

Sour Grapes: When Decanting Gives Rise to Litigation

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By the end of 2018, there were 29 states that had enacted trust decanting statutes, with approximately 22 of those taking effect in the last decade. With the prevalence of decanting increasing, courts are increasingly being forced to consider the circumstances under which decanting is permissible and, relatedly, what remedies are available in cases of impermissible decanting. It behooves fiduciaries, beneficiaries, and trusts and estates practitioners to familiarize themselves with this emerging area of law, so they can recognize and avoid the common pitfalls associated with decanting and recognize the attendant issues associated with decanting before those issues evolve into litigation. This article provides a selective overview of decanting and common themes and issues that have arisen in decanting litigation in the United States, including the authority to decant, the intersection of decanting and family law and special needs trusts, creditor avoidance, and remedies for unauthorized decanting.

It is worth noting that the commonly litigated issues discussed in this article are not exclusive. Given the nearly unlimited ways in which a trust may be modified through decanting, it is foreseeable that a plethora of issues relating to decanting may be litigated, such as tax controversies resulting from decanting, disputes relating to decanted trusts that change the governing law of the trust, or challenges to a decanting that grants powers of appointment to beneficiaries. Because these types of controversies could arise in the future, trustees, financial advisors, and trusts and estates practitioners should consider these and other potential issues that could result from decanting.

Overview of Decanting

What is Decanting?

Taking its name from the act of pouring liquids, such as wine, from one vessel to another, trust decanting refers to the act of distributing trust property from an irrevocable trust to another trust, under the trustee's discretionary authority to make distributions to or for the benefit of its beneficiaries. The ability of a trustee to decant arises principally from the trustee's distribution powers as conferred by the trust instrument. Except where decanting is expressly allowed by statute under different circumstances, a trustee must generally possess the absolute power to invade the trust's principal in order for decanting to be expressly permitted. The practical effect is to allow a trustee with decanting power to amend an otherwise unamendable trust by transferring trust property to a second trust with different administrative or dispositive terms. The power to decant has been described as similar to a power of appointment, subject to fiduciary duties. Melissa J. Willms, *Decanting Trusts: Irrevocable, Not Unchangeable*, 6 Est. Plan. & Community Prop. L.J. 35, 38 (2013). Indeed, when considering whether decanting is advisable, it is critical that the trustee examine all applicable fiduciary duties.

History of Common Law and Statutory Authority Regarding Decanting

The earliest reference to the permissible exercise of decanting power in case law can be found in *Phipps*

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v. Palm Beach Trust Co., 196 So. 299 (Fla. 1940). In *Phipps*, the Florida Supreme Court determined that the terms of a trust that authorized the trustee to distribute trust property to one or more trust beneficiaries *in his or her sole and absolute discretion* also permitted the trustee to create a second trust for the beneficiaries of the original trust. *Id.* at 300-01. In the intervening decades, though not referred to as decanting, this concept was memorialized in the *Restatement (Second) of Property: Donative Transfers (Second Restatement)* and the *Restatement (Third) of Property: Wills and Other Donative Transfers (Third Restatement)*. *Id.* at 37, n.2. In 1992, with the passage of N.Y. Est. Powers & Trusts § 10-6.6(b) et seq., New York became the first state to enact a decanting statute. Since that time, similar decanting statutes have been enacted in over half the states.

Anatomy of a Decanting Statute

In most cases, decanting statutes contain provisions regarding: (i) the authority required to decant; (ii) changes permitted via decanting; (iii) tax-related and other restrictions; and (iv) notice, consent to, and approval of decanting. The operative provision of a typical decanting statute reads in a manner substantially similar to the following:

. . . [A]n authorized trustee who has absolute power under the terms of the trust to invade its principal . . . to make current distributions to or for the benefit of one or more beneficiaries may instead exercise such power by appointing all or part of the principal of the trust subject to such power in favor of a trustee of one or more other trusts . . . including a trust instrument created for the purposes of exercising the power granted by this section . . . for the current benefit of one or more of such beneficiaries.

Fla. Stat. § 736.04117 (2018).

Absolute authority of the trustee to invade the trust principal is usually required to decant, such as in the case of a trustee who is authorized to invade principal for the “best interests” or “comfort and enjoyment” of the beneficiary. Certain states permit more restrictive decanting, however, in situations where a trustee’s discretion to invade principal is limited (e.g., where invasions of principal are subject to the “health, education, maintenance, and support” standard).

