

Secret clauses in trusts

When Dmitri remarried in 1989, he created a revocable trust for his wife and his two sons from his first marriage, his only descendants. The sons were to receive a distribution from the trust at Dmitri's death, but most of the assets were to remain in trust for the life of the surviving spouse. At the survivor's death, the trust would terminate in favor of the sons or their descendants. The sons were named the trustees of this trust.

Some 23 years later, Dmitri had a change of heart. In August 2012 he had the revocable trust restated, removing the sons as trustees, and he also removed the distribution to them at his death. The sons were very unhappy with this development, and they let their father know about it. They were particularly displeased with the choice of Celia Rafalko as successor trustee, as they believed that she was a close confidant of their stepmother. Dmitri took umbrage at their communications, which, he felt, impugned the character of his wife and showed a lack of confidence in his judgment.

Dmitri died in December 2012. In January 2013 one brother wrote to his stepmother proposing that they all agree to terminate the trust, splitting the principal equally among the brothers and the stepmother. He also asked that all records of trust administration be preserved carefully.

Unbeknownst to the brothers, Dmitri had a second restatement of the trust done in September, after the disagreement with the sons. This time the trust included an *in terrorem* clause, which disinherited any beneficiary who interfered with the administration of the trust. When they learned of the secret clause, the first son backed off on his suggestion, and the second son disavowed any knowledge of the suggestion to terminate the trust.

In accordance with the September trust, Rafalko sent the sons releases to be signed, in which they promised never to contest any aspect of the trust's administration. They signed. Nevertheless, Rafalko warned the sons that she was going to consider whether they had violated the *in terrorem* clause. In May 2013 she told the sons that they were disinherited. This would have no effect on the stepmother's trust interest, but it did result in Rafalko having the power to direct the trust assets to charities at the stepmother's death.

The sons challenged their disinheritance, and the Virginia courts found that the trustee had acted in bad faith. Communication regarding a change in the trust's administration is not the same thing as mounting a legal challenge to it, and the brothers instantly backed off when they learned of the *in terrorem* clause. As the purposes of that clause were fully achieved, the trustee's further "punishment" of the sons was an abuse of discretion. The sons were also awarded some \$45,000 in attorney's fees, to be paid out of the trust.

(November 2016)

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