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Unwinding Irrevocable Trusts

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Unwinding Irrevocable Trusts

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Speaker Biography

Tom Simmons is a professor at the University of South Dakota School of Law where he teaches *Trusts & Wills*, *Estate Planning*, *Remedies*, and *Professional Responsibility*. He also co-teaches two *Tribal Wills Clinic* courses and periodically offers a seminar titled *Holocaust Law*. He is a fellow of the American College of Trust and Estate Counsel, the American Bar Foundation, and the American College of Tax Counsel. Prior to joining the academy, he practiced for thirteen years with the Rapid City law firm of Gunderson, Palmer, Nelson & Ashmore, LLP and clerked for District Judge Andrew Bogue.

Presentation Outline

I. Trust Typologies

II. Methods for Varying the Irrevocable Trust

A. *Cy Pres* (for charitable trusts and for non-charitable purpose trusts)

B. Equitable Deviation

C. Decanting

III. Drafting for Varying the Irrevocable Trust

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Written Materials

An earlier version of this paper was originally published in the South Dakota Law Review in 2010.[1] This paper was composed as an update to that article to accompany the *Unwinding Irrevocable Trusts* presentation at the South Dakota State Bar Annual Meeting in June, 2019. This is not intended to be an exhaustive or comprehensive paper and many finer points, exceptions, and even some clarifications have been omitted in the interest of brevity. Also be particularly conscious of statutory amendments, especially in view of South Dakota's active and vital trust statutory framework. These written materials are intended more in the form of an outline or punch list than a full-scale exegesis.

I. INTRODUCTION[2]

Trusts are arguably English lawyers' greatest idea and creation. Trusts have been in use (no pun intended) going back to the Norman conquest of 1066.[3] Today, trusts are widely used as an infinitely flexible property and estate planning tool. They are everywhere. And in South Dakota, they form the backbone of a critical industry, the business of trust administration, attracting trustees and settlors from across the country and the world. Understanding when and how trusts can be modified or changed is essential as both a matter of offensive and defensive planning and strategy.

II. UNWINDING OPTIONS

Revocable trusts are comparatively easy to unwind. Typically, the trust instrument itself outlines the process by which a revocable trust can be revoked, amended, restated, or revised by the settlor.[4] Irrevocable trusts? They're another matter. But the term "irrevocable" is somewhat misleading. In fact, there are multiple ways in which an irrevocable trust can be modified to greater or lesser degrees, and even revoked. Indeed, although reformation of a will is unconventional, even perhaps outlandish, reformation of a testamentary trust (a trust set forth within the text of a will or codicil) is quite straightforward.

A. *CY PRES* (FOR CHARITABLE TRUSTS)

Let's begin with *cy pres*. *Cy pres* is a doctrine designed to keep a charitable trust from failing if its purpose becomes difficult (or even impossible) to carry out or when its terms are incomplete or

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[1] Thomas E. Simmons, *Decanting and Its Alternatives: Remodeling and Revamping Irrevocable Trusts*, 55 S.D. L. REV. 253 (2010). See also the excellent and more current article by Mary Akkerman. Mary Akkerman, *Decanting: A Practical Roadmap for Modernizing Trusts in South Dakota*, 61 S.D. L. REV. 413 (2016). Another very helpful resource is Craig J. Krogstad and Matthew P. Bock, *Modern Trust Governance*, 61 S.D. L. REV. 370 (2016).

[2] The section headings in these written materials deviate from the presentation outline. *See supra* page 1.

[3] Indeed, for you history buffs, the "use" or trust can be traced prior to the Norman invasion of England. F.W. Maitland, *The Origin of Uses*, 8 HARV. L. REV. 127, 128 (1894) (noting that "long before the Norman Conquest we may find a man saying that he conveys land to a bishop to the use of a church, or conveys land to a church to the use of a dead saint").

[4] S.D.C.L. § 55-3-6 (2012). *See also infra* Part II(J).

imperfect.[5] A trust might be designed to find a cure for polio, for example, or to benefit a hospital in a city where there is no longer a hospital. South Dakota expressly recognizes charitable trust for any charitable, religious, educational, benevolent, or public use, even if specific charities or purposes are ill-defined, uncertain, or indefinite in the trust document.[6] Stated another way, vague and poorly conceived trusts with any kind of charitable intention are liberally construed to carry out the donor's intent. Judicial reformation and clarification can be sought by the trustee, the attorney general, or any interested party.

