

Course Title:

"Trust Protectors: What Are They and Why Probably Every Trust Should Have One"

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*"Trust Protectors:
What Are They and Why Probably
Every Trust Should Have One"*

by John "John A" Warnick, Esq.



Presenter: *John "John A" Warnick, Esq.*

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CLE Handout includes:

1. Example: Engagement Letter
2. Example: Redacted Trust Protector
3. Example: Southfork Ranch Dynasty
4. Example: Letter to Trustee
5. Course Case Studies:
 - Case Study 1: Grantor's Remorse
 - Case Study 2: The Dysfunctional Beneficiary
 - Case Study 3: The Recalcitrant Trustee
 - Case Study 4: Unitrust Decision: Unitrust Crisis
 - Case Study 5: The Deadlocked Trustees
 - Case Study 6: The Migrant Beneficiary
 - Case Study 7: Daddy's Favorite Business
6. Directory: State Law Treatment of Trust Protectors (USA)
7. Article: "Powers That Can Be Granted to a Trust Protector"
8. CLE Documents for the Participant
 - Certificate of Attendance, *State Bar of California CLE*
 - Activity/Course Evaluation, *State Bar of California CLE*
 - About our Instructor~ John "John A." Warnick, Esq., *Purposeful Planning Institute*
 - About the Program Director~ Mary Gutheil Anderson, Founder, *Advanced Legal Training Institute*
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Example/Draft:

Offer of Trust Protector Services to Client

October 8, 2019

[Name and address of Trustee]

Re: Trust Protector Services

Dear [name]:

This letter will outline the basis upon which I will provide trust protector services for the Our Family's Multi-Generational Trust (the "Trust") and the manner in which I will bill for services rendered and any disbursements incurred.

The services to be performed by me will be:

- Review of the trust instrument
- Interviews of all adult beneficiaries of the trust, the Trustee, and key advisors for the Trust
- Exercise of discretion pursuant to the authority granted in the trust instrument

With respect to my charges for the services I will render, many factors are taken into account before a billing is prepared, including time expended, nature and complexity of work performed, time constraints, the length and breadth of the engagement, and the results achieved. We both understand that my fees, however, are not contingent on my exercising my discretion according to any predetermined plan or agreement between you and the beneficiaries and remaindermen.

The principal factor in the determination of my charges will be the time expended. My current rate for trust protector services is \$1200 for a half day and \$2400 for a full day with hours expended below or above those increments being billed at my customary rate of \$300.00 per hour and calculated on a quarter-hour minimum. I reserve the right, with at least one-month advance written notice to you to raise my rate in accordance with the then-existing market.

In addition to charging for my services, I will require reimbursement for certain out-of-pocket expenses incurred in the course of my work. These expenses may include travel expenses, legal fees

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incurred in seeking the advice of my own independent counsel, research services, postage and/or courier services, Xerox copies at \$0.20 per page and similar expenses.

You have asked for an estimate of what I believe the total costs for this project will be. I can not at this time accurately estimate what the costs will be but I can give you a good faith estimate based on my understanding at this time of what the scope of my services will cover in the short-run. You have indicated there are five adult beneficiaries and remaindermen and there are two key family advisors in addition to you and other members of your trustee team. I would anticipate I would send three to four hours reviewing the trust document prior to interviewing the family, advisors and Trustee. I anticipate each of those interviews would last between 30 and 90 minutes and will assume an average interview time of one hour. I anticipate I would need to spend several hours consulting with the trust's legal advisors and perhaps may need to seek my own independent counsel. I would then prepare a written report to you and the beneficiaries/remaindermen of my recommendations and suggest we hold a family meeting to discuss the proposed course of action I am suggesting. At this time, it appears to me that I would expend between 15 and 20 hours in this stage and that my fees would be in the neighborhood of \$4500 to \$6000.

If we discover that there isn't a clear consensus among the beneficiaries and/or remaindermen on what direction the "remodeling" of the trust instrument should take or that we need to obtain a reformation of the document rather than just amend the trust, then I am certain the ultimate fees will be substantially higher than this good faith estimate. It is also possible I may recommend engaging a communications expert to help us facilitate arriving at a consensus among the family and that expense is not included in my good faith estimate.

Statements are prepared and mailed monthly and are payable upon receipt. All balances are to be paid within 30 days of billing. I understand that the trust is responsible for my fees and expenses.

Pursuant to the trust instrument, you or a majority of the adult trust beneficiaries have the right to terminate my services at any time. I have the same right, subject to an obligation to give you reasonable notice to arrange for an alternative trust protector. However, pursuant to this engagement letter I will be entitled to be compensated for all services rendered through the date of actual notification of my termination as trust protector. I appreciate your confidence and look forward to working with you and the family.

Respectfully yours,

The Trust Protector

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Redacted Trust Provisions for Magic Key and Trust Protector

by John A. Warnick, Esq. LLC. © All Rights Reserved.

ARTICLE I: CREATION OF TRUST

I.01 Trust Estate. With the exec administer and distribute the initial trust estate and any additions to the trust estate in accordance with the provisions of this Agreement.

I.02 Purposes. My overall purpose is to create a trust which will benefit My Children. The primary motivation for establishing such a trust is my love and affection for My Children, my faith in her abilities and her progress in acquiring the life wisdom, judgment and keys essential to her success and well-being, and my hope that the trust will always serve the best interests of My Children.

There are, however, other purposes which I have had in mind as I established this Agreement.

(a) **Completed Gift.** I intend to make a completed gift for the benefit of My Children, to be held in trust on the terms and conditions in this Agreement.

(b) **Special Assets.** I intend that this trust may hold special assets which may be more difficult to administer than marketable securities and fixed income investments. This might include real estate, life insurance and mineral interests.

(c) **Potential Pour-Over Vehicle.** I intend that this trust may receive additional property from my estate at the time of my death although I will retain complete discretion on whether or not to make additional contributions to this trust upon my death.

(d) **Asset Protection.** I intend that the interests created hereunder shall be protected, to the greatest extent possible from the claims of creditors or anyone who might attempt to interfere with My Children's enjoyment and use of the trust assets.

(e) **Use and Enjoyment.** I want the trust to provide educational opportunities for My Children as well as to be available to assist My Children to become the best person she can be as well as a productive member of society.

(f) **Grantor Trust Status.** Because I want this trust to have substantially similar terms to the irrevocable trust I previously established for My Children's benefit the initial trusts established hereunder won't be treated as a grantor trust for federal income tax purposes. However, if I contribute significantly more assets or if the trust has the opportunity to generate significant growth it might be appropriate in the future that the trust be taxed as a grantor trust. Therefore, I have given the

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power to a Trust Protector to be able to convert this trust from a separate tax-paying entity to a grantor trust if it would prove advantageous later to do so.

(g) **Flexible Trust.** I have also provided mechanisms to permit this trust to be kept "up-to-date" in terms of legal, tax, investment and other considerations which will impact the administration of this trust. Just as I hope My Children will always strive to become the best person she is capable of being, I want My Children (once she understands fully the purposes and advantages of this Trust), the Trustees and other family advisors to always be vigilant for opportunities to improve upon the foundation I have created in this Agreement.

(h) **Annual Exclusion Gifts.** I intend that gifts to this Trust will qualify for the annual exclusion for gift tax purposes. I have paid to the Trustee, as the initial trust estate, the sum of \$10.00. The Trustee shall

(i) **GST Trust.** I also intend to allocate from time to time some or all of my GST exemptions to this Trust so that the GST exempt trust established hereunder will be wholly exempt from the federal generation-skipping tax. I realize there is currently uncertainty about the future of the GST tax system and about how additions to a trust during a period when the GST tax isn't in effect will be treated. To the greatest extent possible I would like to see that all contributions made during the period when the GST tax isn't in effect will be held as part of the GST exempt trust. The Trustee will have the option to create a subtrust under the GST exempt trust in which it will hold contributions during any period when there isn't a GST tax in effect. If the GST tax becomes effective at a later date the Trustee will then need to determine whether to continue to hold such assets in that subtrust or whether to contribute them at that point in time to the non-exempt trust.

1.02 **Roles.** I have created a variety of roles to maximize the benefit and protection which this Trust will offer My Children. There are guidelines and requirements delineating who can fill these roles and what the succession process will be for each of these roles. The following is intended as a summary of what these roles are, who may fill these roles, and where the specific rules and guidelines for these offices may be found in this Agreement.

(a) **Trustee.** The initial Trustee will be

(b) **Trust Protector.** Howard Strauss, CPA, or if at the time of designation, he would be deemed to be subordinate to me or My Children then Bridgett Thomas, CPA, shall be deemed to have been designated to serve as the Trust Protector if that role is ever activated and no other individual is designated. Neither Mr. Strauss nor Ms. Thomas will be signing this instrument at the inception of the trust because neither of them has any active responsibility as the Trust Protector at the time of the establishment of this Trust. Neither My Children nor anyone else who is related to or subordinate to My Children or any other beneficiary, may ever serve as the Trust

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Protector. While I am alive, the Trust Protector must also be someone who is not related or subordinate to me.

INTENT

I believe a trust agreement that can last beyond the lifetimes of its creator and initial trustees needs to be reviewed and refreshed from time to time. The Trust Protector will be given the ability to amend this Agreement from time to time to make sure that it is "up-to-date" in terms of changes in tax or legal rules affecting trusts as well as other provisions of the trust document.

The detailed provisions for appointment of successor Trust Protectors are set forth in Section 3.02 and the functions to be discharged by the Trust Protector are set forth in Article 8.

(c) **Future Roles.** It is possible that at some point in the future there may need to be modifications in these roles or additional roles created to achieve the purposes I have set forth in this Agreement.

EXAMPLE

For instance, I eventually want My Children to be able to serve as a Co-Trustee of this trust and I want her to have as full control of the Trust as is possible without making the trust assets includible in her taxable estate or subject to legal entanglements or threats from legal predators. It is also possible that due to changes in state or federal laws that an initial role given to the Trust Advisor should be exercised by the Trust Protector or the Independent Trustee. I mention this only so that the beneficiaries, Trustees, Trust Advisor and Trust Protector will understand that these relationships and roles are dynamic and will need to be reviewed from time to time to insure that the best interests of the beneficiaries are being served.

The Trust Protector, once activated, will possess the power to amend the trust to make any desired changes in the roles of the various fiduciaries.

My Reflections on Wealth, Relationships, and the Values of Hard Work, Honesty and Integrity. As an additional benefit to My Children, I would like to leave her my feelings about the meaning of money, work, and relationships.

