By **Amelia Renkert-Thomas**

The Trustee's Role in an Owners Council

Decision making must accommodate a fiduciary perspective

When members of the next generation take over ownership of a business from the founder, they may fail to anticipate the challenges that will arise because ownership is now held by a group rather than a single individual. Joint decision making at the ownership level is a skill that must be learned and practiced. One way the next generation owners can manage their responsibilities is to establish an Owners Council, comprised of all owners, both managing and non-managing, to give them a proper forum for discussing ownership-related issues. Acting together as an Owners Council, the next generation owners can articulate their shared purpose and vision for the future of their ownership, as well as have a distinct voice and active role in business decision making. (For more details on the structure of an Owners Council, see "What is an Owners Council?" p. 54.)

But, what if a trust owns the business or part of it? Engaged ownership through an Owners Council is more difficult to achieve when a trust owns shares in a family business, because ownership decision making must accommodate a fiduciary perspective. A trustee of a trust that owns shares in a business has obligations to the beneficiaries that circumscribe her ownership choices.

Increasingly, family business founders are transferring shares in trust rather than outright. A trust can offer tax advantages, creditor protection and professional oversight for a critical family asset. If a founder feels anxious about whether children and grandchildren will be capable shareholders or if the natural objects of his bounty are so young that their abilities aren't yet apparent, he may be more comfortable putting the shares in trust than gifting them outright. A transfer in trust may ease his concerns about the denominator problem that might arise if shares are sprinkled among descendants over several generations, causing ownership to become so fractioned that no individual or family group has meaningful control. At the very least, the founder's estate planner may have pointed out to the founder that he can avoid a major tax bill on his death if he uses a planning technique such as a grantor retained annuity trust or an intentionally defective grantor trust.

Fiduciary Obligations

If the ownership group includes a trustee, how will the Owners Council members need to organize themselves to accommodate the trustee's fiduciary obligations?

The founder might have created the trust for any number of reasons, and the purpose of the trust will have implications for how ownership decision making is organized.

- **Minimizing taxes.** An estate planner might have recommended the trust as part of an estate and income tax minimization plan. Used in this capacity, the trust was created primarily as a tax-advantaged conveyance mechanism to reduce or eliminate a tax levy on the grantor's death that might otherwise have required the company to be sold or stunted its growth opportunities. In such a case, the family's intent was likely that the children—the beneficiaries—would still effectively have the levers of corporate control that they would have had if the shares had been given to them outright. To accommodate the grantor's intent, the beneficiaries will expect to have a voice in ownership-level business decision making.
- **Protecting shares from divorce or creditors' claims.**

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An estate planner may have suggested the trust as an alternative to a prenuptial agreement, to avoid the risk of shares passing to a child's spouse in the event of death or divorce. Here again, the family's intent was likely that the beneficiary would still have effective control, but that share ownership would be protected and kept in the family. The expectation is that the beneficiaries will have a voice in ownership decision making.

- **Providing a stand-in owner when beneficiaries are incapable of acting.** The family may have been concerned that a beneficiary wasn't ready to take on the responsibilities of ownership decision making, whether because of youth, illness, financial or legal troubles or some other circumstance. The trustee was put in place to serve as the stand-in decision maker for so long as the beneficiary remains incapable. In this situation, the trustee is expected to act as the owner of the shares until such time as the beneficiary is able to participate.
- **Concentrating ownership.** The grantor may have wanted to avoid the problem of share ownership being divided into smaller and smaller fractions as the family grows. By holding the shares in a single trust (or perhaps in separate trusts for each branch of the family), decision-making power would remain concentrated. The grantor may have chosen this structure to head off strife among siblings or family branches. The intent was that there be a decision maker separate from the beneficiary group, but it may not be clear whether the grantor intended the trustee or some subset of the beneficiaries to be the ultimate decision maker.
- **Concentrating control while equalizing financial ownership.** The family may have wanted to concentrate ownership control in the hands of one individual—often, the member of the next generation who leads the business—while dividing the economic value of the business interests equally among all of the children. In this situation, the grantor likely expected the trustee to act as the grantor-founder would have acted (though he may not have made clear what his own decision-making criteria would be in such circumstances).

Accommodating the Trust

When one of its members includes a trustee, the Owners Council will want to take the purpose of the trust into consideration in structuring its membership, agenda, education process and voting system.

> The Owners Council can be a useful forum for gathering and disseminating information and for building rapport and mutual understanding between the trustee and the beneficiaries.

When the purpose of the trust suggests that the grantor intended that the beneficiaries would take an active role in ownership decision making, the beneficiaries will need to be included in the Owners Council, along with the trustee. The beneficiaries' voices will be critical to developing the shared purpose and the vision for the future of the business, and the trustee will be expected to vote and act accordingly. The trustee may serve more as a facilitator and, perhaps, mediator, than a decision maker, at least with respect to the beneficiary group and business-related decisions.

