
Folks:

Take-Away: Attorneys and trust officers are now becoming more familiar with the possible use of a nonjudicial settlement agreement to expedite the administration of a Trust or to resolve minor disputes. However, there are limits to the use of a nonjudicial settlement agreement in Michigan, and some lingering questions as to the role of the trust's settlor with regard to such an agreement.

Background: In the past we have covered, albeit in summary fashion, the Michigan Trust Code (MTC) provision that authorizes *interested persons* to enter into a binding nonjudicial settlement agreement *with respect to any matter involving a trust* without involving the probate court. [MCL 700.7111(1).] Entering into a binding nonjudicial settlement agreement is not as easy as one might envision despite the statute's introductory statement.

Limitations: The statute imposes limits on what might be accomplished by the *interested parties* who enter into a nonjudicial settlement agreement. A nonjudicial settlement agreement: (i) may not violate a **material purpose** of the Trust; (ii) may not be used to **modify or terminate** the Trust; and (iii) may **only** pertain to terms and conditions that **could be properly approved by a court**. [MCL 700.7111(2).]

Interested Persons: The *interested persons* are broadly defined in EPIC. An *interested person* includes the incumbent fiduciary, an heir, devisee, child, spouse, creditor, beneficiary, *and any other person that has a property right in or claim against a trust estate*. This broad statutory

definition also carries the caveat: “*Identification of interested persons may vary from time to time and shall be determined according to the particular purposes of, and matter involved in, a proceeding, and by the supreme court rules.*” [MCL 700.1105(c).]

More to the point, the Comments to this definition point out that ‘depending on the circumstances, persons not listed in the statutory definition may be interested persons.’ Accordingly, the statutory description of *interested persons* is illustrative, and while a Trust’s settlor is not mentioned as an *interested person* it may be possible that in some situations a settlor’s consent might be required for a nonjudicial settlement agreement to be binding and enforceable.

With regard to this section that authorizes a nonjudicial settlement agreement, the statute provides that “*interested persons means persons whose consent would be required in order to achieve a binding settlement were the settlement to be approved by the court.*” [MCL 700.7111(5).]

Virtual Representation: Because *interested persons* is so broadly defined, or it depends on the unique circumstances that have precipitated the use of a nonjudicial settlement agreement, the vague (sometimes bewildering) virtual representation rules of the MTC must also be followed along with other the Michigan Court Rule’s notice provisions. [MCL 700.7301-7305.] In short, the determination of who is a required *interested person* and who can consent on their behalf is always a challenge and at time fraught with uncertainty of who is an interested person.

When a Nonjudicial Settlement Agreement Can be Used: The statute provides a list of topics or actions that can be resolved with the use of a nonjudicial settlement agreement. [MCL 700.7111(3).]

The **interpretation or construction of the terms of the Trust;**
The approval of a trustee's **report or accounting;**
Direction to a trustee to perform or refrain from performing a particular act or **to withhold from a trustee any power;**
The **resignation or appointment of a trustee** and the determination of the trustee's compensation;
The transfer of a Trust's **principal place of administration;** and
The **liability of the trustee** for an action that relates to the Trust.

Risk: As the Reporter's Comments to MCL 700.7111 cautions: "*The distinction between modification, which on the one hand requires court approval, and reformation, interpretation, and construction, which on the other hand can occur via an agreement, admittedly may be difficult in some circumstances.*" In other words, a court may later determine that a nonjudicial settlement agreement was not for the purposes of Trust interpretation or construction, but rather was an invalid Trust modification that was attempted to be achieved without the approval of the probate court. [MCL 700.7411 and 700.7412.]

Court Approval: While a nonjudicial settlement agreement can be binding without the need for a probate court order, an *interested person* or the trustee can request the probate court to approve or disapprove of the nonjudicial settlement agreement. When court involvement is formally sought, the probate court must: (i) determine that the MTC's **representation** rules were followed, which is no small matter [MCL 700.7301-7305;] (ii) determine that the agreement does **not violate the Trust's material purpose;** and (iii) confirm that the

agreement contains **terms and conditions the probate court could have properly approved.**

Role of the Trust Settlor: As noted earlier, the Trust's settlor is not expressly included in the statutory definition of an *interested person*. One would surmise, then, that the settlor has no involvement with a nonjudicial settlement agreement, nor could the Trust's settlor file a court petition to object to a nonjudicial settlement agreement. Arguably, the settlor would not even be entitled to notice if the intent was to have a probate court 'approve' a proposed nonjudicial settlement agreement. However, that may not necessarily be the case.

Could be Properly Approved Condition: MCL 700.7111(2) makes it clear that one of the conditions to the nonjudicial settlement agreement being enforceable is that the terms of the agreement can only be those that 'could be properly approved by the court.' Under MCL 700.7411(a), a court may modify or terminate a Trust on the consent of the trustee and the qualified trust beneficiaries (which is silent as to the role of the settlor) if the court concludes that the modification or termination of the Trust is consistent with the Trust's material purposes or that continuance of the Trust is not necessary to achieve any material purpose of the Trust. [MCL 700.4711(a).]

