



Dissident trust beneficiaries can alter power dynamics

Trustees will find it difficult to exercise their fiduciary duties unless they establish good relations with heirs.

HIGH-PROFILE legal battles have increased the burden on trustees. Two examples come to mind: Liesel Pritzker's suit against her father for \$1.6 billion over his handling of her trust, and Bruce Winston's suit against Bankers Trust for \$1.3 billion on claims that it mismanaged the trust's ownership in legendary diamond company Harry Winston Inc.

Grantors generally create trusts to hold family business stock for three reasons:

the family business shares he placed in a trust. After his death, two of his sons, who shared power in the company, created very ambitious strategic growth plans, which included developing some facilities in China.

Over several meetings, the board weighed the advantages of Far East sourcing against the possible risks of such an investment. With the help of an adviser, the board presented the strategy at great length to the family council, which included the founder's widow as well as three other chil-

Why has it become so difficult for trustees to exercise their fiduciary responsibilities?

- **The generational transition** often weakens the relationship between the beneficiaries and the trustees. Many trusts that contain family business stock were established by a senior-generation member who found and named a trustee, typically a bank or an adviser with whom he'd had a long-term relationship. As the beneficiaries come of age, many of them assume leadership roles in the business. When the senior generation edges out of the business, beneficiaries may become anxious about the trustee's job performance and whether the trustee is acting in their best interest.

- **Significant appreciation of the value of assets in trust**, especially private company stock, owing to mergers and acquisitions along with appreciation in the private markets. This development has raised the stakes. Trustees must ensure they are acting in the best interest of the beneficiary, and within the guidelines under which the trust originally was set up. Trustees may believe it's prudent to sell highly appreciated shares and invest them in a more diversified portfolio.

- **Recent growth in the financial services industry** has resulted in many trustees developing extensive asset-management capabilities. Trustees may face an awkward conflict of interest, since they could potentially manage the assets and earn significant asset fees in trust when a liquidity event arises.

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- To avoid or defer taxes on company shares.

- To prevent their children or grandchildren from knowing how much wealth they will inherit.

- To protect the business from being run into the ground by the next generation.

But after the senior generation is gone and their beneficiaries succeed them as managers of the company, the dynamics of power, control and information flow can become tricky.

Take, for example, the case of one of my clients, a second-generation family business involved in manufacturing and distributing cleaning products. Before his death, the founder had named the local bank and trust company as the trustee for

dren. Ultimately, the family council voted to go forward. To finance the China project, the board decided to seek private equity to fund what it considered to be a very lucrative investment for the company, with limited downside.

Prior to the closing of the financing, family representatives informed the trustee of their intention to seek private equity to fund the Chinese project. But the bank and trust company opposed the expansion and the financing, despite the beneficiaries' unanimous support of the venture. This resulted in a lengthy legal battle between the trustee and the beneficiaries, which jeopardized the private equity financing and ultimately the China project.

In fact, that seemed to be the case with the company whose trustees nixed the private equity deal. We had to get lawyers involved to educate the trustees and exert some pressure on them. Ultimately they agreed to vote to allow the financing to proceed.

But the situation might have been avoided had the trustees found ways to improve relations with the beneficiaries. Some recommendations:

1. Know what's in the trust.

Trustees must know the value of the assets included in the trust and the options available to them to maximize the value for the beneficiaries. In today's capital market, options abound for enhancing trust assets. Strategic opportunities may further the growth of the business. Liquidity opportunities through the private equity market or the strategic market may spark interest in recapitalizations or refinancing.

2. Know the beneficiaries. What are their views of the business and the trust? What are their liquidity needs? It's possible to ascertain this

information through regular contact with the beneficiaries. In larger families, tools such as beneficiary surveys could provide information to trustees.

3. Open the lines of communication. It behooves trustees to initiate and maintain communication with beneficiaries. The heirs must be aware of the assets held in trust. At the same time, the beneficiaries

beneficiary surveys and developing other methods of communication with beneficiaries. He or she can also offer an objective viewpoint.

An atmosphere of open communication, objectivity and free information flow will create a "trust effect"—a strengthening of underlying relationships, bringing trustees and beneficiaries together to harmoniously work through issues affecting the

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must communicate their needs and desires to trustees.

The 'trust effect'

An outside adviser can help trustees to perform their fiduciary duties by evaluating the assets in the trust and the options available to maximize the value of these assets. Such a resource person may assist by performing

trust and the assets within it. After all, that is what the grantor of the trust intended. FB

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