Happy Chanukah,
Merry Christmas.
Twice the Happiness,
Twice the Celebration!

A COLLECTION OF ARTICLES
BY THOMAS D. DAVIDOW
FOR THE HIGH NET WORTH FAMILY
AND FAMILY BUSINESS OWNER
“Establishing a good relationship with a family member is not the responsibility of only one person. It takes two people to make a good relationship and to make a bad one. Each member of the family taking responsibility for his or her part – that is the challenge.”

—Thomas D. Davidow

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How Did We Get Here?

When family firms get to the third generation, it’s time for some serious analysis.

By Tom Davidow and Russ Robb

When Rod Laver, one of the world’s greatest tennis players, reflected on his championship years of the 1950s and 1960s, he said, “You are most vulnerable when you are ahead.”
The innuendo of Laver’s statement is to be extremely careful when you are cruising along with the foreseeable position of easily winning, only to find that when the momentum shifts to the “other” player, the previous predictable victory becomes very much in doubt.
And so it is with many third generation family businesses, which by all logic and common reason should be almost assured of continued success once they reach the time earned success in reaching the third generation of continual operation. Yet just like the tennis analogy cited above, family businesses become highly vulnerable as only one out of 10 such businesses succeed in the third generation.
Let’s take a look at one such business as it reached the third-generation tipping point. We’ll call this company the Bridgewater Leather Bag Co. The company and its facts are real but the actual identity of the business and its principals have been disguised for confidentiality purposes.

Getting It Started
Founded in 1920 by Tony Manzella who immigrated to this country from Milan, Italy after World War I, the company
withstood the test of time in the high end luxury women's leather bag business. Alessandro, Tony's son, became GEO in 1965, and his nephew, Louis, became CEO in 2000. Over the years, BLB always made money, but most of it was paid out to the family members by way of dividends to the shareholders and by way of salaries to the five family members working in the company.

In 2004, BLB peaked at $140 million in annual revenue. Then in 2005, BLB’s major African leather supplier delivered two months late, which was devastating for a highly seasonal business. In 2006, BLB’s major customer, representing 30% of its entire annual sales, cancelled all of their orders when the leather bag shipment was halfway across the Atlantic Ocean. With $20 million of bank debt personally guaranteed and fully collateralized by the Manzella family stockholders, the 85 years of business momentum was severely jeopardized after two major upheavals in two consecutive years.

All of a sudden, after all those years of blissful progress, BLB was out of financial covenants and there was a call on the family members to provide the bank with more collateral and guarantees on the loans or liquidate the company. Historically, all members of the family had been living off the company’s income with little of BLB's earnings reinvested in the business.

Family Self-Assessment

At the point of crisis, a family business consultant was retained to bring about a family consensus weighing both the family issues and the business issues. Some of the major considerations were as follows:

- The different levels of involvement by the family members, i.e., those who worked in the business and those who did not.
- The latter contingent are almost always less connected to the company emotionally and yet these non-management family shareholders caused nightmares for those managing family members.
- The company (in this case) is an asset which for several years has not yielded any income to the non-management stockholders, nor does the future appear to be any more positive.

What became clear is that the third generation had no exit strategy (85 percent of family businesses do not) and that most of BLB’s shareholders’ assets were tied up in this business (75 percent of family owners’ net worth is in the company).

Since the family members were at odds with each other, there was a distinct possibility that BLB might fail and not survive the third generation. Louis, at age 60, and the current CEO, was the only family member currently employed by BLB who appeared capable of running the business.

The issues of whether to sell the company now, or wait to sell until the business improved or not to sell the business were all possibilities.

**Dual Problems**

Actually, the company is faced with two critical issues simultaneously. One is the deteriorating business issue caused by substantial losses for two years coupled with a bleak outlook, thus causing management to curtail all dividends to family members. The other major issue is the aging family CEO without a succession plan in place nor the likelihood of finding family unanimity amongst the family members on this issue.

The business is facing this crisis due to their historical lack of communication about issues that are of vital interest to the family and its business. Families generally abhor addressing emotionally laden issues. The family had to face these questions: Can the business survive unless there is a sharp reduction of the working family members’ compensation and indefinite curtailment of dividends to all family members including the non-working family members? And does the family have the strength to address the issue of whether the company should be sold now or whether to continue the business into another generation?

At this point in time, the company implemented three intermediate steps in order for BLB to rectify its family issues and survive beyond the third generation.