When decanting, a trustee must also consider what differences between the terms of the original trust and the newly created trust are statutorily permitted. These considerations commonly include whether the new trust may eliminate a beneficiary’s mandatory withdrawal or distribution rights; whether the beneficiaries of the new trust must be the same as (or are otherwise limited to) the beneficiaries of the original trust; and whether the new trust requires the same distribution standard as the original trust. In addition, some states require notice be given to the settlors and beneficiaries of the original trust before engaging in the act of decanting. If an interested party objects, the trustee may often proceed by petitioning the court for approval.

Common Themes and Issues Arising in Decanting Litigation

Given the recent widespread adoption of decanting statutes in the United States, decanting case law is scant and is ever-developing. Yet common themes and patterns have begun to emerge in the few cases where a decanted trust has been the subject of litigation, which may provide useful guidance to the trustee or attorney who is considering whether to decant a trust.

Authority to Decant

Unsurprisingly, one of the major issues that has arisen in cases that have dealt with decanting is whether the decanting was authorized. Whether decanting is authorized expressly by statute or by common law, courts generally look to the trust instrument to answer this question. The key is the settlor’s intent, and

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whether the trust's language evidences an intent to authorize the trustee to decant.

Trust Provisions Evidencing a Settlor's Intention to Permit Decanting. The authority to decant is generally inferred by the powers given to the trustees, and need not be expressly stated. See *Ferri v. Powell-Ferri*, 72 N.E.3d 541, 546 (Mass. 2017) ("The authority to decant need not be expressly granted to the trustee in the declaration of trust."). For instance, in *Ferri v. Powell-Ferri*, the Court viewed three provisions in the trust as evidence of the settlor's intent to allow decanting. The first permitted the trustee to "segregate irrevocably" net income and principal that the trustee deemed desirable for the beneficiary's benefit. The second allowed the trustee to apply principal and income for the beneficiary's benefit rather than distribute the sums outright. Finally, the trust granted the trustee "full power to take any steps and do any acts which he may deem necessary or proper . . . without order or license of court." *Id.* at 547-48. The *Ferri* court found that these provisions, when viewed together with the entire trust instrument, were consistent with the conclusion that the settlor intended to permit the original trust to be decanted.

Extrinsic Evidence of a Settlor's Intent. In some cases the settlor of the trust is still alive when a decanting occurs. In such cases, how much weight can be afforded to a settlor's statements of his intent, which were made after the original trust was funded? Generally, if the terms of a trust are unambiguous, extrinsic evidence of the settlor's intent are inadmissible as parol evidence. But where there is an ambiguity, such evidence may be considered. In *Ferri v. Powell-Ferri*, the Massachusetts Supreme Court determined that the trust was ambiguous and concluded that an affidavit submitted by the settlor regarding his intent to allow decanting could be considered in determining whether the trustees were authorized to decant. *Id.* Even though the settlor's affidavit was created after litigation arose regarding the decanting (which inured to the benefit of his son), the court determined that it could be considered and doing so would not contradict or vary the terms of the trust, since the trust neither "expressly permit[ted] nor bar[red] decanting." *Id.* at 552.

In contrast, the New Hampshire Supreme Court invalidated a disputed decanting, notwithstanding the fact that the trustees had decanted in accordance with the then-living settlor's wishes. *Hodges v. Johnson*, 177 A.3d 86, 91-92, 97 (N.H. 2017). Although this result may seem at odds with the Massachusetts Supreme Court's analysis in *Ferri v. Powell-Ferri*, it is important to note that, in *Hodges*, the settlor's desire to decant his trusts to eliminate certain beneficiaries' interests arose *after* those trusts had become irrevocable, whereas, in *Ferri*, the settlor was attesting to his intent *at the time* he established the original trust.