When the purpose of the trust suggests that the grantor intended that the trustee, not the beneficiaries, make ownership decisions, the Owners Council typically won't include the beneficiaries (though the trustee would be well advised to hold separate meetings with the beneficiaries to make sure she understands their desires, needs and perspectives in making ownership decisions on their behalf).

When the trustee isn't an insider—for example, when the trustee is a corporate trust company or an advisor—there's a risk that she won't be well versed in either the business or the shared purpose and vision of the family for the future of the business. The grantor of the trust (if he's living) and the Owners Council will want to take time to educate the trustee about the business and the family, to avoid the risk that the trustee will base business-related decisions on her personal assumptions about what's best for the business, rather than the owners' shared purpose and vision. (Furthermore, the trustee may want to undertake a shared purpose and visioning exercise with the owners, the grantor (if he's still living) and with the beneficiaries, to make sure she understands their positions.)

When the purpose of the trust was to provide for a stand-in for a beneficiary who's unable to act, and the trustee will exercise the ownership decision making power for a lengthy period, the work of the Owners Council might instead focus on education: first, education of the trustee in business matters, and second, education and preparation of beneficiaries so that they can assume a greater role in decision making over time. (One of the topics the group should consider is how to articulate a clear standard of what combination of skill, interest, experience and maturity will constitute "ability" in such a situation.)

When the trust was designed to concentrate control or to separate control from the economics of ownership, the Owners Council will play a different role. Because in this case the trustee also leads the business (and may be an owner herself, individually), the trustee already will have a deep understanding of the needs of the business; in many ways, this structure will replicate the control held by the founder. The challenge for the trustee is to balance her business decision making with trust decision making, given the constraints of trust law. From a legal perspective, beneficiaries of a trust don't have a right to participate in decision making around the business, unless such rights are explicitly included in the trust agreement, and in that respect, the trustee is free to make decisions. However, from both a practical and legal perspective, the trustee doesn't have unfettered ability to act and may face personal liability if her actions breach the duty of care or loyalty.

The Owners Council can help the trustee manage her responsibilities, promote effective communication with the beneficiaries and avoid personal liability.

What is an Owners Council?

Discussion topics and governance provisions

An Owners Council is a forum for shareholders—the current owners of the business—to come together to discuss matters of importance to them and to make ownership decisions together. An Owners Council is different from a board of directors (a group that's created by the shareholders to hire and oversee management and business strategy) or a family council (a group comprising the entire family, which focuses on sustaining family relationships and educating family members about the business). Topics that an Owners Council might consider are:

- What's our shared purpose and our vision for the future of this business and our family's capital?
- What decisions should be reserved to the owners, and what decisions will be delegated to the board?
- Based on our own experiences, how should we structure ownership for our children and grandchildren? Do we want to create a representative system, a democracy or, perhaps, a benevolent single leader system?
- How much representation and participation should the council members have in the board nomination process?

The Owners Council meets regularly (typically, quarterly). The council needn't be an entity, but it requires basic governance provisions, preferably in writing, including:

- Purpose of the council and its primary goals and tasks
- Membership
- Leadership structure
- Meetings, including frequency, notice provisions, code of conduct and mandatory agenda items, if any
- How the council will determine its agenda and keep a record of discussions and decisions
- An agreement that the council will speak with one voice to the business, the board and the extended family

— *Amelia Renkert-Thomas*

Whereas an investor who owns shares of a business is generally free to make ownership decisions as she chooses, a trustee must act not in her own interests, but in the best interests of the beneficiaries of the trust. "Best interest" is measured not from the standpoint of an investor, but from the perspective

of an individual. For instance, if the trust requires distributions for the beneficiaries' health, education, maintenance and support, the trustee may be obligated to vote to increase dividends or redeem shares to generate enough trust income to ensure that the beneficiaries' needs are met—particularly if there are no other financial resources available—even if that decision would run counter to the strategic plan for the business. A trustee who also runs the business may thus find her roles at odds with each other and that serving as trustee significantly constrains her choices as leader of the business.

To fulfill her fiduciary obligations, the trustee will need to understand the needs and interests of the beneficiaries, so that she can factor that information into ownership decision making. The Owners Council can be a useful forum for gathering and disseminating information and for building rapport and mutual understanding between the trustee and the beneficiaries.

Beneficiaries Assembly

When ownership of the business includes individuals as well as trusts or separate trusts for different branches of a large family, it may be useful to create one or more Beneficiaries Assemblies. A Beneficiaries Assembly is tasked with educating the beneficiaries about the trust and providing an ongoing forum for trustee-beneficiary discussions. A trustee becomes privy to substantial amounts of private and confidential information, so conducting trust-level discussions in a forum separate from the Owners Council helps to manage information flow on sensitive topics. The trustees of all of the trusts will also sit on the Owners Council for the purpose of making ownership decisions, but the trust-level information discussed in the separate Beneficiaries Assemblies will remain private.

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