In reforming a charitable trust, notice will be given to the South Dakota Attorney General's office and the settlor, if living.[7] The court may then enter an order directing the trust to be administered or distributed "in such manner as in the judgment of said court will, as nearly as can be, accomplish the general purposes of the instrument and the object and intention of the donor" free of any restriction or limitation that would otherwise interfere with the administration of the trust.[8]

B. *CY PRES* (FOR NON-CHARITABLE PURPOSE TRUSTS)

South Dakota recently revamped and improved its purpose trust statutes.[9] Purpose trusts include "pet trusts" and other trusts without an ascertainable beneficiary. A purpose trust, for example, might be devoted to the maintenance and preservation of a landowner's farm, ranch, or small business. A particular sort of non-charitable purpose trust *cy pres* is described as follows:

> If the court finds that the fulfillment of the purposes are or have become impossible, inexpedient, or unlawful, the court shall make an order that the trust be administered in such a manner as, in the judgment of the court, will, as nearly as can be, accomplish the general purposes, the objects, and intentions of the trustor.[10]

C. JUDICIAL AND NON-JUDICIAL REFORMATION

Trusts can conclude and terminate "naturally" such as when the express term of the trust expires.[11] Trusts can also conclude "artificially" in certain circumstances. Non-judicial reformation of an irrevocable trust is generally recognized in two scenarios. First, an irrevocable trust may be modified for any reason with the consent of the settlor and all of the beneficiaries.[12] Second, if the trustor is deceased, unwilling or unable to participate in a modification, an irrevocable trust may still be modified with the consent of all the beneficiaries so long as continuance of the trust on its existing terms is not necessary

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[5] S.D.C.L. § 55-9-4 (2012).
[6] *See* S.D.C.L. § 55-9-1 (2012) (recognizing trusts "for any charitable, benevolent, educational, religious or other public use"), § 55-9-2 (2012) (emphasizing that "[n]o such trust shall be invalid because of indefiniteness or uncertainty").
[7] S.D.C.L. § 55-9-3 (2012); *see also* S.D.C.L. § 55-9-5 (2012).
[8] S.D.C.L. § 55-9-4 (2012).
[9] *See* S.D.C.L. §§ 55-1-21 *et seq*. (Supp. 2018).
[10] S.D.C.L. § 55-1-21.3 (Supp. 2018).
[11] *See* S.D.C.L. § 55-3-23(1) (2012). A trust also terminates when its purpose is fulfilled or becomes impossible to fulfill. S.D.C.L. § 55-3-23(2)-(3) (2012). A trust also terminates if it is revoked. S.D.C.L. § 55-3-23(4) (2012).
[12] S.D.C.L. § 55-3-24 (2012).

to carry out a material purpose of the trust.[13] The statute does not expressly require the consent of the beneficiaries to be in writing. The definition of a "material purpose" is not found in the statute, nor--at least yet--in South Dakota case law.

If one or more of the beneficiaries do not consent to a proposed reformation, the court's approval may be secured if the rights of the non-consenting beneficiaries are not significantly impaired.[14] This allows judicial reformation in the court's discretion over the objection of one or more beneficiaries so long as their rights are not adversely affected.

Two other circumstances where judicial reformations can be sought are also set forth in South Dakota's statutes. First, there is the "unanticipated circumstances" idea. Reformation can be secured where circumstances not anticipated by the trustor have arisen and modifying the trust would substantially further the trustor's purposes in creating the trust.[15]

Second, there is the "mistake" idea. Reformation can be secured "to conform to the trustor's intention if the failure to conform was due to a mistake of fact or law and the trustor's intent can be established."[16] Thus, even if a non-consenting beneficiary's rights will be adversely affected by a proposed reformation, the court can still order a trust modification if either unanticipated circumstances or a mistake of law or fact can be established. This gives the court discretion, for example, to add trust provisions that suspend distributions to a beneficiary who is suffering from addictions if the trustor did not anticipate the beneficiary's particular circumstances, or even to extend the term of the trust beyond its applicable termination date.

Finally, South Dakota's statutes recognize that the foregoing options for modifying and terminating irrevocable trusts are not the exclusive means available to trustees, trustors, and beneficiaries.[17] Thus, common law or the trust itself may provide additional mechanisms for amending irrevocable trusts. The only reported case that appears to have been issued since the enactment of the reformation statutes in 1998 disposed of the reformation request on the basis of the doctrine of laches.[18] This holding was reversed by statute in 2009.[19]

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[13] *Id*.
[14] S.D.C.L. § 55-3-25 (2012).
[15] S.D.C.L. § 55-3-26 (2012).
[16] S.D.C.L. § 55-3-28 (2012).
[17] S.D.C.L. § 55-3-30 (2012).
[18] *In re* Administration of C.H. Young Revocable Living Trust, 751 N.W.2d 715 (S.D. 2008).
[19] S.D.C.L. § 55-3-29.1 (2012). *See also* S.D.C.L. 55-3-29.2 (2012) (rejecting a statute of limitations defense to a trust reformation).