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ARTICLE 1: POWERS OF WITHDRAWAL

ARTICLE 2: DISTRIBUTION OF TRUST ESTATE

ARTICLE 3: TRUSTS FOR DISTRIBUTEES

ARTICLE 4: PROVISIONS GOVERNING DISTRIBUTIONS

ARTICLE 5: RIGHTS OF BENEFICIARIES

ARTICLE 6: TRUST ADVISOR

ARTICLE 7: SPECIAL POWERS AND DUTIES OF TRUST PROTECTOR

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ARTICLE 2:

INTENT

There are certain powers which cannot be given to beneficiaries of a trust without adverse tax or legal consequences.

I have carefully considered how I might design a structure for My Children's benefit that would give her both flexibility, long-term tax benefits and financial security. I don't want to create a trust or to hold assets in a trust just for the sake for having a trust or insuring that something will be left in this Trust for grandchildren that I anticipate will be born in the near future but which don't even exist at this time. It is very important to me that My Children know that I didn't create this Trust because I felt she would "blow it" or that she wouldn't become a great manager of the wealth I will pass to her through this Trust. I would like to explain to both My Children, the Trustee and any Trust Protector who is designated and activated hereafter the "WHY" behind the design of this Trust.

If I left assets to you without any trust to protect those assets, you would have no protection against claims that might be made against those assets if you ever get into some form of legal entanglement. So I explored various possibilities around how I might design something that would make you feel like you were the "owner" of the Trust assets without exposing those assets to the claims of legal predators.

You will find descriptions of my intent regarding the distribution provisions of the Trust so I'm not going to repeat here what I've shared with you previously. Those distribution provisions are tied to what is in your "best interests" and that should be liberally interpreted in your favor. At the same time the Trustee is directed to carefully monitor what threats might arise from third parties that might jeopardize your enjoyment and use of trust assets or the distributions of trust income and principal the Trustee may make.

I carefully considered the possibility that despite all of the flexibility and protection I have built into this Agreement that a time might come where you would simply want to collapse the trust. If I gave you the sole power to decide when and how to collapse the trust it is virtually certain that legally the courts would consider you to be the true owner of the Trust assets which would mean, there wouldn't be any protection for you if you ever need that protection.

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There is a procedure you can follow if you would want to collapse your trust. It is what John Warnick calls a "double key" procedure. It takes two keys to exercise it and you only have one of the two keys. The way you would start the procedure is that you would activate the Trust Protector role. Once a Trust Protector is appointed you would meet with that Trust Protector and explain to him your circumstances and why you want to collapse the Trust. It will be the Trust Protector's duty to make sure he or she fully explains to you the benefits and protections, both tax and legal, you will be giving up if the trust is indeed terminated. The Trust Protector will ask you a series of questions to make sure you understand those consequences and to ascertain whether there is anyone forcing you to make the request that the Trust be terminated. As long as the "coast is clear" and the Trust Protector determines you aren't under any immediate threat of having a terminating distribution of trust assets seized, the Trust Protector will turn the "second key" and instruct the Trustee to distribute all of the trust assets to you. Even if the Trust Protector feels your decision is foolish, the Trust Protector will proceed to collapse the Trust unless you are under a credible threat of attachment, foreclosure, execution of judgment, or litigation.

2.01 When Powers May Be Exercised. An Independent Trustee may exercise any of the powers set forth in Article 8.04 at any time without the necessity for such powers to be activated under Article 8.02. In addition, a Trust Protector may exercise any of the powers set forth in this Article 8 (the "Article 8 special powers") at any time after such powers have been activated under Article 8.02. The Trust Protector shall have no duty to exercise the Article 8 special powers until those powers have been activated and neither the Trust Protector nor any other Independent Trustee(s) shall have any continuing duty to monitor the need to exercise those powers once they have been deactivated.

2.02 Activation of Special Powers of the Trust Protector. The Article 8 special powers granted to the Trust Protector(s) of the Trust(s) administered under this Agreement are activated according to the procedures set forth in this Section 8.02. The Article 8 special powers may be activated by an Independent Trustee or by anyone who possesses and is then authorized to exercise the power to remove and replace a Trust Protector under Article 9.02(d). The person(s) activating the Article 8 special powers shall deliver a written notice of activation to the then-serving Trust Protector(s) hereunder or, if none, shall specify either one or more of the then-serving Independent Trustee(s) of the Trust or any other adult individual (provided such adult individual meets the eligibility requirements of an Independent Trustee set forth in Article 1.06(f)(4) of this Agreement) and shall appoint such person as

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the Trust Protector vested with all or a specified set of the Article 8 special powers. In the event the notice of activation does not specify a particular individual, then Howard Strauss, CPA, so long as he meets the definition of an Independent Trustee at such time, shall serve as the Trust Protector with his sole responsibility hereunder being that of determining whether and how one or more of the Article 8 special powers shall be exercised. A copy of the written notice of activation shall be provided to all adult Qualified Beneficiaries.

2.03 Deactivation of Special Powers of the Trust Protector. The Article 8 special powers shall be deemed to be deactivated according to the procedures set forth in this Section 8.03. The Trust Protector who has been designated through a notice of activation to hold one or more of the Article 8 special powers may at any time deactivate his or her fiduciary responsibility with regard to all or a specific power or set of powers granted under any notice of activation by delivering a written notice of deactivation to the then-serving Trustees, Trust Protectors, Trust Advisors, and any adult Qualified Beneficiary. Such notice of deactivation shall specify whether all or only certain of the Article 8 special powers are being relinquished.

2.04 Trustee's and Trust Protector's Discretion to Delay or Withhold Distributions. Notwithstanding and as a supplement to the dispositive provisions expressly contained in Articles 3, 4 and 5, the following powers and directions are given to the Independent Trustee and Trust Protector (when such Trust Protector has been duly designated through a notice of activation) of any Trust administered hereunder:

(a) **Postponement or Rescission.** If the Independent Trustee or Trust Protector determines, in its sole discretion, that it would not be in the best interests of My Children or any other beneficiary that a distribution be made from or a right of withdrawal be satisfied under any Trust established under this Agreement, then the Independent Trustee, or Trust Protector, shall have the power to direct the other trustees or Trustee, as the case may be, to postpone or rescind that distribution or to suspend or rescind the right of withdrawal. If a distribution or right of withdrawal is suspended, then such distribution or right of withdrawal shall be postponed until the Independent Trustee or Trust Protector certifies the cause or causes which triggered such determination no longer exist or the Independent Trustee or Trust Protector feels the needs and best interests of My Children or such other beneficiary outweigh further delays. The Independent Trustee or Trust Protector may postpone a distribution or right of withdrawal indefinitely with no obligation to make up the missed payment or to pay interest thereon. If a distribution is rescinded, then the Trust shall be administered as if all distributions to My Children or such other beneficiary were entirely left to the sole discretion of the Independent Trustee or to such Trustees to whom the Trust Protector delegates that discretion. If

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a right of withdrawal is rescinded, then the trust shall be administered as if such right of withdrawal had never been granted or exercised.

(b) **Causes for Delay.** The causes for postponement or rescission shall be limited to those circumstances which threaten My Children's or any other beneficiary's ability to enjoy, use or manage the assets subject to distribution or any other behavior that is inconsistent with my strong personal belief in individual accountability, integrity, and financial prudence. The following examples are illustrative, but not limiting, examples of circumstances that would warrant the Independent Trustee or Trust Protector exercising this discretion:

- (1) *the current or prospective involvement of My Children or any other beneficiary in a legal separation or divorce or a bankruptcy or other insolvency proceedings;*
- (2) *the existence of an unsatisfied judgment against My Children or any other beneficiary;*
- (3) *the incarceration of My Children or any other beneficiary;*
- (4) *the actual assertion of legal claims against My Children or any other beneficiary or the threat of litigation arising out of serious vehicular accidents or other possible acts of negligence by My Children or any other beneficiary;*
- (5) *any other behavior that is inappropriate, distasteful or threatening to My Children's or any other beneficiary's ability to use, prudently manage and enjoy the property subject to distribution;*
- (6) *drug or alcohol dependency, excessive gambling or any other compulsive or addictive behavior which the Trustee feels is prejudicial to the health or wellbeing of My Children or any other beneficiary;*
- (7) *My Children's or any other beneficiary's participation in a religious sect or any other organization if such participation is detrimental to My Children's or any other beneficiary's health or well-being;*
- (8) *mental illness which results or contributes to My Children's or any other beneficiary's inability to prudently use her financial resources; and*
- (9) *a prolonged period of voluntary unemployment (other than a choice to stay at home to be with children).*

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(c) **Duty and Authority to Inquire.**

(1) *The Independent Trustee or Trust Protector should familiarize himself with the life and circumstances of My Children and the other beneficiaries so that the Independent Trustee or Trust Protector will act in the best interests of My Children and the other beneficiaries when considering whether to request the Trustee to withhold distributions hereunder. The Independent Trustee or Trust Protector shall also have the authority to require My Children or any other beneficiary to submit to drug testing and/or psychiatric or other evaluation to determine whether My Children or any other beneficiary is dependent on or abusing drugs or alcohol at the time of a contemplated distribution or is suffering from any other condition that would interfere with her enjoyment or use of the assets to be distributed or withdrawn. The failure of My Children or any other beneficiary to submit to such testing or evaluation may be construed by the Independent Trustee or Trust Protector as a determination that My Children or such other beneficiary is in fact abusing alcohol or drugs at such time.*

(2) *The Independent Trustee or Trust Protector shall also have the power to require My Children or any other beneficiary to provide to the Independent Trustee or Trust Protector a copy of any income tax returns filed by My Children or any other beneficiary or by entities controlled by My Children or any other beneficiary as well as with a current financial statement for My Children or any other beneficiary or such entities.*

(3) *The Independent Trustee or Trust Protector may, as a condition of determining whether to advise the Trustee to grant any request from My Children or any other beneficiary for a loan or distribution, insist that My Children or any other beneficiary cooperate in the preparation or implementation of a budget or cash flow forecast prepared by an accountant or other qualified party for My Children or any other beneficiary and her dependents or business interests.*

(4) *The failure to comply with the Independent Trustee or Trust Protector's requests under this Section 8.04(c), or any other request which is reasonably related to the need to fully understand what is going on in the life of My Children or any other beneficiary, shall justify the Independent Trustee or Trust Protector's decision to deny or reduce benefits to My Children or any such other beneficiary.*

(5) *In the event the Independent Trustee or Trust Protector determines that My Children's or any other beneficiary's behavior is impaired by any addictive or compulsive behaviors, the Independent Trustee or Trust Protector may not only withhold distributions from My Children or any other beneficiary but may, in such Trustee's sole discretion, assist My Children or any other beneficiary by paying for all or a significant portion of any treatment, counseling, etc. which the Independent Trustee or Trust Protector feels may be helpful to My Children or any other beneficiary.*

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(d) **S Corporation Protection.** The Independent Trustee or Trust Protector may not cause the income distributions of any Trust which is qualified as a QSST to be delayed or postponed, or to otherwise disqualify any Trust which is or which the Trustee desires to qualify as a QSST.

