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Which Hat Are You Wearing? Potentially Conflicting Fiduciary Duties for Director/Trustees of Trust-Owned Corporations

By Michael P. Connolly

Not all corporate directors are automatically held to the familiar corporate fiduciary duties of care and loyalty. Instead, where a corporate director is also a trustee of a trust that owns shares in the business, that director may be held to stricter trustee-level fiduciary duties in connection with actions that affect the value of beneficiaries' interests in the trust-owned company. This ownership and management structure occurs frequently in family-owned businesses where a founder of a company, as part of his estate plan or for tax purposes, places shares of a business in trust for the benefit of later generations of family members.

Often, the founder will also name one or more family members as trustees of the trusts. Where those trustee family members are also company managers or are themselves beneficiaries of other trusts that own shares in the business, conflicts of interests may arise between the trustees and the beneficiaries with respect to the ownership and management of the company. Such real or perceived conflicts of interest on the part of trustee-directors can lead to later claims of breach of fiduciary duty and breach of trust by the beneficiaries against the trustees. It is therefore important for trustees who are also directors to understand what fiduciary standard will apply when making decisions that may have an impact on the company, the trustees, and the trust beneficiaries in divergent ways.

The Director Versus Trustee Dilemma: An Example from the Orkin Pest Control Company

O. Wayne Rollins was a successful businessman, founding numerous businesses over several decades, including the Orkin Pest Control Company. Between the 1960s and 1980s, Wayne created numerous trusts for the benefit of his grandchildren and funded the trusts with shares of Rollins, Inc., and other family business holding companies, which held shares in the various companies Wayne created. These Rollins business assets were claimed to be worth several billion dollars. Wayne's sons, Gary and Randall, along with a family friend, were named trustees of one of the trusts and Gary, alone, was named trustee of the remaining trusts at issue. Gary and Randall were directors and officers of the various companies and exercised complete managerial and voting control over all the family business entities.

As initially drafted, the trusts required the trustees to distribute annually all of the trust income to the beneficiaries, but gave the trustees discretion to designate what was income and what was principal. The trusts further called for the trustees to turn over to each beneficiary, when he or she turned 45 years old, all property then remaining in each beneficiary's trust.

After Wayne died, four of Wayne's grandchildren brought suit against their father, Gary, and their uncle, Randall. The siblings alleged that the trustees breached the terms of the trusts and breached their fiduciary duties. In particular, they claimed that after Wayne died, Gary and Randall made changes to the structure, leadership, holdings and distribution methods used within the various family entities held within the trusts. The beneficiaries claimed that these changes were designed to, and did, deprive them of hundreds of millions of dollars of trust assets that their grandfather had put away for their benefit. They claimed that the changes also allowed Gary and Randall to concentrate additional management power in their own hands and to permit non-pro rata distributions to themselves and other beneficiaries (namely, Randall's children, who did not sue).

In response, Gary and Randall argued that all of their acts and decisions were permitted under the trust documents. They also argued that the decisions complained of took place at the entity level and not the trust level and therefore the decisions were protected by the business judgment rule since they were made in good faith. To date, this family dispute has led to three separate Georgia appellate court decisions, which are described in more detail below. More generally, the claims and defenses in this case highlight the uncertainty as to what legal rights and responsibilities arise when parties act as both trustees and directors in connection with trust-owned companies.

Differing Fiduciary Duty Standards

It is well established that corporate directors owe fiduciary duties of care and loyalty to the company and its shareholders. Under the duty of care, corporate directors must act in a manner that a reasonably prudent person would under the circumstances. Directors' decisions are subject to the business judgment rule, under which a court will not second-guess or overturn a business decision unless it is shown that the decision was not made in good faith, or with the care that a reasonably prudent person would use and with the reasonable belief that it was in the best interests of the corporation. Directors also owe a duty of loyalty, which requires them to place the interests of shareholders and the corporation above their own interests and to avoid impermissible conflicts of interest, by, for example, diverting corporate assets, opportunities, or information for personal gain. Directors may be able to avoid liability for such interested transactions by disclosing the potential conflicts and gaining approval of the transaction upon the informed consent of the disinterested directors or shareholders.

In the trust context, trustees also owe fiduciary duties to the trust and the beneficiaries. The trustee's management of the trust assets is subject to the duty of prudent administration. Each state's formulation may vary slightly, but this duty is typified in the Uniform Trust Code as follows: "A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution." UTC § 804. Some courts reviewing claims for mismanagement of trust assets have held that this duty is not subject to the protections or presumptions of the business judgment rule. See *In the Matter of Estate of Jacob Schulman*, 568 N.Y.S.2d 660 (1991) (trustee who acquired full legal authority to manage company by virtue of his trusteeship subject to trustee standards of conduct of the affairs of the corporation and not protected by business judgment rule); *Jones v. Ellis*, 551 So.2d 396 (Ala. 1989) (duties of a trustee much stricter than those of a corporate director and beneficiary need only show that losses were caused by trustee's "mere imprudent management of the trust").