D. TERMINATION OF "SMALL" TRUSTS

Unless the terms of the trust prohibit it, a trustee is granted the statutory authority to terminate a trust with a trust estate of less than $150,000.[20] This type of termination authority does not apply to charitable trusts. Nor does it apply to purpose trusts. In addition, the trustee or beneficiary may petition the court to seek termination where the value of the trust estate exceeds $150,000, but the value of the trust estate is insufficient to justify the administrative costs being incurred. (Before 2015, the "termination sum" was set at $50,000.)

E. COMBINATION OR DIVISION OF TRUSTS

A trustee is also given statutory authority to combine two or more trusts or divide a trust into two or more separate trusts (unless the terms of the trust prohibit it) without court approval.[21] This statutory trustee power is arguably an earlier decanting procedure that has been available in South Dakota since its enactment in 1998. It may be undertaken with or without court approval. In some circumstances, the combination or division of a trust might be a preliminary step in a reformation, bifurcating, for example, the trust into one composed of the dissenting beneficiaries and a second composed of the consenting beneficiaries.[22]

F. UNITRUST CONVERSIONS

Whenever a trust provides for the distribution of the net income of a trust to one or more beneficiaries, the trustee was given the statutory power in 2002 to convert the trust to a "total return unitrust" by adopting a written policy providing for the same, sending it to the trustor and beneficiaries, and receiving no written objection within sixty days.[23] If an objection is made or if the trustee elects, court approval for a unitrust conversion may be sought. The unitrust amount is generally three percent of the fair market value of the trust, determined annually.

G. DECLARATORY ACTIONS

An option for obtaining clarity in an otherwise arguably ambiguous provision in an irrevocable trust is a declaratory action.[24] While a declaratory action will not amount to any change in the actual text of a trust instrument, it can resolve its meaning or application. All that is generally required for a declaratory judgment action is the existence of a justiciable and ripe controversy between adverse parties.[25]

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[20] S.D.C.L. § 55-3-27 (Supp. 2018). The statutory trustee power to terminate a non-charitable trust with a corpus of under $150,000 can be drafted around. *Id*. It is in particular strongly recommended that any supplemental needs trust (SNT) contain language such as, "The provisions of S.D.C.L. § 55-3-27 do not apply to this trust or its trustee."

[21] S.D.C.L. § 55-2-29 (2012).

[22] *E.g.*, Ladysmith Rescue Squad, Inc. v. Newlin, 694 S.E.2d 604 (Va. 2010).

[23] S.D.C.L. ch. 55-15 (2012).

[24] S.D.C.L. § 55-1B-6 (2012). *See generally*, S.D.C.L. ch. 55-1B (2012).

[25] Carver v. Heikkila, 465 N.W.2d 183 (S.D. 1991).

Declaratory actions in South Dakota are governed by chapter 21-24 of the South Dakota statutes, and express authority is provided for those seeking a declaration of rights, legal relations, or construction of a trust document.

Declaratory actions can be brought by a wider class of individuals than a petition for trust reformation, but require all persons to be made parties who have an interest or claim in the matter and also require more formal notice and the issuance of a summons. A declaratory judgment that is issued by the court on a question of trust construction or otherwise has the force of a final judgment or decree.[26]

H. TRUST PROTECTORS

The trust document itself can vest a trust protector with powers to amend an irrevocable trust. A "trust protector" is a person who is appointed in the trust instrument.[27] Some attorneys will name themselves as a trust protector in order to correct scrivener's errors or add tax savings language at a later date.

Because of the wide variety of judicial and non-judicial reformations, terminations, declarations, and clarifications that have been available in South Dakota for some time, the new option of trust decanting is less of a watershed event than in states without this attractive menu of options. In other states without, for example, non-judicial unitrust conversion procedures, the trust decanting process is being used for unitrust conversions.

I. DECANTING

The concept of decanting port wine arises from the need to filter out grape leaves and stems. To decant, wine is poured from one container to another, with the aim of improving the drinkability of the wine held in the new vessel. The process is easy to visualize and understand, and provides an excellent analogy for trust decanting.

Trust decanting simply means the act of a trustee making a distribution to a new trust with different terms from the original trust. It is, in some ways, a "backdoor" way of approaching trust reformation. But decanting has also been called the "ultimate" in trust amendment powers for otherwise irrevocable trusts. "Irrevocable"--more and more in the trust world--does not mean immutable. In South Dakota in particular, the relative ease with which changes can be undertaken to an irrevocable trust is quite surprising, perhaps even alarming.