2.05 Power to Reform or Amend Trust.**(a) Periodic Review of Trust Administration and Trust Agreement.**

My Children shall have the power on the fifth anniversary of establishment of this Trust, and every five (5) years thereafter, to ask for a review of the efficacy of this Agreement and the operations of the Trust to determine how successfully it is meeting the goals and purposes I have set forth herein. My Children may choose to spearhead the review process or she might consider asking the Trust Advisor, Trustee, a Trust Protector, or an independent third party to conduct the review. If it is deemed advisable after such review a Trust Protector could be activated and empowered to "remodel" the Trust using the powers granted under this Section 8.05. Such amendments shall not only serve to keep the Trust current, vis-à-vis tax law changes, but may also provide greater benefit and/or protection to My Children and her descendants.

INTENT

I believe that the evolution of legal systems, investment theory and administrative models suggests that frequent reviews of this Agreement, administrative functions and trust operations be conducted. It will be up to the Trust Protector to determine what changes, if any, should be made by amendment or reformation. I also recognize that tax consequences of the Trust may shift over time because of changes in applicable tax laws or rules, and I want the Trust Protector to understand it may be necessary to modify or adapt the Trust to better serve My Children and her future descendants.

(b) **Trust Protector's Power to Reform Trust.** The Trust Protector may petition a court of competent jurisdiction to reform any Trust established under the terms of this Agreement provided the Trust Protector has consulted with any other Trustee and determines that such reformation would be in the best interests of My Children. The court which considers any such petition for reformation shall consider whether such proposed reformation would (i) reduce or eliminate a significant income, transfer, or other tax imposed on the trust estate or as a result of distribution of all or part of the trust estate to My Children, (ii) reduce or eliminate significant administrative costs related to administration of the Trust, including those related to compliance with local, state or federal laws or regulations, (iii) facilitate more effective administration of the Trust, or (iv) facilitate more productive investment of the trust estate. The court evaluating such petition for reformation shall determine by a preponderance of the evidence that such reformation will not result

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in adverse tax consequences. The Trust Protector should not seek to reform the Trust if such reformation would be inconsistent with the purposes expressed by me in this Agreement.

(c) **Power to Collapse Trust.** If the Trust Protector feels that the Trust is no longer serving the best interests of My Children, the Trust Protector may direct the Trustee to terminate the Trust by distributing all of the trust assets to My Children.

(1) *The Trust Protector may also be asked to consider invoking the "two key" process of terminating the Trust for My Children. If the Trust Protector is asked to exercise the two key power the Trust Protector should interview My Children in person for the following purposes:*

- (i) Explain to My Children the benefits of the continuation of the Trust.
- (ii) Explain to My Children the risks of collapsing the Trust.
- (iii) Permit My Children to explain why she wants to see the Trust collapsed and what her intentions+ are with regard to her use of these assets once the trust has been terminated.
- (iv) Ask My Children whether she is aware of any pending or threatened legal entanglements against her.
- (v) Conduct an investigation, and if necessary hire agents to assist in this investigation, to make sure that there are no actual legal threats against my Children.

(2) *If the Trust Protector determines after conducting this investigation that there is no credible threat of an attachment, execution of a judgment, etc. against My Children at the time she is making this request to collapse the Trust then the Trust Protector shall direct the Trustee to terminate the Trust and distribute all assets to My Children. The Trust Protector shall exercise this two key process and cause the termination of the Trust to occur even if the Trust Protector disagrees with My Children's decision unless the Trust Protector becomes aware of credible evidence that My Children is actually involved in or is likely to be threatened in the next couple of years by a lawsuit or some other form of legal entanglement.*

(d) **Limited Power to Amend Trust.** This power to amend may only be exercised by a Trust Protector. I anticipate that generally the Trust Protector will be a person other than the Trustee. However, if a person who is not a beneficiary nor related or subordinate to any beneficiary is serving as Trustee, such person may also serve as Trust Protector. In no event shall any Family Member participate in the exercise of the discretion granted hereunder to the Trust Protector to amend the Trust. I recognize that some of the powers granted under this power to amend resemble dispositive powers or could have the effect of substantially modifying the original dispositive terms under this Agreement or any Trust established hereunder. In exercising the discretion and power

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granted hereunder, the Trust Protector may amend or restate any Trust administered hereunder, including the dispositive, administrative, and other provisions of all kinds, to:

(1) cope with tax and/or other circumstantial changes that may affect such Trust and/or its beneficiaries; and/or

(2) remove from the governing trust instrument any provisions which have become "deadwood" (i.e., no longer operative in the ongoing administration of such Trust due to changed circumstances or legal rules) or to add provisions, either administrative or dispositive, to comply with or take advantage of any changes in laws governing trusts or new developments in trust administration or investment philosophy in whatever way or ways such Trust Protector, in the exercise of such Trust Protector's sole discretion, may deem appropriate or in the best interests, as interpreted by such Trust Protector alone, of My Children with respect to:

(i) such Trust; and

(ii) all Trusts that are subsequently to come into existence under this Agreement to hold part or all of the assets of such Trust. The Trust Protector shall be guided by what, in the sole judgment of such Trust Protector alone, would apparently be my original intent hereunder in the light of the changed circumstances.

(3) modify the trusteeship, the name of any trust or any other dispositive or administrative terms, including redefining the class of contingent remaindermen who might receive benefits under this Agreement so as to permit the Trusts established and administered hereunder to be consolidated with any trust established by another individual for the benefit of one or more of my descendants;

EXPLANATION

Contingent Remaindermen are those in whom the trust corpus would finally vest upon termination of a trust. They are contingent in the sense that the appointment of the trust assets by power of appointment may cause the assets of the trust to be distributed upon termination of the trust to another individual or individuals.

(4) provide for the creation of one or more separate subaccounts (equivalent to a separate trust) in any trust hereunder. Any such subaccount may be more or less restrictive, in comparison to the original Trust or to the other subaccounts created thereby, with regard to its administrative or dispositive provisions. The purpose for exercising this power may be simply to allow certain types of assets to be segregated for tax or administrative purposes or it may be to achieve some

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tax or other benefit that would otherwise not be available if such assets were not segregated or the terms of the original Trust were not modified;

(5) modify, expand, minimize or eliminate the duties, purposes and responsibilities of the Trust Protector in order to allow the Trust to function in the most beneficial and efficient manner possible taking into account the evolution of both the legal and investment framework within which the Trust is being administered;

(6) modify or expand the office of Trust Advisor with such duties, purposes and responsibilities as may be deemed to be desirable or appropriate as determined by the Trust Protector after giving careful consideration to the assets of the Trust, the relationship of the Trustee and My Children, and the current or future needs of My Children, primarily, and secondarily of other members of my family who are either beneficiaries or remaindermen;

(7) modify the Trust to permit it to be treated as a "directed trust" or to prohibit it from being a directed trust for some period of time, which may be renewed, extended or reduced by the Trust Protector from time to time. A directed trust is a trust where either a Trust Advisor or a group of Qualified Beneficiaries may direct the administrative or investment functions of the trust. In no event may the directed trust be used to give the beneficiaries or parties related or subordinate to them the power to direct distributions from the trust;

(8) create the office of Investment Advisor for a separate Trust. Such Investment Advisor could or would have sole or primary responsibility for making all decisions with regard to investments or certain types of investments. Any such Investment Advisor would be subject to removal and replacement by the Trustee for the separate Trust unless the Trust Protector provides for a different means of appointment and removal. This power to create the office of an Investment Advisor doesn't exclude the possibility that a then-serving Trust Advisor might appoint an Investment Advisor to manage any specific asset or portion of the trust assets;

(9) grant powers to any Trustee or person which would have the effect of having the Trust be treated as a "grantor trust" for income tax purposes but not having the Trust be included in my estate for transfer tax purposes. These powers could, for instance, include the power to designate one or more qualified charities to whom I have made charitable contributions as additional beneficiaries;

(10) after my death grant powers to My Children or another Family Member which would have the effect of having the Trust be treated as a "grantor trust" for income tax purposes with My Children or another Family Member treated as the "Grantor" of the Trust for income tax purposes. If it is desirable to do so and if it is possible to do so, I would prefer that this be done in such a

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manner that the Trust would not be included in the estate of the person to whom the Trustee has granted tax-sensitive powers for income tax purposes;

(11) amend the dispositive terms as the Trust Protector may feel would be desirable to achieve certain advantages of a unitrust but without having to adopt or convert the Trust to a unitrust. It may be possible that there will be greater income tax or other advantages possible through a simulated unitrust that would not be treated as a unitrust for purposes of the net income and other tax accounting rules or regulations;

(12) modify the Trust, or any Trust which comes into existence hereafter, after the death of My Children to make the trust terms apply and be personalized for future descendants of My Children or others who will become beneficiaries after My Children's death.

INTENT

In creating this Trust, I have intentionally focused on My Children. My Children will be its primary beneficiary. However, I realize it is quite possible due to future gifts I or others may make to this Trust that the Trust will become quite significant. If the Trust does extend beyond My Children's death, I would want all references in the terms of the Trust that refer specifically to My Children to be amended so that the Trust may become a "personalized" instrument and that My Children's descendants who may become the primary beneficiaries of the Trust in the future will be able to feel like My Children's Trust has become their Trust. The Trust Protector will have the power to accomplish that goal.

(13) modify the Trust in any manner that the Trust Protector, in his sole opinion, feels is not inconsistent with the original purposes of the Grantor and which the Trust Protector determines is in the best interests of current beneficiaries even though it may be detrimental to the interests of remaindermen in the same or more remote generations.

