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OFFICE OF GOVERNMENT ETHICS

Request for Public Input on the Application of the Criminal Conflict of Interest Prohibition to Certain Beneficial Interests in Discretionary Trusts.

AGENCY: Office of Government Ethics (OGE).

ACTION: Notice of request for public comments.

SUMMARY: This notice and request seeks input from members of the public with expertise in trust law concerning the following question: Are there any circumstances under which an eligible income beneficiary of a discretionary trust might, in the absence of a vested remainder interest, be able to compel the trust to make a distribution or payment? OGE will take into consideration all relevant expert input submitted by the public within 60 days of the date of this notice. To be considered, any submission exceeding five (5) pages in length must include a one-page summary of key points and conclusions. Commenters are requested to state briefly the nature of their expertise in trust law.

DATES: To be assured consideration, comments must be received at the address provided below, by no later than 5:00 p.m. on [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, in writing, to OGE regarding this notice and request by any of the following methods:

E-Mail: usoge@oge.gov. Include the reference “Request for Input on Discretionary Trusts” in the subject line of the message.

Fax: (202) 482–9237.

Mail/Hand Delivery/Courier: U.S. Office of Government Ethics, Suite 500, 1201 New York Avenue NW., Washington, DC 20005–3917, Attention: “Request for Input on Discretionary Trusts.”

Instructions: All submissions must include OGE’s agency name and the words “Discretionary Trusts.” All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Comments may be posted on OGE’s Web site, www.oge.gov. Sensitive personal information, such as account numbers or Social Security numbers, should not be included. Comments generally will not be edited to remove any identifying or contact information.

FOR FURTHER INFORMATION CONTACT: Jennifer A. Matis, Assistant Counsel, Office of Government Ethics, Suite 500, 1201 New York Avenue NW., Washington, DC 20005–3917; Telephone: 202–482–9300; TTY: 800–877–8339; FAX: 202–482–9237.

SUPPLEMENTARY INFORMATION:

During the administration of President George W. Bush, a former Director of the U.S. Office of Government Ethics (OGE), Hon. Robert I. Cusick, issued a guidance memorandum addressing a novel legal issue concerning the application of the primary criminal conflict of interest statute to the interests of eligible income beneficiaries of discretionary trusts who lack vested remainder interests. Discretionary Trusts, DO-08-024 (2008). That conflict of interest statute, 18 U.S.C. 208, prohibits an executive branch employee from participating personally and substantially in any particular matter that directly and predictably affects a “financial interest” of

either the employee or a person whose interests are imputed to the employee (*e.g.*, the employee's spouse or minor child). See 5 CFR part 2640, subpart A. The 2008 memorandum articulated OGE's conclusion that, for purposes of the conflict of interest statute, an eligible income beneficiary of a discretionary trust would not be considered to have a financial interest in the holdings of the trust, provided that the beneficiary was not the grantor and did not have a vested remainder interest. Discretionary Trusts, DO-08-024 (2008). The premise underlying OGE's conclusion was that such a beneficiary could never have an "enforceable right to payment." Id. at 1. For this premise OGE relied upon the American Law Institute's Second Restatement of the Law of Trusts. Id. (citing Restatement of the Law (Second) Trusts, § 155).

In 2013, OGE issued a second guidance memorandum on the topic of reporting requirements applicable to a beneficiary who could meet the requirements articulated in its 2008 memorandum. The 2013 memorandum clarified that such a beneficiary would not have to report the holdings of the discretionary trust in an executive branch financial disclosure report filed under the Ethics in Government Act, 5 U.S.C. app. 101, et seq., in the event that the beneficiary were to receive income from the trust during the reporting period, though the beneficiary would have to report the income itself. Reporting Requirements for Discretionary Trusts, LA-13-04 (April 9, 2013). The 2013 memorandum did not otherwise modify the 2008 memorandum or revisit its underlying premise.

The 2008 memorandum, which OGE has continued to apply, is based wholly on the premise that there are no circumstances under which such a beneficiary could ever compel a distribution or payment from a discretionary trust. This month, however, OGE learned that the American Law Institute's Third Restatement of the Law of Trusts may suggest a contrary analysis as to the financial interests of eligible income beneficiaries of discretionary trusts, at

least in some jurisdictions. See Restatement of the Law (Third) Trusts, § 60, cmt. e (Am. Law Inst. 2003) (“A transferee or creditor of a trust beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary personally could not do so. It is rare, however, that the beneficiary’s circumstances, the terms of the discretionary power, and the purposes of the trust leave the beneficiary so powerless. The exercise or nonexercise of fiduciary discretion is always subject to judicial review to prevent abuse.”).

