



# Why Fiduciaries Fail Family Controlled Enterprises:

## The Problem of Trustee Succession

---

**Richard L. Narva, Esq. Founder and Senior Advisor**

### Introduction

“What is the opposite of **Fiduciary**?” the Georgetown University Law School Professor asked. He was presenting a paper, “Psychological Perspectives on the Fiduciary Business,”<sup>[1]</sup> at a Symposium honoring fifty years of teaching law by Professor Tamar Frankel of Boston University School of Law. <sup>[2]</sup> The Conference theme, “The Role of Fiduciary Law and Trust in the Twenty-First Century,” provided the context for the question. But no one in attendance had an answer. Finally, the professor chimed in that he himself had struggled for a long time to find the antonym and finally settled on **Salesman**. It seemed like a good enough answer to me, recalling as I did, the ancient putdown line, “You can trust what I say, after all, I am a commissioned salesman. His choice of **Salesman** worked, at least it followed the money: The opposite of a **Fiduciary**, i.e. a person who is paid a fee to act on behalf of another person in a manner that is devoid of self-interest has as its antonym the **Salesman**, someone who may say or do almost anything in order to sell his product or service and thereby earn a commission check.

It felt like an intriguing intellectual exercise to me, as a former student of Prof. Frankel, keen to honor her teaching career by engaging in a day of intellectual rigor, and free of the burden of choosing to do work that generated fee income. So I asked a question of the professor. The premise of the question was simple and rooted in Massachusetts: Institutional law and wealth management firms in Boston had been serving as trustees for the Brahmin elite and others for more than a century and a half since the legal foundations of American trust law were created by the lions of the Boston Bar. How, then, would he apply his thinking of “Salesman as antonym to Fiduciary” in 2011 [the date of the conference] given that virtually all trust officers in Boston were now compensated by their employers largely on the basis of originating new business? In other words, what utility does the law governing fiduciary conduct retain in the face of the marketplace fact that most trustees are now paid like salesmen of professional services?

On that day it occurred to me that with respect to choosing fiduciaries for family firms, one must confess, in language analogous to Houston as home of the NASA space program, that “Boston, We have a problem.”

## Challenges to Engaging in the Business of Being a Fiduciary for Stakeholders of a Family Controlled Enterprise

The capital created by a business founder and his/her family successors active in the enterprise does not care how it is invested, whether for profit or not-for profit, actively or passively. It simply seeks a return. Once control of family originated capital passes from the founder and/or active family successors' control into the hands of a trustee--an independent third party fiduciary--foreseeable cataclysmic changes are likely to occur in both the family system and in the family controlled enterprise. This article endeavors to highlight these changes, the challenges they present to both family settlers and their offspring as well as to trustees, and to cast a spotlight on why fiduciary administration of family controlled enterprises transferred into trust so often disappoints the beneficiaries of such trusts. Finally, some remedies for sub-optimal performance by both settlor appointed trustees and their successors are suggested.

## Who is Qualified to be a Fiduciary for Members of a Family Shareholder Control Group?

Fiduciaries for one or more members of a family shareholder control group which controls substantial capital face a daunting array of challenges: legal, ethical, educational and experiential. Family controlled enterprises, by which I mean operating companies; investment vehicles; charitable foundations, family offices or other family controlled pools of capital—however invested [together “Family Controlled Enterprises” or “FCE’s”]—and/or substantial wealth created by operating a FCE, require at least two concurrent and widely divergent skill sets. On one hand American legal requirements demand fiduciaries act prudently in the exercise of all aspects of their duties, and particularly as prudent investors of trust capital. This command is codified in state laws governing trusts and estates as well as in federal laws governing retirement and other benefit plans. Legal guidance for fiduciaries and training to act professionally and prudently is widely available.

At the same time understanding and managing the culture, ethnicity and family dynamics of the family of the settlor of the trust requires empathy, process skills and emotional intelligence. Guidance for this side of the fiduciary's endeavors is virtually absent from professional education venues for fiduciaries. And what little education that is offered is a mere shadow of the education and training available on the legal duties of fiduciaries, or for that matter compared to the sales training fiduciaries working in institutional settings receive. In my judgment, in order to succeed as a fiduciary to families who remain active in the affairs of their FCE's, fiduciaries must not only master an understanding of what it means legally to act as a fiduciary, but also to understand that their challenges will vary by each individual family, each individual within the family beneficiary group, and by each family's history. As Tolstoy wrote at the beginning of *Anna Karenina*, “All happy families resemble each other. Each unhappy family is unhappy in its own way.” One must ask how, if at all, institutional firms engaged in the fiduciary business can afford to offer such services in a manner that ensures a fair level of profitability. And since the

distinction between fiduciary and salesman is no longer what it once was, this is not merely a matter for academicians to debate. It should be a grave concern to beneficiaries of FCE's and to the shareholders—public or private—of firms engaged in the business of being fiduciaries.