(e) Restrictions on Limited Power to Amend. Notwithstanding the foregoing, under no circumstances shall any Trustee participate in any amendment which may result in such Trustee or a member of such Trustee's family receiving any financial or other benefit from any such Trust, other than the Trustee's right to compensation for its services under the terms of this Agreement. In addition, no Trust Protector acting under Article 8 shall have the right to propose or make any amendment to:

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- (1) extend the period of any Trust's existence beyond the already applicable rule against perpetuities limitations period, if any;
- (2) invalidate any S corporation election or render the Trust ineligible to be an S corporation shareholder;
- (3) reduce in any way the restrictions and limitations on:
 - (i) fiduciary actions and powers as set forth in this Agreement;
 - (ii) the Trustee's limited power of amendment; and
 - (iii) all provisions referred to in (i) and (ii) above may, however, be amended irrevocably and be binding on successors, to increase such restrictions and limitations in any way such amending Trust Protector may deem appropriate;
- (4) give (i) any Trustee any powers or discretions that are either granted exclusively to another Trustee or from the exercise of which such Trustee is excluded for any reason or (ii) anyone acting in a nonfiduciary capacity any powers granted herein to fiduciaries unless, in either case, such amendment will not have any adverse tax effect on such Trust or any of its beneficiaries;
- (5) result in any accessing of the Family Bank's capital by or distributions to any individual who is not at the time of such amendment both (i) a Family Member, and (ii) already a present or contingent beneficiary of such Trust(s) (unless it is to provide for afterborn or afteradopted children of My Children); or
- (6) make any change that would have the effect of disqualifying any such Trust insofar as such Trust, prior to such amendment, otherwise qualified for and was in fact already taking advantage of, while such advantage otherwise will continue, (i) any exception from a surviving spouse's elective right or from any creditor's right to levy on any beneficiary's interest in any such Trust or (ii) any substantial deduction, credit, exclusion, or other tax benefit (such as any marital or charitable deduction, any annual gift tax exclusion, a section 2032A election, a generation-skipping tax exemption, the opportunity to be a stockholder in an S corporation, a significant grandfathered status under some changed law, and so on).

2.06 Procedures for Amendment. If the Trust Protector does not possess these credentials and experience, then the Trust Protector, prior to exercising the power to amend in this Article 8, shall first consult with a CPA or independent legal counsel, with at least ten years of experience primarily in the areas of tax law and estate planning, and who is widely regarded within his or her community as being an expert in such matters. Such consultation shall be for

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the purpose of gauging what the potential tax consequences, if any, of the potential amendment will be on the Trust, the beneficiaries, and myself, if I am still living. If the Trust Protector feels it is advisable the Trust Protector may, but isn't required, to obtain a tax opinion that such amendment will not result in any adverse tax consequences. Any amendment shall be by written instrument, executed by the Trust Protector with the authority to make the amendment, with all the formalities of a deed, setting forth the Trust or Trusts hereunder to which the amendment applies and the effective date of such amendment.

2.07 Amendment or Release of Power to Amend. This limited power to amend may be released by any Trust Protector at any time, and such release shall be binding on such Trust Protector, Trustee and all future Trust Protectors and Trustees serving hereunder unless the release specifies that it is effective only as to the Trust Protector or Trustee releasing such power or a specific class of Trust Protectors or Trustees described in such release.

Liability of Trust Protector. Once the Article 8 special powers are activated, and only so long as those powers are activated, the Trust Protector who is vested with those powers shall be under an obligation to act in good faith and to use reasonable judgment, but shall not be considered to be a fiduciary for any other purpose unless such Trust Protector is also serving as a Trustee hereunder. Hence, the Trust Protector shall have no duty to act impartially in terms of balancing the interests of vested or contingent remaindermen against the interest of My Children who is currently eligible to receive distributions from a Trust administered hereunder. Instead, the Trust Protector's primary interest shall be in the well-being of My Children and the interests of remaindermen are entirely secondary. Furthermore, the duty of any Trustee not to withhold income which would be payable to an income beneficiary shall not apply to the Trust Protector. In fact, the Trust Protector must take into account my strong desire to see that the distributions and assets of any Trust established for My Children and her descendants not be jeopardized by actual or potential legal entanglements or other circumstances which impair My Children's or any other beneficiary's ability to appropriately benefit from such resources. In making determinations of whether it is in the best interests of My Children to direct the Trustee to withhold distributions or recommend that the Trustee make distributions, or to grant, suspend or rescind rights of withdrawal, the decision of the Trust Protector shall be final and conclusive.

Liability of Initial Trust Protector. Howard Strauss, CPA shall have no liability whatsoever merely by being designated as the initial Trust Protector. If one or more of the Article 8 special powers are activated and Howard Strauss, CPA assumes one or more of those powers, then his fiduciary responsibilities and liability shall be governed by the provisions of Section 8.08. Once Howard Strauss, CPA, or any other duly designated Trust Protector,

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deactivates, pursuant to Section 8.03, any of the Article 8 special powers, he will not have any further responsibility or liability with respect to those powers which he has relinquished.

Interaction of Trust Protector and Any Other Independent Trustee. Howard Strauss, CPA has been designated as the initial Trust Protector and he would be someone whom My Children should feel most comfortable approaching about acting as the Trust Protector for purposes of exercising one or more of the Article 8 special powers. If Larry is unable or unwilling for any reason to act as Trust Protector, I would strongly encourage those who possess the power to activate the Article 8 special powers to consult carefully with one or more of my long-time advisors on legal or financial matters as to who might be the best candidate to serve as the Trust Protector holding one or more of the Article 8 special powers. I also encourage any Trust Protector designated pursuant to Section 8.02 to consult frequently and in depth with my legal and financial advisors as the Trust Protector considers whether and how to exercise his or her discretion hereunder.

INTENT

I intend that the Trust Protector will act as an "ombudsman" and advocate for My Children. But it is also possible that the Trust Protector will have to administer "tough love" or direct the Trustee to say "no" to My Children's or any other beneficiary's request. In the event that the Trust Protector is suggesting that the Trustee say "no" to My Children's or any other beneficiary's request I would expect the Trustee would always consult with any then-serving Trust Advisor as well. Furthermore, the Trust Protector should always pay careful attention to the feelings of the then-serving Trust Advisor about what is in the best interests of My Children.

2.08 Indemnity Provisions.

(a) **Indemnity of Trust Protector.** The Trust Protector shall be indemnified against any claims made against the Trust Protector by any third party. The Trust Protector shall also be indemnified against claims made by My Children or any other beneficiary or any remainderman so long as the Trust Protector has acted in good faith. The Trust Protector shall only be liable for failure to recommend that the Trustee make a distribution, for granting, suspending or rescinding a right of withdrawal, or for imposing conditions or limitations on distributions or the exercise of rights of withdrawal, if the court determines the Trust Protector has acted in bad faith. The finding of bad faith shall require a strong preponderance of evidence that the Trust Protector has abused the discretion given hereunder and acted contrary

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to the express terms of this Agreement. The power of the Trust Protector to recommend that the Trustee make a distribution, or to cause the Trustee to suspend, rescind or impose conditions or limitations on distributions or rights of withdrawal shall be liberally construed in favor of permitting the Trust Protector to act in the manner the Trust Protector feels is in the best interests of My Children even if the Trust Protector feels that requires withholding all distributions and assets from My Children for some particular timeframe.

INTENT

I intend that the initial Trust Protector as well as any other Trust Protector who is exercising the Article 8 special powers will be protected by this indemnification.

(b) **Indemnity of Trustee.** When a Trust Protector has acted, the other Trustees who carry out the instructions of the Trust Protector holding the Article 8 special powers shall be indemnified against and are hereby relieved of any liability resulting from breach of trust, failure to act, or liability resulting from actions taken by the Trust Protector. The other Trustees who do not hold any of the Article 8 special powers shall also be relieved of any duty or responsibility to review actions of any Trust Protector who holds those powers. Furthermore, the Trustee is also relieved of any liability and shall be indemnified against any costs resulting from actions taken in compliance with the directions of the Trust Protector or from any claims which are asserted as a result of inaction of the Trust Protector.

ARTICLE 3: APPOINTMENT, REMOVAL AND SUCCESSION OF TRUSTEE**3.01 Qualifications.**

(a) Trustee.

3.02 Appointment, Removal and Succession.

(a) Appointment of Additional Trustees and Trust Protectors.

(1) Appointment of Additional Trustees.

(2) Appointment of Trust Protectors. *If no Trust Protector is then-serving, an Independent Trustee or anyone who possesses and is then authorized to exercise the power to remove and replace a Trust Protector under Article 9.02(d) may appoint a Trust Protector. The appointment of a Trust Protector shall be by signed notice filed in the trust records and delivered to each appointed Trust Protector, as well as to the adult beneficiary, if any. The appointment may be for general or limited purposes and for a specified or indefinite term. The appointment shall be effective upon delivery of the*

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notice of appointment to the appointed Trust Protector or on such later date as may be specified in the notice.

(b) **Resignation or Incapacity.** A Trustee or Trust Protector may resign at any time by signed notice filed in the trust records and delivered: (i) in the case of the Trustee, to the Trust Protector of the Trust for which the Trustee is serving, and (ii) in the case of the Trust Protector, to the Trustee for the Trust for which the Trust Protector is serving. If there is another Trustee or Trust Protector serving at the time of such resignation, the resignation shall be effective on the date the notice of resignation is filed in the trust records or on such later date as may be specified in the notice of resignation. If there is no other Trustee or Trust Protector serving at such time, the resignation shall be effective on acceptance by a properly appointed successor Trustee. A Trustee or Trust Protector who becomes incapacitated shall be considered to have resigned as of the date the physician's statement certifying the Trustee's or Trust Protector's incapacity is filed in the trust records.

(c) **Removal and Replacement of Trustee.**

(1) **Prior to My Death or Incapacity.** *While I am alive and not incapacitated, I shall have the power to remove and replace a Trustee at any time, provided that the person I appoint as a successor Trustee is not related or subordinate to me.*

(2) **After My Death or Incapacity.** *After the date of my death or incapacity, the following persons successively shall have the power to remove and replace the Trustee, in the order indicated:*

(i) My Children, with the concurrence of at least one other Trustee if she is serving as a Trustee or otherwise with a majority of the then-serving Trustees, may remove and replace the Trustee with anyone who would meet the definition of an Independent Trustee. If My Children wants to replace a person who doesn't qualify as an Independent Trustee with someone who doesn't satisfy the definition of an Independent Trustee the appointment of the replacement Trustee may only be made by either a duly designated and activated Trust Protector or by Independent Trustees.

(ii) After the death or incapacity of My Children, or if My Children is not then eligible to remove and replace the Trustee under Article 9.02(c)(2)(i), the Trust Advisor may remove and replace the Trustee, and if there is no Trust Advisor then-serving, my surviving adult child, if any, may exercise the power to remove and replace a Trustee or may delegate that power to (A) a majority of the adult beneficiaries who have reached the age of 25

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years, (B) a committee specifically appointed by My Children during her lifetime for this purpose or appointed by the Trust Advisor after My Children's death to exercise this power, or (C) by a duly designated and activated Trust Protector. If none of my children are alive or capable of exercising this power to remove and replace the Trustee, then the Trust Advisor, acting in consultation with the adult beneficiaries, if any, may either exercise the power itself or may delegate the power to those described in (A) or (B) of the previous sentence.

(d) **Removal and Replacement of the Trust Protector.** Any person appointed to be Trust Protector under the provisions set forth below must satisfy the eligibility requirements of an Independent Trustee.