The power to decant was recognized under the common law, and the decanting statutes are simply a way of putting flesh on the bones of an existing common law trustee power. Iowa is unique in having case law that recognized this power before any statute attempted to codify the power. In states where the power has not been expressly recognized by case law, the non-statutory basis for the power might be

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[26] S*ee also, e.g.*, *In re* Florence Y. Wallbaum Revocable Living Trust Agreement, 813 N.W.2d 111 (S.D. 2012) (judicial interpretation of a trust document).
[27] *See* S.D.C.L. § 21-24-5.

subject to argument, but in South Dakota, decanting is statutorily recognized.[28] Three important decanting cases are briefly considered below.

Phipps

Generally, the first American case to expressly recognize the power is said to be the 1940 Florida Supreme Court decision of *Phipps v. Palm Beach Trust Company*.[29] The *Phipps* case involved the family of Henry Phipps, a real estate developer who at one time owned about one-third of the town of Palm Beach. In 1932, Ms. Margarita C. Phipps of Palm Beach created an irrevocable trust for the benefit of her four children, naming the Palm Beach Trust Company and her husband as co-trustees. The trust provided that upon the written instructions of the individual trustee, the co-trustees would distribute all or any part of the trust estate to one or more of the four beneficiaries.

Ms. Phipps's husband was given absolute discretion in making such directions, and seven years after the trust was created, he instructed the corporate trustee to transfer the entire trust estate to the trustees of a second trust. The terms of the second trust were to be essentially the same as those of the first trust except that one of the adult children beneficiaries was to be allowed to add an income interest for his wife in the trust by providing so in his Last Will and Testament (thus adding a new beneficiary).

The corporate trustee sought court approval for this proposal. The trial court approved the proposal and one of the grantor's children appealed. The Florida Supreme Court posited the issue thusly: "May an individual and a corporate trustee clothed with absolute power to administer a trust estate in the interest of designated beneficiaries create a second trust estate, for the benefit of said beneficiaries at such time and in the manner determined by the individual trustee?" and answered the question in the affirmative after examining prior case law and the Restatement of Trusts.

The court concluded: "[T]he power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent." Essentially, the Florida court reasoned, the trustees held a special power of appointment. Therefore, the court affirmed the lower court's decision.

Spencer

Estate of Spencer[30] involved the construction of the will of Fern Spencer who died in 1944. Fern owned a quarter section of Iowa farmland; her husband owned the other three quarter sections of the same section of land. Her will left her children a lifetime interest in trust, with the remainder to her grandchildren outright, funding the trust with a quarter section of Greene County, Iowa farmland and granted her husband/trustee a special power of appointment over the property to be exercised when he made a distribution of his own three quarter sections of farmland in the same manner.

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[28] S.D.C.L. § 55-2-15 *et seq*. (2012 and Supp. 2018).
[29] 196 So. 299 (Fla. 1940).
[30] 232 N.W.2d 491 (Iowa 1975).

This case--like *Phipps*--involved the judicial construction of the extent and breadth of a power of appointment held by a trustee/beneficiary when exercised in favor of a second trust. The trustee/beneficiary's husband survived her for 28 years. When he died, his will purported to exercise the power of appointment by devising his wife's quarter section, along with his own three quarter sections, to a trust for his children to extend as long as the rule against perpetuities would permit. The trial court found that the attempted exercise of the power of appointment by use of a trust exceeded the terms of the power and was therefore invalid. Thus, the trial court concluded Fern's quarter section must pass by intestacy (since Fern's will lacked a residuary clause) to the couple's four adult children outright as tenants in common.

The Iowa Supreme Court reversed in part. The court framed the issue presented as whether a special power of appointment could be exercised so as to appoint property in trust. The court concluded that Fern's will did not plainly prohibit the trustee from exercising the special power of appointment in favor of a trustee. Therefore, it held, the power could be exercised by appointing property in further trust. But the court squared the limitations in the powers of appointment with the multi-generational term of the trust created in her husband's will by holding that the trust would terminate and vest final distributions to the grandchildren at the death of the couple's children.

If *Spencer* is read narrowly, it stands for the proposition that when a trustee is granted a special power of appointment, the power can be exercised by either appointing property outright or in trust so long as the grant of the power does not expressly prohibit it. But read more expansively, it would authorize a trustee to decant trust property to a new trust unless plainly prohibited by the terms of the original trust.

Wiedenmayer

In *Wiedenmayer v. Johnson*,[31] John Seward Johnson had established a trust for one of his children, funding it with shares of Johnson & Johnson. The trust directed the Trustees to distribute to the trust beneficiary any or all trust property "from time to time and whenever in their absolute and uncontrolled discretion they deem it to be for his best interests" with the remainder at the beneficiary's death to his children. The parties in the action included a guardian *ad litem* who had been appointed to represent the beneficiary's two minor children.