This Michigan provision is a departure from the Uniform Trust Code (UTC), since it does not contemplate the settlor's consent to the modification or termination of the Trust. In contrast, the UTC 411(a) provides that the material-purpose doctrine can only be judicially changed or eliminated if the beneficiaries *and the settlor* all consent.

Required Notice to the Settlor: While Michigan's version of the Trust

modification/termination provision does not mention the Trust's settlor, MCL 700.7411(3) does require that notice of any proceeding to terminate or modify the Trust must be given to the settlor or to the settlor's representative if the petitioner has a reasonable basis to believe the settlor is an incapacitated. Consequently, while the settlor is not a critical party to a court proceeding to modify or terminate the Trust with a material purpose, the Trust's settlor is nonetheless given notice of that proceeding, and presumably (although not stated in the statute) may be provided an opportunity to be heard in those modification/termination proceedings.

In sum, while the settlor is not an *interested party* (as defined in EPIC) for the purpose of consenting to the terms of a nonjudicial settlement agreement, since the court must determine that the terms of the agreement were something that the court could approve, MCL 700.7411(3) requires that notice be given to the settlor to satisfy the **terms and conditions the probate court could have properly approved** condition of MCL 700.7111(2). Consequently, settlor would have to be given notice of the nonjudicial settlement agreement in order to satisfy the 'could have approved' statutory condition.

Example: The following example is taken from Loring and Rounds: *A Trustee's Handbook* (2023), Section 8:15.7, although its reference to the UTC and not to the MTC, which is a bit different.

Facts: An irrevocable fully discretionary inter vivos Trust was established to fund the college education of five named individuals. They were and are fully competent in all respects. Title to the remainder-in-corpus ultimately passes to a charity. In violation of the Trust's material purposes, the trustee purchased with entrusted funds 5 expensive sports cars and then distributed

a vehicle outright and free of trust to each individual beneficiary. The individual beneficiaries and the charity executed a nonjudicial settlement agreement that approved the trustee's report and accounting. The distributions were fully disclosed in the accounting documentation, affixed to which was a copy of the governing trust instrument. No individual has considered even applying to college. Is this agreement final and binding on all persons? The settlor seeks to have the agreement judicially voided, the accounts re-opened, and the breach of trust judicially remedied.

Notice: A perusal of UTC 813 which regulates the trustee's duty to inform and account says nothing about accounting to nonbeneficiaries. The settlor retained no beneficial interest and no powers. But this is a Trust-modification issue, not a trust-accounting issue.

Constructive Modification: The terms of the Trust have been constructively modified via a nonjudicial settlement agreement that approved the trustee's accountings. The UTC, specifically section 411(a), provides that a Trust may be judicially modified upon the consent of the settlor and all the beneficiaries, even if the modification is inconsistent with a material purpose of the Trust. **[Note: This last statement is inconsistent with Michigan's version of UTC 411(a); the settlor is not required to be involved in the modification or discontinuance of the Trust under the MTC if it is not necessary to achieve the Trust's material purpose.]** In this fact pattern, the court has not been asked to ratify the non-judicial settlement agreement, nor was the settlor a party to it.

Conclusion: Ergo, the settlement is void ab initio, unless there has been compliance with UTC Section 111, which regulates nonjudicial settlement agreements generally. The settlor, via UTC 111(a), would have standing to judicially contest the agreement's enforceability in that he qualifies as an *interested person*. For purposes of Section 111, an *interested person* is a person whose consent would be required in order to achieve a binding settlement were the settlement approved by the court. Under UTC Section 111(c), however, all nonjudicial settlement agreements must comply with the material-purpose doctrine. This even captures an agreement to which the settlor is a party.

Michigan: In Michigan the settlor is not required to participate in a proceeding to modify or terminate an irrevocable Trust as an *interested party*, unlike the UTC's version. However, the settlor is still required to be given notice of those court proceedings under MCL 700.7411(a) with the presumption that the settlor will be provided an opportunity to be heard by the probate court upon receiving notice of the proposed modification or termination of the Trust. [MCL 700.7411(3).] Additionally, the Michigan Court Rules also require that the settlor be given notice of those modification/termination proceedings. [MCR 5.125(C)(32).] From this required notice to the settlor, it is probable that the probate court will entertain the settlor's subsequent challenge to the validity of the nonjudicial settlement agreement.

Conclusion: There are a lot of gray areas to accommodate when it comes to the adoption of a binding nonjudicial settlement agreement. The analysis starts with who is an *interested person* who must enter into the agreement for it to be binding. In addition, the complexity of virtual representation rules must be factored in as to not only who is an

interested person but whose consent can legally bind that person. Then you have the ambiguity of what is a Trust construction or interpretation (subject to nonjudicial agreement) vs a Trust modification (which can only be accomplished by court proceedings.) Finally, as noted above, if a settlor is required to be provided notice of a hearing to modify or terminate a Trust which requires court approval, but the settlor is not an active participant whose consent is needed in those court modification/termination proceedings, does receiving notice under the statute suffice to make the settlor an *interested person* in the nonjudicial settlement agreement process? The bottom line is that pursuing a nonjudicial settlement agreement may be a lot more complicated than initially envisioned.

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