(1) **Prior to My Death or Incapacity.** *While I am alive and not incapacitated, I shall have the sole power to remove and replace the Trust Protector at any time.*

(2) **After I Am Deceased or Incapacitated.** *After my death or incapacity, the following persons successively shall have the power to remove and replace the Trust Protector, in the order indicated:*

(i) The Trust Advisor may activate or remove and replace the Trust Protector.

(ii) My Children.

(iii) After the death or incapacity of My Children, or if My Children is not then eligible to remove and replace the Trust Protector under Article 9.02(d)(2)(ii), the following shall also have the power to activate and to remove and replace the Trust Protector: (A) a child of mine; (B) a committee specifically appointed for this purpose by My Children during her lifetime or an Independent Trustee; or (C) an Independent Trustee. If none of my children are alive or capable of exercising this power to remove and replace the Trust Protector, then an Independent Trustee, acting after consultation with the adult beneficiaries, if any, may either exercise the power itself or may delegate the power to a committee described in the previous sentence.

(3) **Notice of Removal.** *Any removal of a Trust Protector shall be accomplished by a signed notice filed in the trust records and delivered to the removed Trust Protector, the Trustee and the Trust Advisors for the Trust for which the Trust Protector is serving. The removal shall be effective on the date the notice of removal is delivered to the removed Trust Protector.*

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**Notice of Activation of Trust Protector to the Trustees and
Adult Qualified Beneficiary of the Southfork Ranch Dynasty Trust and
Designation of Trust Protectors**

by John A. Warnick, Esq. LLC. © All Rights Reserved.

THIS NOTIFICATION OF ACTIVATION OF TRUST PROTECTOR AND DESIGNATION OF TRUST PROTECTOR (the "Notification of Activation of Trust Protector and Designation of Trust Protector" or the "Activation and Designation") is made and given this 1st day of January, 2011, by John Ross "J.R." Ewing, Jr. As a Co-trustee (the "Designating Trustee") of the Southfork Ranch Dynasty Trust (the "Irrevocable Trust").

Background

1. The Irrevocable Trust was created by a trust agreement (the "Trust Agreement") executed between by Eleanor Southworth Ewing, who is also known as Eleanor "Miss Ellie" Ewing (referred to herein as the "Trustor"), as the Trustor, and John Ross "J.R." Ewing, Jr., of Dallas, Texas, and Cattleman's Bank and Trust Bank, of Parker, Texas, as Co-Trustees.
2. The Irrevocable Trust was created for the primary benefit of Bobby Ewing ("Bobby" or the "Primary Beneficiary") but distributions can also be made to the descendants of Bobby Ewing. Bobby is the sole Adult Qualified Beneficiary of the Irrevocable Trust.
3. The Trustee has administered the Irrevocable Trust pursuant to Texas law.
4. The Designating Trustee of the Irrevocable Trust is a resident of Dallas County, Texas.
5. Pursuant to Section 4.02 of the Trust Agreement the Designating Trustee was given the power to designate a Trust Protector during his lifetime. Furthermore, that same authority allows the Designating Trustee to specify which powers of the Trust Protector which will be activated.
6. NOW, THEREFORE, the Designating Trustee hereby gives notice of his intent to activate the powers of the Trust Protector under the Trust Agreement and to designate Harv Smithfield, Esq., as Trust Protector to determine, in his sole discretion, how and whether the powers of the Trust Protector should be exercised as follows:

Designation and Activation

ARTICLE 1: Harv Smithfield, Esq., of Dallas, Texas, is hereby designated as Trust Protector ("Trust Protector") to serve until he deactivates these powers or until his death or incapacity, whichever first occurs.

ARTICLE 2: The Trust Protector is hereby vested with the power to amend the Trust Agreement so as to cause the Trust to:

[Please Use Your Imagination to Come Up with a Series of Purposes J.R. Would Have Had for Wanting to Have the Southfork Ranch Dynasty Trust Amended]

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ARTICLE 3: The Trust Protector is further vested with such other powers as he feels are necessary to allow him to accomplish the purpose of this Activation. The duties of the Trust Protector shall be performed according to the express terms and conditions provided under the Trust Agreement.

There is no pre-existing agreement between the Trust Protector and the Designating Trustee or any other person on how or whether the Trust Protector will exercise any of all of the powers activated hereby.

In Witness Whereof, the undersigned has signed this Notification of Activation of Trust Protector and Designation of Trust Protector and will deliver the same to all trustees and adult qualified beneficiaries of the Irrevocable Trust.

John Ross "J.R." Ewing, Jr., Designating Trustee

Date

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**AN OPEN LETTER FROM THE GRANTOR TO THE BENEFICIARIES ON
THE ROLE OF CORPORATE TRUSTEES AND THE QUALIFICATIONS AND
CHARACTER ATTRIBUTES OF TRUSTEES AND TRUST PROTECTORS**

by John A. Warnick, Esq. LLC. © All Rights Reserved.

You know that XXX Bank & Trust served for years as trustee of the trust which each of you received modest distributions from when your father passed away. Your dad and I always regretted that your grandparents really didn't build much, if any, flexibility into that trust agreement. In fairness, the trust world and the philosophies concerning the design, drafting and administration of trusts has evolved substantially in the last forty years. One of the things that we were "stuck" with in that trust was a relationship with XXX that was comfortable but never got out of the center ruts in that same old road your father's parents had gone down.

I'm sure that as we learned more about trusts, and particularly as I have had to administer your father's revocable trust for the last three years, we saw ways in which we felt we could greatly improve upon the old model your grandparents used. I'm sure that as you review this trust instrument you will come to appreciate it is 21st century in its approach and that it is built on an entirely different framework than was your grandparents' trust.

Before I share with you my observations about the qualities and background you should look for in a trustee, let me explain why I've chosen Integrity Bank & Trust to serve as "administrative trustee" of the Legacy Trust but have asked others to serve as the "investment trustee" and "distribution trustee." After thorough consideration of all of the different models for trusteeship I divided the functions of the trustee into administrative, investment, distribution, and generative categories.

I have asked Fred Wiley, who as you know was your dad's long-time CFO, to do what he and your father did so well together: making money through investments and family business enterprises. I actually intend to encourage those members of the family who want to learn about the world of investments to work along side Fred as "shadow investment trustees." But I don't expect all of you will take an interest in that and I don't have a problem if you decide you don't want to actively participate in learning the investment function. Part of being a good investment trustee is learning how to select great investment managers or advisors. Not all of your money should be allocated to the family business enterprises and private equity deals your father was so fond of. And you shouldn't go fishing in that pond (can you hear Dad saying that?) unless you have the right pole and know what the fish have been jumping at. If we lose Fred as the investment trustee, unless someone else has gained that prowess or you find someone who possesses those special skills, then I'd strongly encourage you to prudently liquidate the family business enterprises and the private equity deals and refrain from getting involved in any more.

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I would encourage any family members who serve as investment trustee in the future to avoid the danger of thinking, "I know more than anyone else does." Almost every time I slipped into that line of thinking, I ended up being humbled – usually sooner rather than later. You know that your father encouraged me to always have my own investment accounts and to follow the markets and make my own decisions after seeking advice from those individuals we trusted. Looking back now over the last three years I realize how that gave me the confidence to make it through these difficult times without your father to lean on.

At this time the generative trustee slots are vacant. I doubt they will be filled during my lifetime. But I hope you will catch the vision of how a generative trustee (or perhaps in some cases two or more separate individuals in these offices) could play a very valuable role in letting this trust become a dynamic force in building and preserving our family's wealth and values. I won't say more in this letter but will discuss that with you in our next family meeting.

One of the fundamental changes in the model I have chosen is the office of administrative trustee. I feel there are several advantages in having a corporate trustee be the administrative hub. First, the corporate trustee can provide custodial services for a very reasonable fee. If the corporate trustee has custody of the assets, it is very easy for them to provide complete trust accounting. John Warnick has told me that this is perhaps the biggest trap that honest, individual trustees get themselves into. They don't have the systems to do proper trust accounting and when they are questioned, it is often too late for them to be able to retrieve the data and prepare such accountings, or if it is available, the cost is exorbitantly greater than what it would have been if they had done this on an annual or quarterly basis.

Just because we have put a corporate trustee at the administrative hub for the trust doesn't mean that the corporate trustee's role or influence will be dominant. In fact, because of the type of assets I am transferring to this trust as well as the roles and functions we have come up with, I think it is important for the corporate trustee to understand that they will be directed and supervised in all their activities by the individual trustees. That won't be daily supervision. But when something needs to happen, the corporate trustee will be expected to respond expeditiously. I expect these individual trustees to participate actively in my efforts to prepare and educate my children and grandchildren to be great beneficiaries and to be able to have this trust "serve" the family and not merely be a channel for making quarterly distributions.

A corporate trustee might do a very good job serving as the administrative trustee. After Fred steps down as the investment trustee you could have the corporate trustee exercise the investment responsibilities or you could choose to rely on independent money managers. It will be up to the primary beneficiaries, working with the family's advisors, to stay abreast of changes in the models for trust governance and determine who to best choose and monitor the performance of the investment trustee(s) and/or advisors.

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Based on my familiarity with how corporate trustees are functioning in 2015, I would suggest that you only consider using individuals for the distribution, generative categories. Be careful about whom is chosen to serve as the distribution trustee. There are tremendous advantages in letting that role be filled by an independent trustee who has great familiarity with the individual situations of the beneficiaries.

The generative role of the trusteeship should be filled by an individual trustee. Or you may feel it appropriate to use a trust protector or a protective committee comprised of trustees, consultants, family members, etc. to best mentor the younger beneficiaries. I have deliberately chosen to give you and the trustees a great deal of latitude in how these roles will be filled and would caution you to always be seeking to improve on the trust governance arrangements so that they are always serving the best interests of the beneficiaries.

Now let me share with you some general observations about what I would suggest you do with regard to the actual role of the Trust Protector. At John Warnick's suggestions I've included the role of Trust Protector to give this Legacy Trust what we are calling rigid flexibility. You will find that the role of Trust Protector allows the trust to deal with any situations which I may not have contemplated. Because I don't know what the future may bring I've intentionally given the Trust Protector broad powers. This is both a positive but it could be a negative if that power ends up in the hands of the wrong individual(s).

I've suggested that, based on my experiences and current vantage point, you select your trust protectors from the types of professions I have outlined. This role is very demanding and requires great familiarity with not only how our trust was set up to function but what is going on in the world of trusts in terms of changes in investment philosophy, tax laws, administrative policies or trustee powers.