Effect of a Beneficiary's Right to Access Principal. If a trustee has unfettered authority to invade principal, a problem arises where a trust also authorizes a beneficiary, at some point, to access principal. Obviously, if the trust mandates distributions of principal to the beneficiary, the trustee lacks the authority to do otherwise. But where the trust merely gives the beneficiary the right to access principal, the trustee's authority to decant becomes less clear. The courts that have addressed this issue have taken differing approaches. The Massachusetts Supreme Court, for instance, reasoned that a beneficiary's ability to access principal was not mutually exclusive from a trustee's authority to decant. Instead, the court likened the principal that had not been withdrawn by the beneficiary to assets of a terminated (but yet to be distributed) trust—the trustee retained full legal title and rights of possession of the trust assets that had not been withdrawn and retained "ongoing duties to control and protect the trust assets and [could] continue to act pursuant to the powers provided under the trust instrument." *Ferri v. Powell-Ferri*, 72 N.E.3d 541, 549-50 (Mass. 2017).

The New York Surrogate's Court and Appellate Division took a different approach in addressing this issue. Rather than framing the issue as whether a trustee loses his ability to decant once a beneficiary gains

the right to access principal, the court examined whether such circumstances would result in a self-settled trust. See *In re Kroll*, 971 N.Y.S.2d 863, 865-66 (2013); and *Kroll v. New York State Dept. of Health*, 39 N.Y.S.3d 183 (2016). Both the surrogate's court and the appellate division concluded no. It is important to note, however, that in *Kroll*, the decanting occurred before the beneficiary's 21st birthday, which was the point at which the trust instrument granted him the right to access the original trust's principal.

The Connecticut Supreme Court also addressed the issue of whether the new trust holding decanted assets that were subject to a beneficiary's right of withdrawal prior to decanting was self-settled. In *Ferri v. Powell-Ferri*, 165 A.3d 1137 (Conn. 2017), the court reasoned that the new trust funded with decanted assets was not self-settled, because the trustees had decanted the original trust's assets without the beneficiary's advance permission, knowledge, or consent. *Id.* at 1148. Because the beneficiary had no involvement in the decanting, it was immaterial that he had previously had the ability to access the principal of the old trust before the decanting. *Id.*

Satisfaction of Statutory Requirements. Notwithstanding a trust's grant of decanting authority to a trustee, some states impose additional requirements that limit a trustee's ability to decant. For instance, notwithstanding language that appeared to permit decanting, the New Hampshire Supreme Court removed two trustees for decanting two irrevocable trusts at the direction of the settlor where the decanting eliminated the beneficial interests of certain beneficiaries. *Hodges v. Johnson*, 177 A.3d 86, 99 (N.H. 2017). There, the court held that the trustees had breached their statutory duty of impartiality because they had failed to treat the beneficiaries "equitably in light of the purposes and terms of the trust," where one of the implicit purposes of the trust was to provide support to the beneficiaries. *Id.* at 97. Query whether any decanting that eliminates the beneficial interest of a beneficiary would ever survive this standard.

Similarly, in *Harrell v. Badger*, 171 So.3d 764 (Fla. 2015), a Florida court invalidated a decanting that resulted in the creation of a new trust that benefitted additional persons who were not beneficiaries of the decanted trust on the grounds that the decanting violated a Florida statute that required that the new trust into which assets were being decanted could include only beneficiaries of the original trust. *Id.* at 769.

Family Law: Decanting Around Support Obligations and Marital Property

In addition to recognizing some of the situations where decanting may not be permissible, it is also important to be cognizant of the circumstances in which a dispute over decanting may arise. One common scenario in which decanting litigation arises is marital dissolution proceedings. In some equitable distribution states, a beneficiary's interest in a trust may be considered a marital asset, and any income received from a trust may be considered when determining alimony. As such, decanting can be a powerful tool for trustees who wish to shield trust assets from the reach of their beneficiaries' soon-to-be ex-spouses.

Again, the case of *Ferri v. Powell-Ferri*, 72 N.E.3d 541 (Mass. 2017), is illustrative. In *Ferri*, the trustees of an irrevocable trust established for the benefit of settlor's son decanted the trust into a new trust following the institution of marital dissolution proceedings by the son's wife. *Id.* at 544. Although the original trust permitted the beneficiary to access principal, the new trust was a spendthrift trust, leaving the beneficiary with no power to demand payment of trust assets. *Id.* In effect, the trustees had removed the original trust from the reach of the beneficiary's estranged spouse (and the court). Although the Connecticut and Massachusetts Supreme Courts ultimately upheld the decanting as valid, the Connecticut Supreme Court recognized that the beneficiary's wife had a colorable claim of injury, which accorded her standing to contest the decanting, because the trustees' action had affected the "dissolution court's ability to make equitable financial orders" and consider trust assets in fashioning alimony. *Ferri v. Powell-Ferri*, 165 A.3d

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1137, 1144-45 (Conn. 2017).