A trustee also owes the trust and its beneficiaries a duty of loyalty. The duty of loyalty is the fundamental character of the trust relationship. A trustee is thus obligated to administer the trust solely in the interests of the beneficiaries. Under the Uniform Trust Code, for example, a "transaction involving the investment or management of trust property entered into by the trustee for the trustee's own personal account or which is otherwise affected by a conflict between the trustee's fiduciary and personal interests is voidable by a beneficiary affected by the transaction" unless it is expressly permitted by the trust document or approved by the beneficiary. See UTC § 802. Further, a transaction is presumed to be affected by a conflict if entered into by a trustee with "a corporation or other person or enterprise in which the trustee, or a person that owns a significant interest in the trustee, has an interest that might affect the trustee's best judgment." A trustee's breach of trust can lead to an award of equitable relief against the trustee, including an order to pay money or to restore property; an order to account for the use or disposition of trust property; removal of the trustee; the appointment a special fiduciary to take possession of the trust property and administer the trust; and the denial or reduction of trustee compensation. See UTC § 1001.

No Uniform Application of Fiduciary Standards

Courts have not consistently applied either the director or the trustee fiduciary standard when faced with claims against trustees who are also directors of trust-owned businesses. Indeed, as one New York surrogate court long ago noted: "the extent to which a court may interfere with the conduct of corporate affairs by the directors of an estate owned corporation is a question that does not lend itself to a simple answer . . . [t]he problem is one that usually falls somewhere between the field of the law of corporations and the law of estate and trust administration." *In re Estate of Schumer*, 242 N.Y.S.2d 126 (N.Y. Sur. Ct. 1963). The Massachusetts Appeals Court has similarly cautioned: "in each capacity [as trustee and as corporate director], the defendant had fiduciary duties. Wearing more than one hat requires a fiduciary to be nimble as well as most prudent. While the fiduciary may purport to wear one hat at a particular moment in truth all hats are worn together at all times." *Johnson v. Witkowski*, 573 N.E.2d 513 (1991).

The Delaware Supreme Court also has observed that "in conducting a review of allegations of self-dealing, the standards of trust law and corporation law are different." *Stegemeier v. Magness*, 728 A.2d 557 (1999). In addressing claims that could implicate both standards, the court continued: "[w]hich standard will apply, therefore, is governed by the legal format the grantor chose to accomplish his purpose." In the analogous, but not identical, situation where a corporate director holds dual or multiple directorships with different corporations, Delaware courts also have long held that there is no dilution of that director's fiduciary obligation to any particular company for the benefit of another company. See *Quadrant Structured Prods. Co.*

v. Vertin, 102 A.3d 155 (Del. Ch. 2014), *citing Weinberger v. Uop*, 457 A.2d 701 (Del. 1983). Further, if the interests of the beneficiaries to whom the dual fiduciary owes duties diverge, "the fiduciary faces an inherent conflict of interest. There is no safe harbor for such divided loyalties in Delaware."

These general pronouncements highlight the uncertainty that trustees may face in predicting what standard will apply. However, they do not provide bright-line rules that may assist trustee/directors in evaluating the risk of a later claim arising from their conduct concerning the trust-owned company. If anything, a survey of cases from across the country reveals that each decision is extremely fact-dependent.

Rollins v. Rollins, 741 S.E.2d 251 (Ga. App. 2013)—The Georgia Appeals Court Applies Trustee-Level Fiduciary Duties to Corporate Directors Who Are Also Trustees

In the *Rollins* case, the parties asked the trial court to decide the applicable standard for fiduciary duties concerning the trust-owned company. Relying on their competing views of whether the trustees, Gary and Randall, owed trustee or corporate director duties to the trust beneficiaries, both parties filed summary judgment motions. The trial court determined that the trustees made their decisions at the entity level rather than the trust level. As such, the trial court held the trustees to a corporate fiduciary standard and determined that the beneficiaries' reliance on the terms of the trusts to support their breach of fiduciary duty and breach of trust claims was misplaced. The trial court allowed the trustees' summary judgment motion and the beneficiaries appealed.

On appeal, the Georgia Appeals Court determined that the trustees should be held to trustee-level fiduciary standards of care as their actions related to the family entities that were held within the trusts at issue. The trustees' control over the family entities was a central factor in this decision. In its ruling the appeals court stated: "once a trust relationship is established between a beneficiary and a trustee managing a corporation for a trust, the fiduciary standards of care apply to his conduct regarding the affairs of the corporation." Further, the court held that where trustees elect themselves officers and directors, they actually operate the business as representatives of the estate. The appeals court concluded: "were it not so, the clever manipulation of corporate structure could result in the validation of myriad transactions that otherwise would be proscribed."