## Law versus Family Culture and Values

Beyond recognizing the power of culture and ethnicity of each family requiring understanding, fiduciaries must understand that when family life is controlled by legal documents a displacement of the culture of the family of origin occurs, as the legal values enshrined in the common law take precedence over the historic core values of the family. Writing in an early volume of The Family Business Review a Professor of Anthropology, George E. Marcus, concluded as much after a detailed study of two multi-generational, dynastic families in Galveston Texas, one in which the culture of the family was displaced by the culture of the legal system, and another which succeeded in sustaining its family culture even after ownership of the family's business passed into trust. He concluded that . . .

[W]hen adopted as a plan for the organization of wealth, legal instruments also serve as models of social organization which come to have important consequences for processes with the social units to which they apply. However, the effect of law tends to be subtle and cumulative, since legal matters within a family, governed by the formal authority of the state, remain ideologically the antithesis of family values founded on personal, face-to-face interactions. Thus, when they arise within a family, legal issues as such always appear marginal, technical and inconsequential—or else a mask for deeper emotional, interpersonal conflicts. [3][4]

## The Absence of Integrated Bodies of Knowledge

Nearly three decades after the founding of The Family Business Review ["FBR"], and many undergraduate university based family business and family enterprise programs, there remains little in the way of law or business professional education—either in degree programs or in the realm of continuing professional education—that prepares legal and business advisors to serve as fiduciaries to stakeholders of family controlled enterprises by addressing the family dimension of advising FCE's. As the founding editor of the FBR noted in his introduction to Volume 1, Number 1 of FBR: "[R]esearchers find it difficult to study both the family and the business simultaneously: They are trained in one field or the other, and they have gained entry through only one of the two systems." [5] There is an adage [repeated less often now than in the 1970's] that military justice is to the civilian justice system as military music is to classical music. One might analogize in a similar way regarding the vast majority of fiduciaries: Their understanding of family systems is akin to most poets' grasp of GAAP [generally accepted accounting principles] rules governing accelerated depreciation. Yet, especially in the world of family controlled

enterprises, there may be [as discussed in more detail below] no greater skill required of a fiduciary advisor to beneficiaries of FCE's held in trust than superior training and experience in counseling families. This is true first and foremost because money is such an emotionally powerful reality in the lives of those blessed and/or cursed with having it; and secondly, because the culture of the legal system often supplants the culture of the family.

As one veteran, clinically trained advisor to FCE's has said, "Emotionally powerful and difficult family matters rarely stay hidden. In fact, families enact their dramas on the stage of business whether or not they are aware that they do it. . . . Unaddressed conflict may spawn frustration, disgruntlement, hostility and even depression. . . . A thriving family firm may be materially compromised by the failure of its owners and managers, family and non-family, to address the family dramas being enacted on the business planform. [6] How can it be possible that the simple fact of transferring ownership from a founder or his/her family successor to a trustee eliminates these risks to the FCE? And if the trustee eschews engaging with beneficiaries on these issues, is s/he acting in any existential way as a prudent fiduciary? And what of the very difficult case of mental illness, where it has been shown that family control of wealth provided by a FCE can offer unique salutary strategies, [7] an opportunity that may be lost when an otherwise prudent, but emotionally unintelligent trustee controls the FCE?"

## Compensation

"Tamar Frankel's writings remind us of the difficulties that face a legal ethic of service to others—i.e. fiduciary responsibility—in a culture that celebrates personal wealth, achievement and consumption. . . . You can't really expect to 'fiduciarize' a business that is all about selling unless you are prepared to reorient its economic structure entirely, which—economically and politically—we are still far from willing or able to do with the securities industry." [8] As Dirk Dreux, one of my colleagues in the world of advising family enterprises, often exclaims, "If you follow the dollar, you are very likely able to predict the behavior of the advisor." As noted in the introduction to this essay, compensation for this very demanding endeavor of serving as a fiduciary of a trust, the corpus of which is one or more FCE's, is the threshold challenge confronting any individual trustee and his/her institutional employer. Sales-driven trustees have come to replace virtually all fiduciaries trained and practicing in the original fiduciary culture of disinterested service that arose in the mid-19<sup>th</sup> century. Trustees whose cultural norms and training were closer to nineteenth century views of law and wealth than to the core values of the people who control operations and fruit of the hedge fund, private equity and IPO world of 2017 are today an endangered species. In a world of wealth management where sales success drives advisor compensation, how does a professional advisor who seeks to act as an emotionally intelligent, prudent fiduciary build a career?