The Trustees proposed to distribute the trust estate to the trustees of a new "substituted" trust for the settlor's son/beneficiary without the contingent remainder interest to the beneficiary's children. In fact, the opinion suggests, the Trustees conditioned distributions upon the beneficiary "setting up a substituted trust" after determining that this was in the beneficiary's best interests on account of his "matrimonial problems, divorce and the consequences thereof." The court approved the Trustees' request, reasoning that if the Trustees could distribute to the beneficiary, they could also "to safeguard the son's best interests, condition the distribution upon his setting up a substituted trust." Presumably, the substituted trust incorporated stronger spendthrift provisions and creditor protections for the beneficiary as against his estranged spouse. The Trustee had concluded that the beneficiary's peace of mind would be promoted if his children were disqualified as potential residual beneficiaries under the

[31] 254 A.2d 534 (N.J. Super. 1969), *aff'd*, Wiedenmayer v. Villanueva, 259 A.2d 465 (N.J. 1969).

terms of the new trust.

The court considered, but ultimately dismissed, the interests of the contingent remainder interests held by the beneficiary's two children under the original trust. It stated:

> [I]f distribution of the Corpus of the trust were made to the son absolutely, as permitted within the unqualified discretion of the trustees, as opposed to the challenged distribution subject to the condition imposed, the same loss of the contingent remaindermen's interest would equally be effected. Thus, these children are not suffering by this approved new setup the loss of any vested remainder interest.

The majority hung its hat on honoring the grantor's intention to provide first and foremost for the "best interests" of his son and deferred to the Trustee's analysis of those interests. One judge dissented. Both the dissent and the majority, however, appeared to agree that the issue presented was the construction and breadth of a trustee's distribution powers, implied or otherwise, by the terms of the trust. *Wiedenmayer* construes a trustee's power to make distributions for a beneficiary's "best interests." Unlike *Spencer* and *Phipps*, there was not a specific power of appointment vested in a trustee/ beneficiary to be analyzed. In *Spencer* and *Phipps*, the courts were construing a power held by a beneficiary. In *Wiedenmayer*, the power to decant was considered as an implied trustee distribution power.

The Restatement's Take on Decanting

The position of the Restatement (Second) of Property is that the holder of a power of appointment may appoint property in further trust, so long as the scope of the power does not specifically prohibit it. Thus, if there is a power to appoint property to a distributee outright, there is generally also the power to appoint property to a trust with the distributee as beneficiary.[32]

A trustee's power to invade the principal of a trust estate and distribute it to one or more beneficiaries is categorized as a limited power of appointment. Thus, it stands to reason that a trustee with power to invade trust principal has the power to either distribute outright to a beneficiary or to another trust with beneficial rights for the beneficiary of the first trust. This reasoning underlies the case law that recognizes the existence of trustee decanting powers under a common law analysis. The Restatement notwithstanding, authority was actually split on the question of whether--absent on-point case law or statutory authorization--the holder of a limited power of appointment could appoint in further trust.

Statutory Decanting

South Dakota's statutory framework for decanting has been in place now for twelve years. The framework is codified under the title "Duties and Liabilities of Trustees."[33] The power to decant is an

[32] RESTATEMENT (SECOND) OF PROPERTY § 19.3 (1986); *see also* RESTATEMENT (SECOND) OF PROPERTY § 11.1, cmt. D (1986).
[33] *See* S.D.C.L. §§ 55-2-15 *et seq*. (2012 and Supp. 2018).

inherent trustee power. In this sense, it is similar to the trustee power to terminate small trust or undertake a unitrust conversion. The statutes were in some measure modeled after Delaware's decanting statutes. The bill was titled "An Act to Permit Trustees to Decant a Trust under Certain Circumstances" but the word "decant" does not otherwise appear in the legislation. The bill passed both houses unanimously, but for a single "nay" vote from Rapid City's Senator Bill Napoli.

The South Dakota decanting statutes effectively grant trustees of irrevocable trusts the discretion to make a distribution to a beneficiary to exercise that authority by appointing trust assets to a new trust. The "first trust" must, by its terms, grant its trustee "discretionary authority" to make a distribution (of income or principal) to (or for the benefit of) a beneficiary. There are a number of exceptions to a trustee's ability to exercise such a power, which are primarily concerned with preserving federal estate and gift tax objectives in the original trust. So long as none of the exceptions to the exercise of the power are present, however, the trustee is free to appoint trust assets to a new trust, even a new trust created or administered under the laws of another state or even another country's jurisdiction.