This discovery drew OGE’s attention to an article in the Quinnipiac Probate Law Journal by Alan Newman, Professor of Law for the University of Akron School of Law. See Newman, Alan, Trust Law in the Twenty-First Century: Challenges to Fiduciary Accountability, 29 QUINNIPAC PROB. L. J. 261 (2016). Professor Newman writes,

“[I]f, in fact, the beneficiary of a discretionary trust had only an expectancy with respect to the trust, arguably the beneficiary would be unable to hold the trustee accountable to enforce the trust. However, as noted elsewhere, ‘the difficulty with this theory is that it is not true.’ Although there is a longstanding debate whether a beneficiary of a trust has a property interest in the trust assets, merely a claim against the trustee, or both, it is well-established that: (i) the beneficiary’s interest in the trust itself is property, regardless of whether the trust terms provide that distributions to the beneficiary are at the trustee’s discretion; and (ii) the beneficiary may enforce them.

Id. at 282 (quoting Jesse Dukeminier & Robert H. Sitkoff, *Wills, Trusts, and Estates* 689 (9th ed. 2013)).

Professor Newman further explains that cases denying the claims of a beneficiary’s creditors against the trust reflect only a “policy-oriented” approach to addressing the claims of creditors and do not necessarily stand as evidence that the beneficiary lacks “an enforceable property interest with respect to the trust.” Id. at 283. At the time of its 2008 memorandum, OGE’s research focused on cases addressing the rights of creditors or the eligibility of

beneficiaries for public assistance, but Professor Newman’s article raises a question as to whether OGE should have focused instead on cases addressing the rights of beneficiaries as to trustees of discretionary trusts. See, e.g., id at 284 (“[R]ecently enacted statutes stating that beneficiaries of discretionary trusts do not have property interests with respect to those trusts are part of the enacting jurisdictions’ trust codes addressing the rights of beneficiaries’ creditors, not the relationship between the trustee and beneficiaries, and appear intended to apply only in the creditors’ rights context.”).

OGE reviewed one of the cases cited in Professor Newman’s article. In that case, the Seventh Circuit wrote,

We see no reason why a beneficiary, simply by virtue of being the beneficiary of discretionary trust, should be denied the ordinary equitable rights that flow from the fiduciary duty that runs from a trustee to a beneficiary. Included in those rights is the right to bring an action for breach of trust.

Scanlan v. Eisenberg, 669 F.3d 838, 844 (7th Cir. Ill. 2012). The plaintiff in that case, a beneficiary of several discretionary trusts, sued for malpractice and breach of fiduciary duty after the trusts invested millions of dollars in a real estate investment trust that later went bankrupt. The Seventh Circuit found that she possessed the required stake to establish standing as a result of her interest in the trust. Id. at 846. To the extent that the plaintiff had standing by virtue of being affected by the trust’s potential for gain or loss, that “stake” would appear to meet OGE’s definition of a disqualifying financial interest for purposes of the conflict of interest prohibition. See 5 CFR 2640.103(b) (“the term financial interest means the potential for gain or loss”).

Other cases also seem to lead to this conclusion. For example, a New York court similarly provided the following guidance, under the trust law of that state, as to the rights of the beneficiary of a discretionary trust:

In the present case, the trustees' discretion is absolute and not limited by any standard. However, even in such a case, the trustees may be compelled to distribute funds to the beneficiary if they abuse their discretion in refusing to make distribution.

Estate of Gilbert, 156 Misc. 2d 379, 383 (N.Y. Sur. Ct. 1992). Likewise, a California court held that, under that state's trust law, a trustee who has discretion to make or withhold a payment, may not withhold a payment with the intent of avoiding child support. Ventura County Dept. of Child Support Services v. Brown, 117 Cal. App. 4th 144, 150 (Cal. App. 2d Dist. 2004) (quoting Prof. Russell Niles, consultant to Cal. Law Revision Com., Memo Re Spendthrift and Related Trusts (Nov. 6, 1984)). In the California case, the outcome may well have been determined in part by language in the trust instrument requiring that the trust be administered for the benefit of the beneficiary's children in the event of the beneficiary's death, see id. at 148; however, this contributing factor would serve only to complicate the issue for OGE by leaving open the possibility that subtle variations in trust language may be relevant in determining the existence of a financial interest for purposes of the conflict of interest law.

Because it is not clear to OGE whether these materials represent the rule, an exception, or differing approaches to trust law in various jurisdictions, OGE would benefit from the input of members of the public who have expertise in trust law. Specifically, OGE seeks expert input concerning the following question: *Are there any circumstances under which an eligible income beneficiary of a discretionary trust might, in the absence of a vested remainder interest, be able to compel the trust to make a distribution or payment?* Should this question be appropriately answered in the affirmative, OGE may need to revisit the premise underlying its 2008 guidance memorandum on discretionary trusts—*i.e.*, that such a beneficiary could never have enforceable right to a distribution or payment from the trust. OGE will take into consideration all relevant

expert input submitted by the public within 60 days of the date of this notice in response to the question posed before evaluating the continuing validity of OGE's guidance memorandum, Discretionary Trusts, DO-08-024 (2008). To be considered, any submission exceeding five (5) pages in length must include a one-page summary of key points and conclusions. Commenters are requested to state briefly the nature of their expertise in trust law.

Approved: December 23, 2016

Walter M. Shaub, Jr.

Director, U.S. Office of Government Ethics.

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