## Ethical Challenges to Serving as a Fiduciary: Conflicts of Interest

When I began to practice law in the middle 1970's it was not uncommon in my home town of Boston to find trusts where the fees charged by fiduciaries were computed as a percentage of assets under management, as if offering legal advice to a trustee managing a trust with \$50,000,000 in assets merited fees 25% higher than a trust with \$40,000,000 in its corpus, all other factors being equal. Moreover, the law firm trustee was often not only named as trustee in the trust indenture written by one of its partners, but the beneficiaries were often stripped of the power to remove the trustee, even for cause. And finally, the "independent fiduciary" often also managed the funds, and some law firms still do. The result was an annuity income stream for the law firm often unrelated to the actual work required, with the entire year's fees frequently debited from the corpus of the trust on the first business day of January of each year. Such grotesque business practices have been modified substantially over the ensuing decades for a number of reasons, but the history of conflicts of interest in fiduciary administration in the United States is not something about which anyone who cares about fiduciary duties should be proud. Against this history of conflict of interest, greed and control in the guise of exercising fiduciary duties, one cannot easily be sanguine about the future quality of fiduciary administration of trusts whose corpus consists in substantial part of investments in non-public, family controlled enterprises and whose professional cadres are trained and compensated as sales personnel, however empathetic and earnest they may be.

## Who Chooses to Serve as a Fiduciary?

Like the United States Marines who hopes to recruit "the Few and the Proud," to become "the Marines," serving as a fiduciary for family members whose families remain active in the enterprises the fiduciary controls is not for the faint of heart. Nor is it to every business or law school graduate's taste. In the introduction to my first book of essays on Family Enterprise issues I wrote, "The realities of daily life in a family-controlled firm can, like raw herring, be very difficult to swallow—unless, of course, you grew up eating this Northern European delicacy from childhood. Eating herring is intended here as a metaphor for behaviours that are rooted deeply in a particular family's history rather than in best practices learning in business school." [9] In the United States, this line of work is rarely chosen by the top graduates of America's leading professional schools [not that there would be a curriculum to study at such schools if such graduates wanted to enter this line of work]. The discontinuity between the supply of talent and absence of training on one hand and the surging demand for fiduciary services—compromised as it is by the insidious transmogrification of traditional fiduciaries into salesman/fiduciary hybrids—remains a crisis to be resolved if the needs of families whose enterprises are placed in trust are to be met.

## Finding Successor Fiduciaries: Searching for Needles in Haystacks

Perhaps the situation most analogous to appointing successor trustees to a trust whose corpus controls a family controlled operating company is the process of electing independent directors to family controlled, publicly traded [listed] companies. Fortunately, this issue has been analysed rigorously and thoroughly by a distinguished law professor in a long law review article entitled appropriately, “Guests at the Table? Independent Directors in Family Influenced Public Companies.” [10] In her wonderful article Prof. Deborah A. DeMott addresses situational constraints to serving in this role and the qualifications for directors who would undertake such service that are required over and above the qualifications of directors for other, non-family controlled companies. I have elsewhere endeavored to expand on her research with my own essay focusing solely on the family systems related roles directors play in listed FCE’s, “The Role of Independent Directors in Family Controlled Listed Enterprises.” [11]

This article is not the place to endeavor to replicate the scholarship of Prof. DeMott, nor am I the person best qualified to undertake such legal scholarship. But, as an advisor to FCE’s—publicly traded and private—for nearly four decades, a member of the bar since 1975 and most significantly, as a trustee of a trust that controls and includes in its corpus an operating company with many tens of thousands of employees, and engaged deeply in the process of searching for successors to several long term trustees, I am able to frame the questions that must be addressed in a search for successor trustees, with which any FCE trustee must wrestle in order to find trustees qualified and willing to serve. Here are some of the questions with which my co-trustees and I are engaged currently.