I think it is very important that anyone who is appointed to serve as Trust Protector get to know my family on a personal basis. They should demonstrate, both by their words and their actions, a great sensitivity and concern for the beneficiaries but I also feel they owe a duty of loyalty to me as the creator of the Legacy Trust to always consider what my primary purposes were in creating this trust. Unfortunately, individual Trust Protectors don't last forever. They do wear out, become incapacitated or die. I will discuss below how the impact of these risks of incapacity or a significant reduction in their analytical skills or judgment because of aging or illness, can be lessened through having co-trustees or trust advisors who are willing to assume the responsibility of the Trust Protector at some point in the future. I've chosen our long-time corporate attorney, Jim Phelps, as the person who would serve as Trust Protector if you didn't nominate anyone else at the time you activate the office of Trust Protector. But Jim will probably retire in the next ten years. I've suggested his daughter, Susan, as his back-up because she is slowly being mentored to take over her dad's clients and she knows each of you pretty well.

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I trust their judgment and know that each will know when it is time for him or her to step aside and let a younger trust protector assume the role of Trust Protector.

When you begin to give very careful thought to whom will fill Jim's and Susan's shoes I hope you will consider my thoughts on the attributes and qualifications of the ideal trust protector. Recruit one or more individual(s) who you expect will serve for at least 10 to 30 years if they prove to be an outstanding selection. Give them an opportunity to serve alongside Jim and Susan in a Trust Protective Committee. This would provide a unique opportunity to let Jim and Susan "transfer" their perspectives on our family values and traditions. It would also give the "new" trust protector a clearer vision of the ways in which the purposes of this trust blend into your lives.

I don't think I can stress enough how important communication and family financial education are to accomplishing the goals I have for this trust. So as you choose your trustees and trust protectors make sure you don't pick someone who is so busy that they cannot attend meetings, can't find the time to get to know the beneficiaries and get involved and really understand the family's business and investment assets.

Now let me close with just a few comments on selecting trustees. You know how important I feel it is to have a corporate trustee in the role of administrative trustee so that you have a solid handle on the compliance and accounting functions. But I certainly don't discourage you from selecting individual trustees for the other roles of the trusteeship.

I believe that for both the trust protectors and trustees the single most important factors are integrity, availability and communication skills. In addition to time and accessibility, however, it is important that an individual trustee possess a good knowledge of or have significant experience with investments and accounting. Your trustees should have enough experience, analytical ability and judgment that lawyers and investment bankers won't intimidate them. An individual trustee doesn't have to be a lawyer but it would be extremely helpful if they have the temperament to work well with the trust's legal advisors and understand the importance of complying with laws and regulations and staying abreast of opportunities and challenges.

Don't choose a trustee based on just what trustee fees or charges will be. Trustee fees are negotiable as a general rule. But be mindful you often get what you pay for in trust services as well as other areas of life. I have always been willing to pay a premium fee for services if I was convinced I was receiving value commensurate or in excess of the fees I was paying. Be aware of the "bundling" of trust fees. Unfortunately, I know from talking with friends and associates that too often corporate trustees haven't been as transparent as they should be about what hidden or back-end charges they may be receiving.

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In evaluating candidates to serve as trustee, whether it be individuals or corporate trustees, I think it would be helpful to have a list of personality and character traits which should be possessed by anyone who would serve as trustee of our family's trusts. If you are interviewing corporate trustees, look for these characteristics in all of the employees who would be working with the trust. No institution will be so homogenous that you will find all of its employees fit this profile. But be careful. It only takes one distasteful personality to make a professional or business relationship unbearable. I've included on the next page some thoughts on what you should look for in the ideal trustee in terms of personality, character and background.

PERSONALITY AND CHARACTER TRAITS OF THE IDEAL TRUST PROTECTOR

Honest	Can Say No Gracefully
Wise	Common sense – not just book smart
Not power minded	Good Listener
Epitomizes High Values and Integrity	Asks the "right" questions at the right time
Doesn't play games	Logical
Down to earth	Can relate to and get along with people
Honors confidential information	Can see the big picture, as well as the details
Respectful	Compassionate and Empathetic
Won't bend under pressure	Willing to learn
Brings out the best in people	Thoughtful
Sense of humor	Patient
Loyalty	Shuns self-dealing or the appearance of it

BACKGROUND AND EXPERIENCES THAT MIGHT PROVE HELPFUL FOR THE IDEAL TRUST PROTECTOR

Trust Administration	Legal – particularly tax or estate planning
Family Wealth Consulting or Coaching	Finance or Private Banking
Accounting	Investments

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"Trust Protectors: What Are They and Why Probably Every Trust Should Have One"

CASE STUDIES: TRUST PROTECTOR

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Case Study #1 Grantor's Remorse

Doug is a serial entrepreneur. Twelve years ago he and Sandy established a GST Exempt Trust for gifting purposes. At the time neither Doug nor his advisors anticipated three things which are creating significant stress—what I call Grantor's Remorse—in 2009:

- The "investment performance" of the asset which was used to fund the trust caused the trust to grow from \$1.2 million at its inception to almost \$250,000,000 today.

Challenge: The GST Exempt Trust was designed as a family pot trust. The family wants to create much more of an ownership mentality among the beneficiaries. The pot trust really doesn't lend itself to that. What might we do to increase each adult beneficiary's feelings of "trust ownership"?

- The trust was created in a jurisdiction which has a significant state income tax. This would not have been a problem if the trust had only grown to the level originally anticipated--\$5 or \$10 million. At those levels the income of the trust when spread over Doug and Sandy's descendants would not have been so great that there was likely to be significant accumulations in the trust. But at its current value the expected taxable income is going to be far more than the family is comfortable distributing.

Challenge: What can we do to insulate the trust from state income taxation? Can we change situs of the trust to a state which doesn't have a state income tax? Can we do that without changing trustees? If not, is there a way to take create a role for one or more of the existing trustees without creating an income tax problem for the trust? Could the the right trust protector make a difference?

- The trust's investment boilerplate isn't 21st century. The distribution model is based on a HEMS standard.

Challenge: There are several levels of opportunity and challenge here. First, a large percentage of the trust is tied up in a single position. What can we do to permit the trustee to continue that pattern of overconcentration? Second, the HEMS standard is completely out of touch with the economic reality of this trust. The family would like to use the GST Exempt Trust as a Family Bank. They would also like to be able to ask the Trustee to support the family, as a whole, or an individual

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number of the family who desires to explore their philanthropic mission. What could a trust protector do to assist?

Questions to consider include:

- How Might a Trust Protector Help in These Situations?
- What Type of Trust Protector is Needed to Effectively Solve This Dilemma?

Case Study #2 The Dysfunctional Beneficiary

Nancy George died two years ago in a private plane accident after working a lifetime to build up a profitable business (George Industries) with worldwide sales. Nancy grew up in a very poor town in West Texas. Her father was an alcoholic. Nancy fled the physical and emotional abuse at age fourteen and finished high school in an adjoining state in the home of her mother's brother, a disabled vet. She learned early on to take care of herself and to help bring in money to support her family.

Nancy saw her wealth as means of providing lifetime security and comfort for her children and grandchildren. She wanted to see the business remain in the family and be a source of employment for her children and grandchildren. She never wanted any of them to suffer through the struggle she faced. So Nancy's will created two trusts, a GST exempt trust and a non-exempt trust, with XYZ Bank & Trust as trustee. Nancy has two children, Peter (28) and James (26), each of whom has struggled since Nancy's death.

Peter

Peter was a star athlete in high school. His devotion to soccer excused his poor performance in the classroom. He got a soccer scholarship to a prestigious East Coast institution but for reasons Nancy never fully understood ("the coach just didn't understand me and we never got along") he lost his scholarship half-way through his sophomore year. Peter did graduate eventually with a "C" average and had a great time at school. He agreed to come into the family business as a sales trainee but was quickly promoted and given the title of "Assistant Vice President" in the marketing department. Within two years Peter was given responsibility for European sales. Nancy helped Peter buy an expensive flat in London. The distance and generous access to a trust fund his mother had created that gave him quarterly distributions that were twice his salary helped hide a dark side to Peter's life: more than recreational drug usage.

After Nancy's sudden death Peter's life spiraled downward. He ended up in a London hospital on a drug overdose and was admitted to a treatment program. The trustees thought that Peter had overcome his drug habit but there are disturbing signs recently that Peter might be out-of-control

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again and his boss has delicately suggested to the interim CEO that they find another position for Peter that isn't quite as demanding or critical to the long-term success of the business.

James

James was the good student in the family. And he has excelled in the financial reporting side of the family business. His aptitude for numbers is incredible. He just completed his MBA and has been named as the CFO's special projects coordinator. Some of the company's executives, including his boss, see James as the "future" of George Industries. What they don't know is that James' fascination with numbers plays out in weekend trips to Las Vegas, Reno or Atlantic City. James has accumulated huge gambling debts as well in betting on sports teams. The trust's distribution model is based on "best interests" and "absolute discretion" and the trustee's legal department has been asked what duty, if any, the trustee has to deal with the dysfunction which has become obvious to this point.

Questions to consider include:

- How Might a Trust Protector Help in This Situation?
- What Type of Trust Protector is Needed to Effectively Solve This Dilemma?
- Would a Trust Protector Be Willing to Act If the Bank Isn't?
- What Language Might Be Helpful to Convince a Trust Protector to Take a Proactive Approach?

Case Study #3 The Recalcitrant Trustee

John Dodds was a successful entrepreneur. Late in his business career he hired a young corporate attorney, Reginald C'trant, to serve as his general counsel. Reg, as John and his children called him, served John and his family in a variety of non-legal capacities. Eventually, in John's final years and bowing to pressure from his children, Reg reluctantly formed the Dodds Family Office and became its first head. When John signed his last will, Reg was named as trustee and John insisted on leaving control over both the family enterprises and the trust structures to Reg. There was no right of removal vested in the hands of the beneficiaries. The only judicial grounds for removal in the state where the trust is going to be administered is breach of fiduciary duties.

Now 28 years after John's death the following has occurred. Two of John's three children have passed away. The surviving child is incapacitated. The grandchildren range in age from 57 to 36. For the first couple of years after John's death Reg continued the tradition of holding family meetings. Eventually, however, those meetings stopped and communication between the trustee and the beneficiaries worsened. Behind Reg's back stories are being shared within the third generation that are pretty unflattering and raise questions about whether Reg truly has the family's best interests at

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heart or whether his agenda is simply to make his life as financially rewarding and hassle free as possible. Reg's patience wears awfully thin with what he feels are incessant demonstrations of entitlement among the third and fourth generations of the family. Recently, the eldest member of the third generation approached Reg and suggested the family needed to start exploring trustee succession issues. Reg exploded at this suggestion and said that he had already designated his successor trustee. He refused to identify who that individual was which left the family to worry about the mystery successor trustee. At this point some family members are demanding Reg resign or at least designate a co-trustee but other family members don't want to become directly adverse to Reg and fear this could drive a big wedge between family members.