In reaching this decision, the Georgia Appeals Court relied on cases from other jurisdictions including Alabama, New York, and California. See *Jones v. Ellis*, 551 So.2d 396 (Ala. 1989)(where trustee holds dual roles of trustee and director, the "trustee should have acted with complete and undivided loyalty to his trust, excluding all personal or selfish interests as well as those of third parties."); *Tannenbaum's Estate*, 248 N.Y.S.2d 749 (N.Y. App. Div. 1964)("in dealing with corporate property, an individual who acts both in the capacity of a director of the corporation and in the capacity of a fiduciary of an estate having proprietary interest therein, is held to be fully accountable as an estate representative."); *In re Fruehauf Trailer Corp.*, 431 BR 838 (U.S. Bankr. Ct. C.D. Cal.)(2010) ("once a trust relationship is established between a beneficiary and a trustee managing a corporation for a trust, the fiduciary standards of care apply to his conduct regarding the affairs of the corporation."). After deciding that the trustees had trustee-level fiduciary duties for their actions concerning the family entities held within the trust, the appeals court went on to define those duties. The court stated: "a trustee is a fiduciary and as such is held to the highest standard of the law, because a fiduciary is a person who is required to act for the benefit of another person on all matters within the scope of the relationship; one who always owes to another the duties of good faith, trust, confidence, and candor."

The appeals court then determined that the trial court erred in determining that the trustees did not owe fiduciary duties to the beneficiaries for the trustees' actions taken at the entity level. The appeals court remanded the matter to the trial court for further proceedings in order to evaluate the trustees' conduct against the trustee-level fiduciary duty standards.

Rollins v. Rollins, 755 S.E.2d 727 (Ga. 2014)—The Georgia Supreme Court Rules That Corporate-Level Fiduciary Duties Apply to the Trustee-Directors

The trustees appealed the appeals court's ruling to the Georgia Supreme Court. The supreme court acknowledged that the appeals court held that actions taken by the trustees in their capacities as managers of the family entities must be scrutinized according to heightened trustee-level fiduciary standards instead of the more deferential standards that apply to the conduct of corporate entity managers. The supreme court stated, however: "[a]lthough that holding may be appropriate as a general rule, it is inappropriate in this case both because the cardinal rule in trust law is that the intention of the settlor is to be followed, and because the trusts hold only a minority interest in the family entities."

The supreme court further ruled that on the facts before it, "the only reasonable conclusion with regard to the settlor's intention is that he did not intend for the trustees to be held to trustee level fiduciary standards when performing their corporate duties." The supreme court also found the standard set forth by the appeals court to be inappropriate because the trusts held only a minority interest in the family entities. In such a scenario, "it is generally best to allow the trustees to act in the interest of all the shareholders and to require that they be held to a corporate level fiduciary standard when acting as directors."

The Georgia Supreme Court recognized that other courts may have held otherwise (i.e., trusts holding minority interests can still lead to application of trustee-level fiduciary duties), citing specifically to New York state law cases. Nonetheless, the supreme court held that where, under the terms of a trust, a trustee is put in control of a corporate entity in which the trust owns a minority interest, the trustee should be held to a corporate-level fiduciary standard when it comes to his or her corporate duties and actions. The supreme court then remanded the case to the appeals court in order to apply the corporate fiduciary standard when considering the trustees' conduct with regard to their management of the corporate family entities held within the trusts.

Rollins v. Rollins, 766 S.E.2d 162 (Ga. App. Ct. 2014)—On Remand, the Appeals Court Highlights the Uncertainty as to When Trustee-Level Duties Apply

On remand, the appeals court reiterated its prior holding that the trustees would be "held to trustee-level fiduciary standards of care as to their actions related to the Family Entities, which they control, and which are held within the trusts at issue." The appeals court also noted that the supreme court found that the appeals court's prior ruling that trustee-level fiduciary duties should apply "may be appropriate as a general rule." However, the appeals court noted that "[t]he Supreme Court did not, at this juncture, define the parameters of the 'general rule,' leaving unclear exactly when or how a trustee level fiduciary analysis should be applied in similar situations." The appeals court nonetheless acknowledged that it was directed to apply "a corporate fiduciary standard when considering the trustees' conduct with regard to their management of the corporate family entities held within the trusts." In doing so, the appeals court determined that factual issues still existed concerning the trustees' conduct under this standard, which precluded the allowance of summary judgment in the trustees' favor. The appeals court again remanded the matter to the trial court for further proceedings.