If a trustee is prohibited from exercising the power to decant (because, for example, the trustee is also a trust beneficiary[34]), then a co-trustee or successor trustee may exercise the decanting power.[35] South Dakota statutes clarify that the exercise of the power to decant is to be considered the exercise of a power of appointment, but not an exercise of a general power of appointment to the trustee individually.[36] Another statute also clarifies that the statutory framework for trust decanting is not intended to displace or abridge a trustee's existing common law power to decant,[37] or any power to decant that may be granted under the terms of the trust itself.[38]

The power to decant is subject to several exceptions and limitations. First, as mentioned above, a trustee who is also a beneficiary of the first trust cannot decant. A trustee also lacks the power to decant if a beneficiary may change the trustees of the first trust.[39] A beneficiary is deemed to have the power to change trustees only if the beneficiary can--alone or jointly with others--name the beneficiary himself as trustee, or name a trustee who is a related or subordinate party.[40]

The procedural process by which a trustee can exercise the power to decant is straightforward. The process does not require judicial approval. Nothing prohibits a trustee from seeking judicial approval, which may, in many cases, be warranted for various reasons. Decanting typically involves an additional task that other varieties of trust unwinding do not: retitling trust assets in the name of the new or "second" trust. If the trust has assets which present retitling challenges, this task can be quite involved.

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[34] S.D.C.L. § 55-2-15 (Supp. 2018). "[A] trustee if the first trust is a restricted trustee if either the trustee is a beneficiary of the first trust or if a beneficiary of the first trust has a power to change the trustees…" *Id*. *See also* S.D.C.L. § 55-2-15(3) (Supp. 2018).
[35] S.D.C.L. § 55-2-16 (Supp. 2012).
[36] S.D.C.L. § 55-2-15(9) (Supp. 2018). *See also* S.D.C.L. § 55-2-19 (2012).
[37] *See supra* (discussing common law decanting in the case law from other states).
[38] S.D.C.L. § 55-2-21 (2012).
[39] S.D.C.L. § 55-2-15 (Supp. 2018).
[40] S.D.C.L. § 55-2-17 (2012).

However, an amendment to the decanting statutes in 2017 allowed decanting without retitling.[41] Originally, the decanting statues required the trustee to give beneficiaries not less than twenty days' advance notice of decanting. However, notice may now be carried out post-decanting.[42]

Decanting under South Dakota law need not be approved by a court, nor by the beneficiaries. In some cases, the Trustee may consider obtaining written waivers and releases from beneficiaries, but in cases where implied gifts by beneficiaries may result, express beneficiary consent or direction should be avoided even where it can give the Trustee a measure of liability protection. Conceivably, beneficiary consent should also be approached with caution where a shifting of beneficial interests could arguably be subject to being invalidated as a fraudulent transfer.[43]

Court Supervision of Trusts

Unlike many other states, South Dakota boasts a comprehensive and flexible statutory framework for making changes to irrevocable trusts. The options range from *cy pres* and reformation to decanting and other methods, as outlined above. Non-judicial reformation especially has provided a useful means by which scrivener's errors can be corrected, administrative provisions inserted, or even dramatic changes undertaken with irrevocable trusts.

Seeking judicial approval of a trustee's decision to decant or the beneficiaries' desire to reform is optional. However, circumstances may suggest benefits to be obtained from receiving the court's blessing, especially where Representation or Virtual Representation (discussed below) warrants court approval. The formality of a petition with notice of hearing gives the trustee or trust protector protections from a beneficiary who might later decide to challenge or question the outcome of a trust having been decanted or reformed. This gives the trustee, advisors, and beneficiaries assurances that the decision is indeed appropriate and consistent with fiduciary considerations and provides a specific time and place with the judge for any beneficiary concerns to be articulated, addressed, and laid to rest.

The great majority of trusts administered in South Dakota are not under court supervision. Accordingly, to seek judicial approval of decanting, the trust must first be brought before the court. The procedure for doing so can be coupled with the petition to approve a decanting proposal so that only one hearing is necessary. If the trustee elects, it could also file accountings for court approval along with any other trust administration matters such as the sale assets without readily ascertainable value, distribution proposals, trustee fees, and the like.

The way in which court supervision can be invoked is described in South Dakota Codified Law.[44]

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[41] *See* S.D.C.L. § 55-2-15 (Supp. 2018) (providing that "a trustee may also exercise the power [to decant] by modifying the first trust without an actual distribution of property, in which case the second trust is the modified first trust.").
[42] S.D.C.L. § 55-2-18 (Supp. 2018).
[43] *See* S.D.C.L. ch. 54-8A (2013).
[44] S.D.C.L. ch. 21-22 (2012). *See also, e.g., In re* Wintersteen Revocable Trust Agreement, 907 N.W.2d 785 (S.D. 2018).

