that using them would be advisable under the circumstances.

In conclusion, this is a time of action for trustees. Trustees can be certain that their conduct in 2020 and beyond will be closely watched and heavily scrutinized by concerned beneficiaries. The best way to protect themselves from future liability is to take proactive steps to adapt trust administration to these uncertain times.

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