WHEN IT COMES TO ESTATE PLANNING
EVEN BILLIONAIRES MAKE MISTAKES!

Celebrities, including wealthy billionaires, often provide important financial lessons for the rest of us. Since wealthy people usually have enough assets to overcome the losses resulting from their mistakes, avoiding the mistakes they may make is more important for the rest of us who can not absorb those losses.

The latest important lesson to be learned has come to us from the former owner of the Los Angeles Clippers NBS basketball team, Donald Sterling.

The previously low-profile Sterling received a lot of attention a few months ago, after recordings of him making racist comments were publicized. The comments were made to his girlfriend, who had recorded them. You may remember that Sterling was married.

NBA owners quickly moved to declare that Sterling no longer could own a team. Sterling just as quickly said he wouldn't sell the team and began to take legal action against the league. In the midst of this standoff, Sterling's wife, Shelly, asserted herself. Most of Sterling's assets, including the Clippers, were owned by a revocable living trust of which the Sterlings were co-trustees.

Shelly Sterling, who (not surprisingly) was estranged from Donald, declared that he was mentally incompetent, and that she had authority under the trust agreement to manage trust assets on her own. She took this action after doctors examined Donald, and concluded that he was mentally unfit to be trustee. She put the Clippers up for sale. Donald sued to stop her.

The central issue before the court was whether Shelly acted appropriately in removing her husband as co-trustee of the trust that owned the team, for reasons of mental incapacity. Two doctors had independently diagnosed Donald as being in the early stages of Alzheimer's disease, triggering a clause in the trust that allowed for Donald's removal.

On Monday, July 28, 2014, Judge Michael Levanas of the Los Angeles County Superior Court ruled in favor of Shelly, and prevented Donald from blocking the $2 billion sale of the team to former Microsoft executive Steve Ballmer.

Here we had a billionaire who put substantial assets in what appears to be a standard revocable living trust. The trust no doubt primarily was created to avoid probate on Sterling's assets and as a will substitute. But, as in many other estates, Sterling didn't plan much for the potential of his incapacity. In fact, he put in place a plan that left him exposed if he had minor or marginal cognitive issues.

In the wake of this decision, there's been a great deal of discussion in the legal community about how to draft documents to better protect our clients from being removed in similar fashion. Without excusing Mr. Sterling's girlfriend vs. wife issues, it's easy to see why some observers would be left feeling a little queezy to see a man forcibly removed from his position as trustee by his own estranged wife, on the basis of what he and his legal advisors said was a fuzzy definition of incapacity.

No document, no matter how often and carefully it's updated, can perfectly handle every potential situation, particularly when you're dealing with an issue as volatile as incapacity. The purpose of such clauses is to remove a client from a decision-making position when his ability to make those decisions has been compromised. There's always going to be a fight when it's time to actually do the deed. In this case, arguing the relative differences between the early and late stages of Alzheimer's becomes inconsequential. Donald Sterling's capacity was compromised (regardless of the progression of the disease), and the clause kicked in and removed him. He might not be happy, but isn't that what was supposed to happen? In the case of the Sterling Trust, isn't the removal of a Trustee with Alzheimer's from control of a multi-billion dollar asset the very definition of "working as intended."

Many of you probably have very similar trusts. Even those of you without revocable living trusts need to pay attention to this case because similar clauses "kick in" in the case of durable powers of attorney for finances, property and health care.

You may elect to put in place a better, or at least different, plan for handling your affairs in the event of your incapacity than Donald Sterling had done for himself. That need for that plan applies, whether you have a revocable living trust or a financial/health care power of attorney.

Take a look at articles on this topic, which are included in the estate planning materials located on our web site [www.wisclaw.com]. And if you are interested in discussing personally with us, just give us a call.

As far as Donald Sterling is concerned, in hindsight, the incapacity terms of his revocable living trust were inadequate for his situation and needs. You need to review your own situation, and estate planning documents (including any revocable trust and powers of attorney) for these key considerations:

A clear definition. There should be a clear, precise definition of incapacity. Mental incapacity is tricky. Unlike many other medical issues, mental incapacity or cognitive problems aren't clear cut. Mental decline tends to be gradual. A person can be highly functioning and competent one day and less so the next. Variations are likely within the course of a day. Also, a person can have symptoms or a diagnosis of Alzheimer's, or other cognitive issues, and yet still be legally competent for many purposes.

Your estate planner should be able to offer you several definitions for your trust and POA. Select the one that makes you most comfortable.

The "trigger" clause. The trigger clause defines how power actually is transferred once a person meets the definition of incapacity. In Sterling's case it apparently was vague enough to cause litigation. His wife obtained an opinion from a doctor and declared as co-trustee she had the power to remove him as trustee.

There's no right or wrong way to phrase the trigger clause. For example, the transfer could occur by a vote (either majority or unanimous, your choice) of three to five people you trust and name in the document. They can consider whatever evidence they want, or you could require that they hear from at least one doctor who's examined you.

Some documents allow the determination to be made by a single medical doctor. Consider whether you want this to be any medical doctor or one with a particular specialty. Others require agreement of two or three doctors, though that can be both time-consuming and expensive. As I said, there's no clearly preferable provision. You might be content with what happened in the Sterling case. But both the definition of incapacity and the process by which incapacity is determined should be clear and precise.

Who receives the power? Whether you have a revocable living trust, or a durable power of attorney, or both, you want the right person to be managing the assets. You might trust your spouse or oldest adult child, for example, to do a lot of things but do you trust him or her to manage your business: What about other assets you have?

When you own a business or real estate or have unique assets, you might want more than one successor trustee or an agent for your financial POA. There might be a certain person or people you want managing the business while other people handle other assets. Most people don't give this issue a lot of thought, but it can be key to determining the success of your plan and security of your loved ones.

Returning to capacity. There's an assumption in most plans that mental incapacity is a one-way street. A plan might state what happens if the owner becomes incapacitated or has diminished capacity. But few plan for the possibility that a person might become incapacitated and then regain capacity.

For example, a person might have a stroke and need a period of rehabilitation and recovery. After that period, full or substantial mental capacity might be restored. The estate planning documents might have provided for a smooth transfer of decision making after the stroke. But most are silent about what would happen after a recovery. A complete plan has a clear definition of a return to capacity and a triggering process for restoring the owner to power.

Review and update. It's easy to recognize this now, in "hindsight", but when Donald Sterling became estranged from his wife, the trust should have been updated. This would be difficult, of course, since they weren't divorced, and as co-trustees probably would need to negotiate changes to the trust. Or perhaps he created the trust himself and unilaterally could have revoked it or sought return of the assets. He apparently tried that, but the court did not support him.

You also need to regularly review the other terms of your estate planning documents. Since medical knowledge changes, are your definitions of incapacity and the triggering process still optimum? Do you need to make changes in the people involved, either because of changes in relationships or because someone passed away or retired?

This is an issue no one really wants to talk about. But at almost any age you are more likely to be disabled than to pass away. An estate plan isn't complete and ready to preserve your assets unless you have a clear plan for "what happens" in the event of your own incapacity.