Jurisdiction is appropriate in South Dakota courts if: (1) a trustee resides in the state; (2) a beneficiary resides in the state; or (3) any part of the trust estate has its situs within the state.[45] The matter should be venued in the county where the trust estate, or a part thereof, is sitused. If there is no part of the trust estate in South Dakota, then venue lies where a beneficiary resides, and if no beneficiary resides in the state, then in the county where a trustee resides.[46]

Petitioning the court for court supervision is as simple as filing a petition asking that the court exercise supervision. The court is to fix a time and place for hearing, and, upon hearing, enter an order assuming supervision unless good cause to the contrary is shown. Within thirty days of the hearing, the trustee is required to file: (1) a verified inventory showing a description of all trust property, valuation estimates, encumbrances, and any claims against the trust; (2) a certified copy of the trust; and (3) a verified list of the names, residences and post office addresses of all beneficiaries and trustees, with ages of any minors.[47]

If the trustee is a nonresident, the trustee is required to file an appointment of agent for service of process.[48] If the trust document fails to waive bond for the trustee, the court must determine an appropriate bond.[49] The bond requirement should not apply to corporate trustees, but the potential requirement of an individual trustee to file a bond acts as a deterrent against seeking court supervision.

Once court supervision is commenced, any trustee or beneficiary may petition the court as to any matter that may be relevant to the administration of the trust. Court supervision can be dispensed with, or later resumed, upon notice and hearing.[50] If court supervision continues, however, annual accountings and a final accounting upon trust termination must be filed unless the court has waived them.

Notice, Representation, and Virtual Representation

In most cases, trusts will include current as well as remainder, contingent, and possibly unascertained and unborn beneficiaries. In a trust which pays to *A* for life and then to *A*'s issue, the identity of *A*'s issue will remain unknown and incapable of ascertainment until *A*'s death. A could adopt or have more children, for example. And *A*'s existing children (if any) may have an incapacity on account of minority or disability. Providing appropriate notice to minors, disabled persons, and especially the unborn can present challenges. South Dakota's Virtual Representation statutes address these kinds of issues.[51] In a trust decanting situation, whether or not court supervision is undertaken, the Virtual Representation Statutes must be followed with care in order to ensure that proper notice of the Trustee's proposal to decant is given.

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[45] S.D.C.L. § 21-22-2 (Supp. 2018).
[46] S.D.C.L. § 21-22-5 (2012).
[47] S.D.C.L. § 21-22-3 (Supp. 2018). "Immediately upon the filing of the papers required by §§ 21-22-3 and 21-22 4, supervision by the court shall be deemed to commence." S.D.C.L. § 21-22-6 (2012).
[48] S.D.C.L. § 21-22-4 (2012).
[49] S.D.C.L. § 21-22-10 (2012).
[50] S.D.C.L. §§ 21-22-7, 21-22-8 (2012).
[51] S.D.C.L. ch. 55-18 (Supp. 2018).

South Dakota's "Virtual Representation"[52] First-generation statutes were originally enacted in 1998. They recently enjoyed a total rewrite.[53] They apply in any "proceeding," meaning both judicial and nonjudicial trust proceedings.[54] Essentially, Virtual Representation may reduce, or in some situations define, the number of persons who actually need to be served or consent in a trust matter. This idea has a common law basis as well as a statutory one.[55] When notice or consent is made consistent with the statutes, the decree or order entered is binding on all persons upon whom notice was not required. Non-judicial reformations and decantings are similarly to be conducted under the provisions of the Virtual Representation statutes.

Unborn or unascertained persons need not be provided notice unless there is no person with the same interests as them, and in that case, the court must appoint a guardian *ad litem* to represent their interests.[56] Of course, a court proceeding would be required to secure the appointment of a guardian *ad litem*.[57] No persons who are the potential appointees of a power of appointment need be noticed.[58] Nor is it necessary to provide notice to the takers in default of a general power of appointment.[59] Virtual Representation accounts for the scenario of one noticed beneficiary with significantly aligned interests sufficing as notice on another beneficiary. Representation accounts for various forms of fiduciary and nonfiduciary representations.

When a beneficiary is under a disability, for example, the disabled person need not be served so long as he or she has the same interest as another person who is being served. If notice must be served because there is no other person with the same interests, then notice to minor is given to their conservator, their guardian, a parent, a person responsible for their care, and so on. Notice on the South Dakota Department of Social Services (DSS) is required if an interested beneficiary may owe a Medicaid debt to DSS.[60] Notice may be expanded by the terms of the trust instrument itself. Notice is required when a

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[52] The provisions of chapter 55-18 are more properly titled "representation" statues which also include virtual representation. See UNIF. TRUST CODE Art. 3 (2010) (titled "Representation") cmt. (explaining that the Uniform Trust Code's Article 3 "deals with representation of beneficiaries, both representation by fiduciaries … *and* what is known as virtual representation.") (emphasis supplied).