Creditor Avoidance

Given the outcome in *Ferri*, a trustee might be tempted to use decanting in order to protect a beneficiary from creditors. After all, the trustees in *Ferri* were able to successfully transfer the original trust's assets to a spendthrift trust in order to place those assets outside of the reach of the beneficiary's spouse. But the use of decanting as a method of creditor avoidance may still be vulnerable to claims of fraudulent conveyance under certain circumstances. For example, in an unreported 2016 case, a trustee's attempt to decant was invalidated and held to be a fraudulent conveyance. *United States v. Lazare*, No. 2:14-cv-01075-APG-VCF, 2016 WL 1127627 (D. Nev. 2016). There the original trust was essentially insolvent (but for the decanted asset) and subject to multiple creditors' claims, including substantial tax liens by the federal government incurred by the settlor-beneficiary of the trust. The trustee had notice of an imminent adverse ruling in which he would be enjoined from transferring any of the trust's assets and, before the injunction was ordered, he decanted an income stream owned by the trust to a new trust beyond the reach of the settlor-beneficiary's creditors. Not only was the validity of the decanting at stake in *Lazare*, but also the trustee had exposed himself to personal liability under federal law for his attempt to use decanting to avoid paying the settlor-beneficiary's debts to the US government.

Disability Planning: Special and Supplemental Needs Trusts

Another area in which decanting litigation has arisen is special needs trusts. These types of trusts allow a person with a disability to benefit from familial assets (or her own personal injury award) without those assets disqualifying the person with a disability from receiving means-tested public benefits. Jennifer Field, *Special Needs Trusts: Providing for Disabled Children Without Sacrificing Public Benefits*, 24 J. Juv. L. 79, 79-80 (2004). In doing so, the person with a disability may receive means-tested public benefits for medical care or other support, while relying on trust funds for other needs not provided by public benefit agencies. *Id.* at 80. These trusts fall into two basic categories: those settled by third parties, such as a parent, guardian, or other relative (supplemental needs trusts), and those settled by the child, through his parent or guardian (special needs trusts).

Given the particular language of special or supplemental needs trusts, decanting is particularly useful in situations in which a preexisting irrevocable trust comes to have a beneficiary with a disability, such as when a new child is born or an individual is injured in an accident. In the case of *In Re Kroll*, 971 N.Y.S.2d 863 (N.Y. Sur. Ct. 2013), trustees decanted the assets of a typical descendant's trust into a special needs trust for its now-disabled beneficiary. *Id.* at 864. The New York Attorney General argued that the decanting created a self-settled trust, which in turn required a "payback provision such that the remainder of the trust is paid to the state for reimbursement of medical expenses paid on behalf of" the beneficiary after the beneficiary's death. *Id.* at 865. But the trial court concluded that this was not the case given that the decanting occurred before the vesting of the beneficiary's withdrawal rights on his 21st birthday. *Id.* at 866. On appeal, the ruling of the trial court was affirmed, with the appellate court reasoning that because the withdrawal rights had yet to vest, the principal of the original trust did not yet constitute a resource of the beneficiary. See *Kroll v. New York State Dep't of Health*, 143 A.D.3d 716, 719-20 (N.Y. App. Div. 2016).

Remedies

With the rise in cases involving allegedly-wrongful decantings, courts have had to consider the equitable remedies best suited for these circumstances. Arguably, the first case to broadly consider remedies for improper decanting was that of *Ferri v. Powell-Ferri*, No. MMXCV116006351, 2014 WL 3397927 (Conn. Super. Ct. June 5, 2014). At a stage in the *Ferri* litigation when the wife had been granted summary judgment on her declaratory judgment claim that decanting violated the terms of the original trust, the

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court considered multiple requested remedies. *Id.* at *1. Upon consideration, the court permitted: (i) restoration of the assets removed from the original trust plus income, dividends, and other gains that flowed from those assets; (ii) a full accounting of the second trust; and (iii) attorneys' fees (though this was later reversed on appeal for violating the American Rule). See *id.* at *2-*5. By contrast, the court did not allow: (i) a return of funds expended by the second trust in the suit, on the grounds that the trustees had authority under the terms of the original trust to retain and pay counsel; (ii) an accounting of tax consequences of the decanting, on the grounds that this is more proper for a breach of fiduciary duty claim; and (iii) trustee removal, on the grounds that there had been no finding of breach of fiduciary duty.