Questions to consider include:

- How Might a Trust Protector Be Helpful in This Situation?
- What Mechanism Might Best Trigger the Role of the Trust Protector?
- Would a Five Year Peer Review Protocol Be a Good Thing to Use in this Situation?
- What Precautions, if any, Do We Need to Build into the Trust Protector Role to the Independence of the Trustee?
- If the Trust Protector is Appointed by the Trustee Will That Independence Really Be Present?
- What if the Trust Protector is Appointed by the Beneficiaries?

Case Study #4 Unitrust Decision/Unitrust Crisis

Henry Rooks passed away in early June, 2003. Henry was survived by his third wife, Karen, age 58, and by his three children, Mark, age 67, and his twin daughters by his second wife, Carolyn and Michelle, who just celebrated their 57th birthday. Henry's trustee is a corporate trust department inside a regional bank. Henry's will provided that an exemption trust would be created for the benefit of his children, primarily, and for his spouse only if the distributions from the Marital Trust are not sufficient to maintain her lifestyle in which case the trustee may distribute income from the exemption trust and principal, if necessary, to Karen.

Mark is a Senior Vice President of a public company and lives in New Jersey. Mark, who has no children, actually disclaimed any benefit from the exemption trust. His only interest in the trust today is the fact that he is a remainderman of the Marital Trust. His New York estate planning attorney has been watching over the actions of the trustee to "protect", in Mark's words, his sister's interests.

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The Marital Trust provided for the payment of all income and sufficient principal to maintain Karen in the lifestyle she was accustomed to at the time of Henry's death. The Marital Trust represents almost 90% of Henry's estate. The remainder beneficiaries of the Marital Trust are Henry's children and Karen's child from a prior marriage was excluded entirely from Henry's plan.

Henry and Karen had enjoyed a lavish lifestyle with a winter home in Palm Springs, their primary residence in St. Louis, and a summer cabin in upper Michigan. The trustee suggested that Karen purchase Henry's interest in the winter home in Palm Springs and the primary residence in St. Louis. The trustee set these up on 30 year mortgages with interest at the long-term AFR. The trustee was going to fund a portion of the exemption trust for the children with the summer cabin as Henry's all have a sentimental attachment to that long-term family asset.

Karen was first upset to find out that she didn't own the primary residence and winter home. She had always understood Henry to say "you don't have to worry about anything if I pass away. You will always have our homes and more than enough cash and income to live comfortably." Initially she balked at the trustee's suggestion that she "buy" her homes. But the key factor that convinced her to move forward on that plan was the fact that if she bought those two properties her heirs, rather than Henry's children, will enjoy the benefit of any appreciation in the value of the properties. She is still upset that the value of the homes at the time of Henry's death will go to his children and that significant cash flow she thought might be reinvested for the long-term benefit of her children will now have to be used for mortgage payments.

To the trustee's credit they understood the sensitivity of these issues. Through the financial modeling the bank's financial planners did they were able to help Karen understand that at least in the early years of the mortgage she would get almost all of that cash flow back through the net income provision of the trust. However, Karen's new attorney suggested that she ask the trustee to make the mortgage an interest only mortgage. This, of course, caused Mark to blow a gasket. He realized that the real estate constituted almost 40% of the Marital Trust. An interest only mortgage would be similar to investing in bonds. Interest rates were extremely low and the initial negotiations between the trustee and Karen's attorney were going to set that interest only mortgage at 4.75%.

Mark's New York counsel prepared a lengthy memorandum suggesting that the trustee take advantage of the unitrust conversion statute. This would allow the trustee to invest the remaining 60% of the trust assets on a total return basis. Due to the building hostility the trustee's legal department insisted the trustee seek input from all of the beneficiaries and remaindermen on the plan to convert the QTIP Marital Trust to a unitrust. The trustee proposed paying 4% of the value of the Marital Trust, each year, to Karen in lieu of the net income. This was quite satisfactory to Mark and his attorney. However, it incensed Karen to realize that she wouldn't be getting all of the

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interest she would be paying back as income. But ultimately her attorney convinced her that she should accept the unitrust conversion proposal because it would assure that she would receive 4% of the entire value of the Marital Trust which they felt would be significantly more than what the net income would have otherwise been.

The unitrust idea worked well until late 2008. But in the economic blizzard of 2008 the value of the Marital Trust's portfolio fell by almost 50%. There was no smoothing clause in the unitrust. So the trustee had the difficult task of advising Karen that her income for 2009 was going to decline by almost one-third. The trust's legal department, in a review of the document, discovered it contains a trust protector clause.

Questions to consider include:

- How Might a Trust Protector Help in This Situation?
- What Type of Trust Protector is Needed to Effectively Solve This Dilemma?
- Would a Trust Protector Be Willing to Act If the Bank Isn't?
- What Language Might Be Necessary or Helpful to Convince a Trust Protector to Step into this Crisis?

Case Study #5 The Deadlocked Trustee(s)

Nancy George died two years ago in a private plane accident after working a lifetime to build up a profitable business (George Industries) with worldwide sales. She wanted to see the business remain in the family and be a source of employment for her children and grandchildren. Nancy named two trustees. One was Harold, her Vice-President for Finance. The other trustee was Richard, a long-time family friend and the key wealth manager for Nancy's investment assets.

Harold

Harold is both a CPA and MBA. He is the numbers guy inside George Industries. Of the current management team Harold has been around the longest. After Nancy's death he became increasingly suspicious of what was going on with James who had been his budding protégé. Unfortunately, the auditors confirmed his intuitive discomfort when they discovered a very complicated financial scheme which James had engineered and used to essentially embezzle several hundred thousand dollars from the company. Harold blew the whistle on James which he found to be a distasteful and most difficult responsibility. Needless to say, the relationship with James that had once been so promising is now shattered.

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Harold believes his duties as trustee are to not only the family but he feels a moral obligation to the employees and management of George Industries as well. Nancy had employed many people who were from backgrounds not unlike her own. Many of them don't have great job skills but have been able through the training opportunities provided at George Industries become productive at specialized tasks in the manufacturing processes. But there really aren't any other employers near Midland/Odessa who could use those skills. With the downturn in the oil and gas industry Harold is worried what would happen to these individuals if the company were sold. He knows that because of the age of the company's plant and machinery it is likely that a purchaser would export the jobs and just keep the distribution and marketing channels.

Richard

Richard's business has been significantly impacted by the Economic Blizzard of 2008. On the positive side he has become much closer to Peter and James since their mother died. And he is happy to accommodate them however he can. He is proud that he has been the "first contact" point between Nancy's sons and their wealth.

While Nancy was alive he was happy to see the business growing and thriving because it meant that Nancy had a 20%-25% annual growth in her liquid assets as well. Since Nancy's death, both Peter and James have become very critical of the management team. Since he was forced to resign his position, James has done an in-depth review of the company's financials and has suggested to Richard that the return on the business assets isn't nearly what it should be. Management has just submitted a business plan which calls for significant capital expenditures over the next five years and this will significantly reduce the distributions and dividends and will still require incurring substantial debt.

The Plan and The Deadlock:

Harold not only favors the plan. He was instrumental in formulating the plan. He sees it as a bold but justified step that is necessary to allow George Industries to compete in a global economy with much lower cost producers outside the U.S. He doesn't understand why Peter and James can't see the long-term benefits. And he feels that Richard is motivated by the opportunity to significantly increase his compensation through the assets under management.

Richard is armed with the numbers and a proposal from an investment banker to shop the company. Harold and Richard have met twice during the last month and each meeting has ended badly. They are dug into what seems like an irreconcilable deadlock. Neither can advance his agenda without the other. And both have retained lawyers to protect them. It is getting really expensive and the fight hasn't even started.

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Questions to consider include:

- How Might a Trust Protector Be Helpful in This Situation?
- What Mechanism Might Best Trigger the Role of the Trust Protector?
- What Type of Trust Protector is Needed to Effectively Resolve This Dilemma?
- What Enabling Language Would Best Assist the Trust Protector in Breaking the Deadlock?

Case Study #6 The Migrant Beneficiary

Norman Contreras fled to the U.S. with his parents from communist Cuba. Norman's parents established a highly successful "mercado" business in Little Havana. His older sister and her husband moved to Tampa and established another store. Then in the early 1980's Norman moved to Southern California where he opened the first branch of the family business outside of Florida. Norman's children graduated from high school in California and all but one of them has ended up going to work for the family business. Norman's oldest child graduated from UCLA medical school and after his residency in cardiology has joined a practice in Las Vegas. Norman and his wife, Norma, are exploring the option of moving to Las Vegas to be nearer to their new granddaughter. Norman wants to know if such a move might reduce the burden of California income taxes on himself and the trusts of which he is a beneficiary or co-trustee.

Three years ago Norman's mother passed away at age 92. She had been a widow for twenty years. She sold the Florida stores to her daughter and son-in-law in the late 1980's. About ten years ago she agreed to sell her interest in Norman's California operations to Norman. A prominent firm in South Florida suggested that this sale be made to an intentionally defective grantor trust (the "IDGT") that would be GST exempt. Norman serves as a co-trustee with his Los Angeles corporate attorney. The trust holds about a 40% interest in the LLC which owns the real estate in California that leases on a triple net lease to the Mercados and other tenants. The trust also holds about 30% of the C Corporation which operates the Mercado business. This trust is generating approximately \$2,000,000 a year in taxable income, most of which is California source income from the real estate. Norman intends to start investing significant after-tax cash flow in marketable securities and perhaps some Nevada real estate.

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Norman's share of his mother's estate also ended up in a multi-generational trust known as the Isabel Contreras Trust. It isn't GST exempt and its assets consist of non-California real estate and marketable securities. It's currently estimated to be worth about \$15 million and is generating approximately \$1,000,000 a year of distributable income. Norman has been receiving \$150,000 a year (\$12,500 a month) from this trust since his mother's estate was settled.

The provisions of the two trusts are similar in some respects such as the trusteeship but quite different in others. The Isabel Contreras Trust provides that the trustee shall distribute to Norman, as the primary beneficiary, such amounts of income and principal as are necessary for the beneficiary's health, maintenance, support and education.

The IDGT provides that an independent trustee, in that trustee's sole and absolute discretion, may distribute to Norman such amounts of income and principal as such trustee deems advisable for the best interests of Norman and Norman's descendants so long as such distributions wouldn't jeopardize Norman's reasonably foreseeable needs for health, education and support.

The IDGT grants Norman a broad special power of appointment over the trust assets. The Isabel Contreras Trust grants Norman a testamentary general power of appointment.

The tax partner of the California corporate lawyer has advised Norman and his co-trustee that Norman won't significantly reduce California income tax in the IDGT because of the California source income. Even if Norman is successful in gradually reinvesting after-tax cash flow from the real estate into assets that wouldn't be California source income there are problems with potential California state income tax because of the terms of the trust and the residency of its trustees. Norman moving to Nevada would still leave this trust with one California resident resulting in at least 50% California taxation on the non-California source income.

