Trustees and Powers of Appointment

Background: Back in the 1930's Professor Barton Leach of Harvard Law School provided us with a great quote describing powers of appointment. *A power of appointment is the most efficient dispositive device that the ingenuity of Anglo-American lawyers has ever worked out."* These days when it is preached that trusts need to be drafted to maximize flexibility, the first concept usually mentioned is to give lifetime trust beneficiaries a power of appointment to be able to redirect trust assets in a different manner, or in trust, contrary to the terms of the trust instrument. Thus, it is common to find trust instruments that contain powers of appointment, either general powers of appointment to obtain an income tax basis step-up on the death of the power hold, e.g., *free-basing with grandma*, or limited powers of appointment, to redirect assets either to different beneficiaries than the trust's remainder beneficiaries, or to impose 'continuing trusts' on those remainder beneficiaries, effectively changing the distribution of trust assets in a manner different from what the trust instrument specifies.

Types of Powers: There are different types of powers of appointment. There is a general power of appointment that permits the power holder to appoint the property to anyone, including themselves or their estates, and non-general (or limited) powers of appointment which allows the power holder to appoint the property to a smaller group or class of individuals, or charities, or both, e.g., the settlor's descendants. In addition, a power of appointment can either be presently exercisable by the power holder, or it may be not presently exercisable, meaning the power of appointment is limited to being exercised at some future point, or in a testamentary document like a Will or a trust which takes effect only on the power holder's death. The Uniform Powers of Appointment Act also adds yet another definitional split between an exclusionary and non-exclusionary power of appointment. Under the Uniform Act, the defaults are generally exclusionary powers. Non-exclusionary powers are specifically described, which allow others to take as well as those specifically identified.

Michigan: Michigan adopted its power of appointment statute back in 1967. Michigan has not yet adopted the Uniform Powers of Appointment Act that other states have adopted, which claims to provide a *modern* definition, limited to dealing with a power holder who acts in a non-fiduciary capacity. Michigan did amend its 1967 Powers of Appointment statute to expressly deal with a trustee's decanting power (which, practically speaking is a power of appointment) to make albeit limited changes to a trust's dispositive provisions.

Question: With limited powers of appointment being promoted for *modern* trust instruments, to provide additional flexibility to respond to future changes in circumstances, then raises the question of the trustee's responsibility, or duty, to implement the beneficiary's exercise of his/her limited power of

appointment in a manner that does not comply with what conditions the limited power of appointment requires. What is the trustee's duty when compliance with the power of appointment terms is not completely accurate? A couple of court cases provide a trustee some direction.

In red Robert McDowell Revocable Trust: In this case the Nebraska Supreme Court addressed the validity of the exercise of a limited power of appointment in favor of the power holder's own revocable trust. This limited power of appointment was exercised in the power holder's own Will in favor of his own revocable trust, in short, in favor of his own estate, contrary to what the limited power of appointment permitted. The trustee of the trust that contained the limited power of appointment never looked at whether the attempted exercise of the limited power of appointment was authorized. The trustee simply transferred the assets from the initial trust to the power holder's trust. Later, a taker-in-default of the exercise of the limited power of appointment, who would have received the property subject to the power of appointment but for its attempted exercise. That taker-in-default objected claiming that it was not a permissible exercise of the limited power of appointment. The initial trustee was sued, claiming that it breached its fiduciary duty by not conducting an independent exercise of the limited power of appointment. The Nebraska Court found that it was an improper exercise of the limited power of appointment since it was not to a permissible appointee. Then the Court found that the trustee had an independent duty to confirm that the power of appointment had been validly exercised. In sum, the trustee had a duty to investigate and confirm the valid exercise of the limited power of attorney, more than simply act in response to the power of appointment.

Benjamin v. Corasaniti: In this case the Connecticut Supreme Court dealt with the exercise of a testamentary limited power of appointment. Here, the exercise of the limited power of appointment was to a permissible appointee, at least on its face of its exercise. The power exercised in favor of a charitable trust which was within the class of permissible appointees. However, there was an issue whether (or not) the trust, a charitable trust, existed when the power was exercised. If charitable trust did not exist (it held no assets prior to the appointment), then the attempted exercise of the limited power of appointment to it was invalid. In this case, the trustee of the trust that granted the limited power of appointment conducted its own independent investigation, and it concluded that the exercise of the power of appointment was appropriate; the fact that the charitable trust had not received assets prior to the exercise of the limited power of appointment to it did not render it an impermissible appointment, and therefore the exercise of the limited power of appointment in favor of the charitable trust was a proper exercise of the power. The trustee filed a petition with the probate court and asked that court whether this was a proper exercise of the limited power of appointment- before it released the assets to the charitable trust. The probate court found that it was a proper exercise of the testamentary limited power of appointment. There was then an appeal. The Connecticut Supreme Court agreed that it was a permissible exercise of the limited power of appointment by the power holder, and by implication that the trustee took the correct approach; even though the trustee

concluded it was a valid exercise of the power of appointment, it nonetheless decided to spend the time, and trust assets, to obtain a court order that it was acting correctly.

BMO Harris Bank N.A. v. Towers: This case originated in Illinois. Here the question, again, was the validity of the exercise of a limited testamentary power of appointment. Once again, the trustee undertook its own exam and concluded that the purported exercise of the power was proper. The trustee concluded that the exercise of the limited power of appointment was impermissible. In this case, the trustee then filed a petition with the probate court seeking a court order that the attempted appointment was impermissible, i.e., validating its conclusion. The appointee that would have benefited from the exercise of the power if it was a permissible exercise then counterclaimed against the trustee, claiming a breach of fiduciary duty by asking the probate court to pass on the validity of the exercise of the power of appointment. In effect, the appointee claimed that the trustee should not have done anything, and it had wasted trust funds (along with time and effort.) The Illinois appellate courts found that the trustee was correct, that it had been an impermissible exercise of the testamentary limited power of appointment. More to the point, the court said that the trustee has *"twin duties, among others. It has a trust of impartiality to all the trust beneficiaries, but it also has a duty to administer the trust pursuant to its terms. So, if a legitimate question arises, it's perfectly appropriate to seek a judicial ruling on the permissibility of the exercise of a power of appointment."* Moreover, the court when out of its way to make it clear that irrespective of the outcome of its determination as the exercise, the trustee was protected in its petition."

Conclusion: Trustees can expect to see more limited powers of appointment in the trust instruments that they administer. The trustee should always take an independent review of an attempted exercise of the limited power of appointment to confirm that its exercise is consistent with the scope of the power. Even if the trustee has interpreted the trust instrument correctly, or the power holder's exercise of the limited power of appointment, the trustee should always go to the probate court for confirmation if there is any possibility of a dispute. Finally, going to the probate court seeking confirmation about the power is appropriate and not a breach of fiduciary duty is there is going to be a disappointed party about the exercise (or nonexercised) of the power of appointment.