### What is the Settlor’s Intent?

Most entrepreneurs I have advised are given to uttering some form of the qualifier, “If I die, . . .,” prior to reciting what their estate planning intentions may be. My frequent rejoinder is, “I think the word you are struggling to find is “when,” not “if.” The rare entrepreneur will articulate his/her core values in the preface to an indenture of trust or even in a letter of wishes or Ethical Will. But these individuals are the exception, not the rule. American estate planning focusses generally on economics, not values. But for those advisees who are willing, or at least open minded, there are ways to encourage them to articulate their values. [12]

### Is the FCE a Values or Mission Driven Business?

One of the most imaginative exercises in trust drafting I have ever encountered can be found in the annual proxy materials disclosed on the website of the New York Times Corporation, wherein the controlling shareholders, the Trustees of a trust created in 1997 for the benefit of the descendants of Iphigene Ochs Sulzberger, which controls the enterprise through a special class of non-publicly traded shares, disclose the only situation under which they would not be constrained by the trust from voting for a change of control transaction relative to the newspaper whose slogan remains, “All the News That’s Fit to Print.” The trust language provides,

‘The Trustees, . . . are directed to retain the Class B stock held in the 1997 Trust and not to sell, distribute or convert such shares into Class A stock and to vote such Class B stock against any merger, sale of assets or other transaction pursuant to which control of The New York Times passes from the Trustees, unless they determine that the primary objective of the 1997 Trust can be achieved better by the sale, distribution or conversion of such stock or by the implementation of such transaction.’ [13]

It seems to me that this language from the trust that controls the company precludes the Trustees of the Trust ab initio from authorizing a change of control transaction whereinafter the buyer would reduce the paper’s news coverage and laden the enterprise with debt to finance the acquisition, as many private equity and other institutional buyers are wont to do. It is a splendid example of legal writing in furtherance of the concurrent goals of family control and faithful adherence to the core values of the New York Times’ founding family.

Not all businesses held in trust were or remain controlled by their founding families. Nor are all FCE’s held in trust businesses with values or missions as clearly articulated as the New York Times. But for those FCE’s that remain values driven there are ways to enforce the commitment to core values that Collins and Porras found distinguished great companies from their merely good competitors. [14]

## Team Offense

While it is not practical in many cases, there are plenty of trusts whose corpus is large enough to support a team of trustees, with a wide range of qualifications over and above competence to provide administrative support and investment advice. Whether the team of trustees is staff on the payroll of an institutional trustee, or a group of individual trustees who come together to form a cohesive trusteeship team over time, forming a fully qualified trustee team has more in common with the NBA draft than with recruiting rookies out of college for American sports leagues. The trustee is by definition, in my view, a person of age: Put another way, age is a bona fide occupational qualification, which provides a legitimate statutory exception for choosing trustees on the basis of age. Trustees, like grandparents, should come to their duties seasoned by experience and leavened by an enduring affection for the subjects of their duties. Fiduciaries, like fine wine, age well in place. But the character of the candidate, like the terroir of the grape from which a wine is made, constitutes the *sine qua non* of a duly qualified member of a fiduciary team.

## Footnotes

1. D.C. Langevoort, "Psychological Perspectives on the Fiduciary Business," 91 B.U.L. Rev. 995 [2011].
2. See generally, the proceedings of Symposium The Role of Fiduciary law and Trust in the twenty-First Century: A conference Inspired by the Work of Tamar Frankel, at 91 B.U.L. Rev. 833 [2011]. A full discussion of whether and how the discussion of how fiduciaries fail family controlled enterprises might be parsed as among the varying roles of full trustee, directed trustee, trust advisor, and trust protector is beyond the scope of this article, but is surely worthy of discussion.
3. G. Marcus, "Law in the Development of Dynastic Families Among American Business Elites: The Domestication of Capital and the Capitalization of Family," IV Fam. Bus. Rev. 75 [1991] at 100.
4. See also, J. Troast & M. McGoldrick, "Culture, Ethnicity and Family Business," Fam. Bus. Rev.
5. I. Lansberg, "Family Business as an Emerging Field," 1 Fam. Bus. Rev. 1, at 3 [1988].
6. S.W. Narva, "The Power of Family," in R. Narva, Ed., Family Enterprises: How to Build Growth, Family Control and Family Harmony [2015].
7. See G. Fierman and J. Fierman, "Family Enterprise Guide to Major Mental Illness," in R. Narva, Ed., Sustaining Family Enterprises: Meeting the Challenges of Continuity, Control and Competitiveness [2016].
8. Langevoort at 995.
9. Family Enterprises at 8.
10. 33 J. Corporation Law, 819-863 [2009].
11. Family Enterprises at 205.
12. See generally, J. Reimer and N. Stampfer, **Ethical Wills & How to Prepare Them: A Guide to Sharing Your Values from Generation to Generation**
13. [http://s1.q4cdn.com/156149269/files/doc\\_financials/proxy/2015/2015-Proxy-Statement.pdf](http://s1.q4cdn.com/156149269/files/doc_financials/proxy/2015/2015-Proxy-Statement.pdf) at 7.
14. See, J. Collins and J. Porras, Built to Last: Successful Habits of Visionary Companies, 1997.