- Established buy/sell agreements which enable those family members who want to liquidate their investments to do so. These agreements have to be flexible ad creative with an understanding that minority investments in illiquid companies are valued at a discount.
- Conveyed to all family members that almost always there is an inherent problem of family members who have divergent interests, to therefore it becomes paramount that the family members come together as a community to communicate their common interests.
- Created a form of complete transparency with all family members on financials, strategic goals, capital expenditures, etc. through regular meetings which include all members.

The various issues of compensation, management benefits, strategic direction and executive succession were resolved over a year of continual and intense interaction with the counsel and guidance of an unbiased, third party family business consultant.

BLB defied the odds and survived the third generation, but without overcoming the ever dangerous tipping point. In this case study, the family addressed the immediate financial crunch by indefinitely running the company on a severity program eliminating all dividends, excessive salaries and “perks.” Simultaneously, the family solved the succession issue and avoided the sale of the company by bringing in as well-qualified family member who currently was an executive for a Fortune 500 company as heir apparent CEO.

The tipping point was real, the solution was successful.

Russ Robb is Managing Director of Tully & Holland in Wellesley, MA
Debate: “What’s the best thing to do with a family business whose members have lost their emotional attachment?”

By Tom Davidow and Howard Leigh

Tom Davidow says:

The larger the family business and the more successful the family has been in passing the ownership on to the next generation, the higher the number of owners. Each of these owners will have different levels of involvement with the business as well as a different emotional connection to it.

Members of a family business traditionally link their identity to that of the business; being the business owner helps define them. However, as ownership gets passed to succeeding generations, family members tend to become less connected to it emotionally. When that connection becomes purely financial, family members see it as an asset that does or doesn’t yield a financial return on their investments.

A large number of non-active, disconnected family shareholders can be a nightmare for management. Unhappy family shareholders can drain emotional energy like nothing else. By having the right point of view and taking the necessary steps, the family can ensure that its members will continue to add value to the business rather than be a drain on it. Here are three ways to minimize problems with multiple shareholders:

• See yourselves as a community: The more the shareholder group sees itself as a community with common interests, the more potential there is for that community to be functional. An important criterion for a sense of community is that the individual community member chooses to be there. Otherwise, the pleasure of being there is seriously compromised; the community member can feel trapped.
• Spend time on buy/sell agreements: The content of the buy/sell agreement is confined by the creativity and thoroughness of its authors. Attorneys ought to sit with as many of the owners as possible and listen to their concerns. The more informed they are, the more practical and useful the document will be. You can provide the marketplace for the family to buy and sell shares. The company can agree to guarantee the value of the stock so some dollar amount may be used as collateral for a loan to a bank. This arrangement might free up some family members to buy a house or car. The buy/sell agreement is not a panacea. There are many realities in a family business that will not allow the stock to be as liquid as owning a share in a publicly traded company. There are usually well defined criteria for who can be an owner. The business and/or other family members may not have the liquidity or interest in buying more shares. However, the agreement should be as flexible and creative as possible. Understand that the emotional and financial privilege of being a family owner can be very different for members of the same family.

• Encourage regular communications: Every good community needs to be well informed about its activities, the challenges it faces and how its leadership is dealing with those challenges. It’s important to have ongoing scheduled community meetings where the leadership informs and the membership asks questions. All shareholders ought to receive information about the financial performance of the business, its strategic goals, capital expenditures and other important information. Regular meetings allow for the sharing of information and offer the opportunity not only to explain the financial performance, but also place that performance into the context of the marketplace.

Consistently scheduled meetings prevent the undesirable occurrence that the community gathers for the first time because it is being confronted with a significant issue such as whether keep or sell the family business.

Howard Leigh says:

Most family businesses are started by strong-willed, determined individuals who have the energy, tenacity and vision to launch a business on their own. Founders will feel a strong emotional connection to the business they have grown and cultivated and often wish to pass on their company to the next generation of family members. However, keeping it in the family is not always the best option for the family or the business, especially when the number of shareholders increases with each generation.

I have worked with many family businesses that would benefit from selling the company even though the decision is not an easy one to make.

Pressure is frequently applied to succeeding generations to “help out” and “do the decent thing” by working within the family business, a business that may even bear the family name. Members of the next generation can find themselves pressured to working within the business when in fact a completely different lifestyle and occupation would be much more suitable and desirable.

Forced succession is usually detrimental to the business. For example, I recently encountered a company being run by a seventh-generation family member who felt under extreme strain, which he found difficult to accommodate. When he took over the business it was at the point of impending disaster and he felt immense pressure not to be the family member who lost the family business.