Based on a review of the relevant case law undertaken by the authors, it appears that since mid-2014, restoration and removal have risen to the top as the most often requested and rewarded remedies for improper decanting. For example, in *Acheff v. Lazare*, No. 1:12-CV-00100-JCH-RJS (D. N.M. May 2, 2014), the court invalidated a trust created by decanting and ordered restoration of the original trust where the defendant had decanted in order to move assets outside the jurisdiction of the court. See *id.* at *3-*4. Notably, the government-plaintiff was able to recover only \$7,031, as it could not proffer evidence as to the total amount of assets in the original trust prior to the act of decanting. *Id.* at *5. Similarly, in *Harrell v. Badger*, 171 So.3d 764 (Fla. 5th DCA 2015), after finding an act of decanting invalid for failure to provide statutory notice to certain beneficiaries of the original trust, the court reversed and remanded "to determine the value of the Trust at the time of decanting . . . and enter an order requiring the return of the . . . value to the trust." *Id.* at 769. Further, the court ordered the trustee of the original trust removed for related breaches of fiduciary duties. *Id.*

Indeed, it appears the remedy of removal has been ordered only in circumstances in which the decanting trustee undertook the decanting in bad faith and in deliberate violation of the duty of impartiality. As in *Harrell*, the court in *Hodges v. Johnson*, 170 A.3d 86 (N.H. 2017), removed trustees who decanted a trust without expressly considering and taking into account the future beneficial interests of certain beneficiaries that were eliminated as a result of the decanting. *Id.* at 97-99. In doing so, the appellate court expressly determined that it was reasonable to conclude that such an act was a "serious breach of trust." *Id.* at 99. On the other hand, in *Ferri v. Powell-Ferri*, 165 A.3d 1137 (Conn. 2017), the Supreme Court of Connecticut affirmed the decision of the Superior Court not to remove the trustee, the brother of the beneficiary, despite the objections of the beneficiary's ex-wife that the brother-trustee had a conflict of interest that compromised his ability to administer the trust. The court determined there was no harmful conduct where the brother-trustee decanted a trust for the benefit of his brother into another trust which also benefitted his brother. *Id.* at 1147. Arguably, the brother-trustee owed no duty to the beneficiary's ex-wife, because she was not a beneficiary of the decanted trust.

Also, of note is the fact that at least one court has ordered decanting itself as a remedy, particularly in the context of a divorce proceeding. In *Thomson v. Thomson*, No. FA134024747S, 2015 WL 5237783 (Conn. Super. Ct. Aug. 4, 2015), a husband established an irrevocable life insurance trust for the benefit of his wife and children, with the wife serving as trustee. *Id.* at *3. The trust further provided that the wife would cease to be a beneficiary of the trust upon dissolution of the marriage. *Id.* As part of the marital dissolution proceedings, the court ordered the wife to decant the trust into a new trust of which the husband would serve as trustee but ordered the husband as the trustee of the new trust to continue to maintain the wife and children as beneficiaries so long as the husband owed a support obligation to any one of them. *Id.* at *11. In another case involving familial discord, *In re Soble Family Trust*, No. 334411, 2017 WL 6503004 (Dec. 19, 2017), one sibling requested that the court terminate or order decanting of a family trust because her brother was effectively freezing her out of decisions affecting the trust.

Conclusion

As the law in this area of law continues to develop, courts, trustees, and trusts and estates practitioners will invariably encounter previously unaddressed issues raised by decanting. Novel arguments for validating or invalidating a given decanting and additional creative remedies are certain to be formulated given the relative dearth of case law on this topic. In short, it is hard to anticipate how decanting will be used and what kind of attendant litigation can be expected from decanting. This notwithstanding, it behooves the prudent trustee or trusts and estates practitioner to familiarize herself with the current trends, themes, and extant case law on decanting, in order to anticipate common challenges to decanting or, where appropriate, to avoid decanting in the first instance.