[53] Thomas E. Simmons, *Conflict-of-Interest-Infected Virtual Representatives and a Cure*, 64 S.D. L. REV. 1 (2019). *See also* Martin D. Begleiter, *Serve the Cheerleader–Serve the World: An Analysis of Representation in Estate and Trust Proceedings Under the Uniform Trust Code and Other Modern Trust Codes*, 43 REAL PROP. TRUST & EST. L.J. 311 (2008).

[54] S.D.C.L. §§ 55-18-1(16), 55-18-2 (Supp. 2018).

[55] *E.g.*, Weberpals v. Jenny, 133 N.E. 62, 65 (Ill. 1921) (explaining that "[w]here it appears that a particular party, though not before the court in person, is so far represented by others that his interests receive actual and efficient protection" that notice requirements are relieved).

[56] S.D.C.L. § 55-18-5 (Supp. 2018).

[57] *See* S.D.C.L. § 15-6-17(c) (2015); S.D.C.L. § 21-65-6 (2012).

[58] S.D.C.L. § 55-18-5 (Supp. 2018).

[59] *Id*.

[60] S.D.C.L. § 55-18-8 (Supp. 2018). However, no beneficiary is "considered a person who may owe a debt to the department solely on account of the person's residence in this state." *Id*.

beneficiary demands it or the court orders it.[61] And notice on the attorney general may be required if the trust is a charitable trust.[62]

Fiduciary Issues

Fiduciary duties in the broad sense are typically broken down into two major subtypes: the duty of care and the duty of loyalty.[63] These duties are also imposed on trustees. Generally, the duties imposed on trustees can be summarized as five fundamental duties: (1) the duty to be generally prudent; (2) the duty to carry out the terms of the trust; (3) the duty to be loyal to the trust and its beneficiaries; (4) the duty to give personal attention to trust affairs; and (5) the duty to account to trust beneficiaries. Although these duties are modified to some degree by South Dakota statutes, the trustee should be cognizant of trustee duties at all times.

The general duty of loyalty carries with it the specific duty to treat beneficiaries impartially. "Fair doesn't necessarily mean equal," it's often said. The same applies here. The duty of impartiality as between current and remainder beneficiaries often arises in connection with the conflict between income generation and long-term capital appreciation and also between current discretionary distributions that have the effect of depleting the trust estate that will remain for the remaindermen. In many instances, this inherent conflict will be exacerbated depending on the specific reformation or decanting proposal under consideration.

J. UNWINDING THE *REVOCABLE* TRUST

We noted at the outset the ease with which revocable trusts could be amended, unwound, or revoked. But what of an individual settlor with a revocable trust who has lost capacity? Is such a trust revocable or irrevocable? It seems that technically it is correct to say that a revocable trust remains revocable until the death of the settlor (or as otherwise set forth in the trust instrument). After all, the settlor could (at least in theory) retain capacity at any moment prior to death. But as a practical matter, amending a revocable trust is not an available option for a living settlor without capacity (again, unless the trust instrument provides for this contingency in some manner) unless some sort of reformation proceeding is undertaken. South Dakota statutes, interestingly, do provide for such a proceeding in the guardianship code.[64]

CONCLUSION

When the country's first statutory scheme for trust decanting was adopted in New York, generation skipping transfer tax (GSST) planning was the primary benefit in mind for state legislators. Countless other uses for this trustee power have since been identified. It has proved an important new tool in

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[61] S.D.C.L. § 55-18-7 (Supp. 2018).
[62] *See supra* note 7.
[63] *See* S.D.C.L. §§ 55-2-1, 55-2-7 (2012). *See also* GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT, AND AMY MORRIS HESS, BOGERT'S THE LAW OF TRUSTS AND TRUSTEES §§ 541, 543 (June 2019 update).
[64] *See* S.D.C.L. § 29A-5-420 (2004). *See also* Matter of Guardianship of Nelson, 903 N.W.2d 753 (S.D. 2017).

administering trusts, as has reformation, *cy pres*, and other options outlined above.

Some have expressed reservations about the scope and startling reach of the decanting trustee power and other rather liberal trust reformation procedures. Drafting against the possibility of future trust decanting or reformation is possible, as is expanding and further liberalizing the process. Trusts, as the greatest creation of English law, are subject to being rewritten by their trustees, by the courts, or by the beneficiaries in certain circumstances. Navigating and considering these various methods is essential to any attorney drafting, administering, or litigating a trust matter.

Thomas E. Simmons
Professor of Law
University of South Dakota
School of Law suite 212
414 East Clark Street
Vermillion, SD 57069-2307
Tel. 605.658.3533
Email: tom.e.simmons@usd.edu
Web: https://www.usd.edu/faculty-and-staff/Tom-E-Simmons

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