The picture on the Isabel Contreras Trust is bleaker. The tax attorney advises Norman that the distribution language in that instrument and the general power of appointment makes him a non-contingent beneficiary for California income tax purposes resulting in taxation of the trust's non-distributed income so long as Norman remains a resident of California.

The tax attorney also advises Norman that if a trust protector is appointed for either trust to try to remodel the trusts to avoid California state income taxation that the trust protector should be a non-California resident.

Questions to consider include:

- How Might a Trust Protector Be Helpful in This Situation?

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- Is There a Way We Could Modify the Role of the Trust Protector so that a California Resident Can Serve with the Risk of Being Treated as a Fiduciary for State Income Tax Purposes?
- What Type of Trust Protector Could Best Serve the Needs of the Family in this Situation?
- Would It Be Helpful If the Trust Protector Resides in the State Where the Trust Will Be Moved to?

Case Study #7 Daddy's Favorite Business

Ralph Taylor had an idea one day while working for his father's lawn and garden business. That idea proved to be a commercial success the next summer in their tiny community in Ohio. And that led to a dream of franchising this process all over the U.S., in fact all over the world. Ralph's dream would become a reality over the next 25 years resulting in enormous wealth.

At his death Ralph was worth approximately \$75 million. Fortunately, the company he had founded survived the transition of leadership that is always a challenge at the death of a founder. Ralph had given quite a bit of stock away to trusts for the benefit of his large family. But there was still a 49% block of stock which passed, at his death, into a trust for the benefit of his family. Ralph named a nationally prominent trust company as the primary trustee of this trust.

In the last ten years since Ralph's death the trustee has attempted to "sell" the family on the idea of diversification. But the children and adult grandchildren are very reluctant to assent to such a diversification strategy and instead each year are signing documents acknowledging their wish to continue to hold such a large position in a single company.

Recently, a key family advisor met with the trustee and was advised that even with the consents from the beneficiaries a recent decision in the jurisdiction where the trust was being administered had convinced their legal department that it was imperative a diversification strategy be commenced.

Questions to consider include:

- Could a Trust Protector Avoid the Concern Which Is Propelling the Trustee to Sell?
- Who Would Be Willing to Serve as a Trust Protector in this Situation?

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- Is There a Way to Protect the Trust Protector from the Same Risks the Trustee is Worried About?
- Is There an Even Better Way That a Trust Protector Could Accomplish What Family Wants and Satisfy the Trustee's Concerns?

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Powers That Can Be Granted to a Trust Protector

by John A. Warnick, Esq., *Purposeful Planning Institute*

Note to Reader: Very few states define with specificity the powers granted to trust protectors. Therefore, it is very important that the powers which are intended to be vested in a Trust Protector be set forth in the trust instrument. Here is a list of possible powers you might want to consider giving to the Trust Protector:

1. Power to remove any person (*individual or entity*) serving as a trustee or co-trustee.
2. Power to remove a corporate fiduciary (*bank or trust company*).
3. Power to replace the trustee or co-trustee who has been removed. Note: this power is usually coupled with a limitation on who can be so appointed, such as limiting the field to corporate fiduciaries or to unrelated and non-subordinate persons vis-a-vis IRC §672(c).
4. Power to appoint an additional co-trustee and, if so, what limitations should be included as to who can be so appointed.
5. Power to appoint a replacement trustee or co-trustee when a nominated trustee or co-trustee declines to serve.
6. Power to appoint a trustee or co-trustee when a then-serving trustee or co-trustee resigns as such.
7. Power to appoint an independent trustee. Note: this power may include guidelines on what type of independent trustees may be appointed, e.g. amount of assets under management, capital, or relevant expertise and experience.
8. Power to add or remove an investment manager or advisor. Note: this power may include limitations as to who can be appointed.
9. Power to veto or direct trust distributions. Note: In essence this makes the Trust Protector a director of a directed trust.
10. Power to add or remove beneficiaries of the trust.

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11. Power to advise Trustee on matters of beneficiary behavior –such as substance abuse or other areas included by the grantor.
12. Power to appoint a Trust Distribution Advisor who may direct the Trustee on when, what amount and what type of distributions will be made to impaired or incapacitated beneficiaries.
13. Power to consent to the exercise of a power of appointment.
14. Power to approve trust accountings
15. Power to amend the trust as to administrative provisions.
16. Power to amend the trust as to distribution provisions (*often found in special or supplemental needs trusts*)
17. Power to approve or veto the sale of trust assets, such as interests in a closely-held entity (*corporation, limited liability company, partnership, etc.*) or certain real property.
18. Power to cast the deciding vote when there is a deadlock among co-trustees (*tie breaker*).
19. Power to change the situs or governing law of the trust.
20. Power to grant a beneficiary a power of appointment (*general or non-general*).
21. Power to determine whether an event of duress has occurred (*typically in an asset protection trust*)
22. Power to determine whether a trustee or beneficiary is incapacitated (*may include procedures the Trust Protector must follow but can be a way to expedite or by-pass a formal adjudication of incapacity*).
23. Power to exercise a special power of appointment, including a power to add or remove beneficiaries or classes of beneficiaries.
24. Power to exercise tax sensitive powers such as are commonly used in intentionally defective grantor trusts.

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25. Power to remove the powers which make a trust a grantor trust for federal income tax purposes.
26. Power to mediate disputes between beneficiaries and trustee, or alternatively to select a mediator or arbitrator.
27. Power to approve a settlement of a law suit or threatened complaint against the trust or the trustee.
28. Power to adjust the payout of an Unitrust or to convert a trust to unitrust status.
29. Power to initiate a trust review process (perhaps this is an Olympic—every four years—or less frequent process) which would evaluate the effectiveness of the trust in meeting the grantor's express purposes; tax or investment efficiency; the positivity of the trustee/beneficiary relationship; and any other aspect of the administration and operations of the trust. Note: this needs to be carefully defined and should not conflict with the trust accountings or trust settlement processes.
30. Power to initiate a decanting of the trust as well as to create the new trust into which the old trust will be decanted.
31. Power to hire fiduciary consultants, legal, accounting and investment experts, relational and behavioral consultants, to advise the Trust Protector in carrying out his/her duties.
32. Power to direct the trustee to pay for a beneficiary coach or advocate.
33. Power to create or modify a family bank structure within the trust, including the power to direct the trustee on the funding of the family bank.
34. Power to determine whether the conditions of a financial skills trust, business skills trust, etc. have been met and to direct the trustee in revising or applying the criteria which will be used to evaluate distributions requests from a beneficiary who has successfully completed the curriculum or skills acquisition required in the trust instrument.
35. Power to equitably consider whether the terms and conditions of an incentive trust should be softened or eliminated and to direct the trustee in that regard.
36. Power to terminate the trust.

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SEMINAR ACTIVITY EVALUATION FORM

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Note: Send this form to the State Bar only if you are audited.

Course Title:

"Trust Protectors: What Are They and Why Probably Every Trust Should Have One"

advanced legal training institute

CLE ONLINE LEGAL TRAINING CENTER

About our Instructor~ **John "John A." Warnick, Esq.**, *Purposeful Planning Institute*



John "John A." Warnick, Esq.

- Founder, *Purposeful Planning Institute*, Collaborator and Multiplier; Initiator of the *Paradigms of Purposeful Planning*
- Listed in *The Best Lawyers in America*, (Trusts and Estates)
- Author: *Private Annuities, 805 T.M., Tax Management, Inc.*
- *The Bureau of National Affairs, Inc.*; "ESOPS- Another Exit and Estate Planning Strategy for Business Owners"
- *Colorado Bar Association CLE, 2001*; "The Ungrateful Living: An Estate Planner's Nightmare the Trial Attorney's Dream"
- *George Washington University, JD, with honors, American University, Brigham Young University, BA, Magna Cum Laude*



Purposeful Planning Institute offers Collaborative Solutions to Family Wealth Transitions: The Purposeful Planning Institute is designed to build collaboration between all of the professional disciplines and to support professional advisors who want to serve their clients, and their clients' families, in deeper and more positive ways.

Membership Benefits of Joining the Purposeful Planning Institute

- **Thought Leader Webinar Series** – Weekly webinars and teleconferences with nationally renowned thought leaders and industry innovators. Easy downloading of the recorded sessions & associated handouts in our **online archives** if you are unable to join us for the live sessions.
- **The Mastery Program** – Open invitation to participate in the Purposeful Trusts & Gifts Mastery Program at no additional cost!
- **The Connecting Point** – Post your customized professional profile on our web-based directory, describing how you collaborate with other professionals and how you serve individuals and families, allowing other collaborators to connect with you and engage you.
- The **Purposeful Planning Resource Center** – An Online Library of Resources on best practices for Legacy Families and Families in Business as well as practice pointers, client exercises, conversation scripts, design letters, redacted forms, and skills building resources.
- Access to the **private PPI LinkedIn** groups where you can share ideas, questions and practice developments with our Network of over 350 Purposeful Planning Institute members from more than 20 different disciplines and professions.
- An early invitation to **Fusion Collaboration** and the **Annual Rendezvous**, premier events that offer unique learning and networking opportunities and that bring together thought leaders and industry innovators to collaborate and share best practices.
- Special **Collaborator Rates** on Other Purposeful Planning Institute Programs, including a 20% or greater discount on Purposeful Planning Institute Sponsored Workshops & Gatherings

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- Live and Recorded MCLE Seminar/Teleseminar Packages (including Audio CDs, Video DVDs & Workbooks)
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- Business Succession Planning

About the Program Director~ **Mary Gutheil Anderson**, Founder, *Advanced Legal Training Institute*



Mary G. Anderson

- Legacy and Succession Planning Consultant
- Organizational Consultant/Business Coach
- Founder, *Advanced Legal Training Institute and Life Management Consulting*
- Author of "Pet Protection Legal Care Plan: Financial and Legal Planning to Protect Your Companion Pet"
- Author of "My Estate Management Guide: Financial and Legal Planning to Protect Yourself, Your Family, Your Assets and Your Legacy"
- Corporate Training Manager, *Hewlett Packard*, 20 years of experience as an Executive Trainer
- Certified Conflict Resolution/Mediator Specialist
- Consultant/Management Training Specialist @ Fortune 500 Company/Entrepreneur
- Producer and Host of "Voice of the Valley" Television Show
- Graduate, Bachelor of Arts, Secondary Teaching Credential, *Willamette University*, Salem, OR

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- Conflict Mediation Among Heirs
- Funeral Planning (Eulogy, Obituary, Reception, etc.)

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