The trustees appealed this ruling to the Georgia Supreme Court, arguing that the appeals court erred in remanding the case to the trial court for a determination of any factual issues concerning the trustees' alleged breach of their corporate fiduciary duties. Nonetheless, based on the Georgia Supreme Court's earlier decision, where a trust holds a minority interest in a corporate entity and the settlor specifically permits the challenged conduct through the trust instrument, it appears that the trustee would be held to a corporate-level fiduciary standard, at least under Georgia law. In other jurisdictions, that still may not be the result. See, e.g., *In re Scuderi*, 667 N.Y.S.2d 913 (N.Y. App. Div. 1998)(where trust held less than majority interest in company over which trustee exercised working control, trustee subject to trustee-level fiduciary duties).

How to Clarify Which Fiduciary Standard Applies and to Monitor Compliance with That Standard

Everyone who is a party to, or who is affected by, the trust instrument—the settlor, the trustee, and the beneficiary—should consider and understand from the beginning what fiduciary standard will govern a trustee's conduct while that trustee is also managing a trust-owned company. The parties should likewise consider what standard a reviewing court will later apply if a beneficiary challenges the actions of a trustee in this context. Otherwise, the matter may turn on a particular trial court's view of the equities of a particular fact-pattern, which may only evolve through time-consuming, expensive, and public litigation. The following measures may add clarity from the outset and prevent later disputes over trustee conduct and confusion over what standard applies.

1. The settlor can include a provision in the trust instrument explicitly permitting a trustee to undertake certain interested transactions in connection with the corporation that would otherwise create a presumptive conflict of interest. The Uniform Trust Code and many state trust statutes provide such a safe harbor. See UTC § 802(b)(1). The settlor can also waive the rule of undivided loyalty by implication by knowingly placing a trustee in a position with the corporation that might conflict with the interests of the beneficiaries. In the *Rollins* case, for example, the Georgia Supreme Court relied on the fact that the settlor was a sophisticated businessman who certainly would have recognized the potential for the trustees' conflict of interest while also serving as a director of the trust-owned companies. Yet, he placed the trustees in that position anyway, evidencing "that he did not intend for the trustees to be held to trustee level fiduciary standards when performing their corporate duties." Rather than leaving the parties to try to recreate the circumstances surrounding the creation of the trust and inferring the settlor's intent, however, the settlor would be better served to expressly state what standard of conduct the trustee must meet.
2. The settlor may be able to shield a trustee/director from trustee-level fiduciary duties if the trust is funded with only a minority share of an entity. As the Georgia Supreme Court held, in such a case, "it is generally best to allow the trustees to act in the interest of all the shareholders." This is not uniformly the law, however, as certain other courts, notably in New York, have applied trustee-level fiduciary duties to director conduct even where the trust owns only a minority of an entity's stock.
3. The settlor may decide to separate the trustee and corporate management positions entirely. While the settlor may wish to keep the trustees and company management "all in the family," the various skills and personalities of the people involved may not be conducive to smooth future relations between the trustee/managers and the beneficiaries. In such a case, it may be advisable to engage a competent, disinterested third party individual or institution to act as trustee of the trusts. This option brings with it the added expense of a third party fiduciary and the vetting process for finding a trustee qualified to monitor the performance of a privately owned business.
4. Once the trust is formed and the settlor has funded the trust and manifested his intentions as to the trust's administration, it is then within the power of the trustees to administer the trust and within the beneficiaries' power to monitor the trust's and trustee's performance. If the trustee does not have explicit authority to engage in a trans-

action with respect to the trust-owned entity that could later be subject to challenge, the trustee would be best served to obtain either advance consent or ratification of any such actions, as permitted, for example, by the Uniform Trust Code, § 802(b)(4).

5. Finally, beneficiaries have a right to receive periodic information concerning the trust's activities and the performance of its holdings. While the beneficiaries do not waive breaches of trust by failing to actively monitor a trustee's conduct, they would be well served to routinely receive, review and understand what the trustee is doing on their behalf. For their part, trustees should faithfully carry out their obligations to keep the beneficiaries reasonably informed about the administration of the trust.

Conclusion

If managed well, a family-owned business can support many future generations of family members, often with little need for any particular family member's active involvement with the business. However, personality conflicts and other relationship-based tensions that are unique to the family structure can lead to disputes that would not likely arise in the setting of a non-family business. Where a founder or other owner of shares of a family-owned business intends to pass the ownership of the business to later generations by placing the shares in one or more trusts, the settlor should take care to spell out as clearly as possible the trustees' responsibilities in administering the trusts and in managing the trust-owned business. By doing so, all interested parties can better understand what fiduciary standard will govern the trustee's conduct, what claims the beneficiaries may have the right to bring for any later alleged breaches, and what standard a reviewing court will need to apply.

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