Instead of growing from generation to generation, the business had been passed down to emotionally unconnected family members and had consequently not made much progress.

The individual concerned had never wanted to run a business and so eventually too the difficult decision to sell. Although it was a hard choice to make it was in the interest of both the business and the family; the previous owner was much happier being an employee with no decision-making responsibilities and the company could once again grow under new management.

Time and again discussions between parents and children as to the future of the business leads to headed rows. In these instances a family business can divide rather than unite the different family members and generations and prove very damaging to both family and business relationships.

Once case I was involved in saw a father tell his son he wished he had never invited him to join the family business. The son believed he had given 10 years of good, loyal and dedicated service and was aghast his father should think this.

When questioned further about his reasoning for the comment, the father revealed it was not his son’s service that was the problem but the breakdown of a normal family relationship between the pair. The father explained he wanted to spend time talking to his son about family, children, sport and other normal bonding issues, but instead was constantly battling head-to-head in meeting rooms full of lawyers and accountants.

Another business I have worked with was founded in the late 19th century and by the time it was sold had some 70 shareholders, all of whom had completely different objectives and needs. For some the annual dividend was a lifesaver that enabled them to keep going, for others it was complete irrelevance that didn’t cover the costs of heating a swimming pool.

Shareholder meetings we re not happy events and eventually management grew tired of being the custodian of family wealth where even simple decisions could not be taken. The company was advised to form a small executive committee with representatives from each of the different groups within the shareholders. The business was then sold at a price that enabled each to have their own wealth management.

There are, of course, many examples of businesses that survived the family trauma. However, this is a small proportion of the tens of thousands of businesses started by determined entrepreneurs. Many founding shareholders, instead of looking to a potentially uninterested next generation, decide to capitalize at a time when the business still has premium value.

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Sudden Money Loss
A Seven Step Plan for Families on the Edge of a Financial Cliff

By Thomas D. Davidow, Ed.D and Patricia M. Annino, Esquire

Suddenly money loss can occur in a myriad of ways: You get fired; your house burns down; Madoff’s Ponzi Scheme wipes you out; you own a small business, and your major vendor goes bankrupt, leaving you with a cash shortage, tremendous bills and nothing in the pipeline; your family’s prime breadwinner becomes disabled or dies, leaving you unprepared and unprotected; your business partner dies unexpectedly; you suddenly lose your reputation, and/or your business does; a confluence of small bad breaks leads to the perfect storm.

However the crisis occurs, when it does, you can’t believe it’s happening to you. Your boat has capsized and you don’t have time to look for a life jacket. With no preparations for the disaster and no time to adjust psychologically, you’re overwhelmed by fear, anxiety, depression and shame. You’re going to let your family down - they may not yet know that they are also in the capsized boat. You don’t know what to do, how to think or where to go.

Finding that life jacket and figuring out how to get safely to shore is a process that may take years, perhaps a decade - you did not get into this suddenly and you will not get out of it suddenly - but there are things you can do to help you find your way back to shore:

Acknowledged that you are in crisis: Your immediate re-
sponse may be like Scarlett O’Hara’s in Gone with the Wind: “I can’t think about that right now. If I do, I’ll go crazy. I’ll think about that tomorrow.” Although denying the incompre-
hensible is natural, it doesn’t solve the problem. It paralyzes you. If you don’t pick up that certified letter, don’t answer the phone, ignore the beginning communications, etc., things will only get worse.

Calling your family in a state of hysteria will also not work. The blame game will begin. You may feel that it is your fault, that you screwed up and/or that others did - they spent too much money, did not support you, gave you bad advice and you didn’t stand up to them. There are a million reasons to blame yourself, your lawyer, accountant, anyone. But what good does finger pointing do? You still have not acknowledged the problem and your part in it, and you are still paralyzed.

If you were in a major car accident, and you lost an arm, you would focus on only that: You lost an arm! You could not consider all the consequences to the rest of the system, let alone to your future functioning. You would get yourself to an emergency room a.s.a.p. Here, too, there is only one way out: acknowledge that you are in crisis and that you cannot think your way out of it by yourself.

**Acknowledge your emotions:** Getting that notice will trigger shame, which is a horrible feeling, attached to embarrassment, especially when it comes to families. All the humiliations you have experienced during your life will resurface. You will be angry, at yourself and everyone else. You will feel like life itself has let you down. Your anger is a cover for sadness at your loss. Anger is more tolerable and easier to manage than sadness, which can be overwhelming to the point of paralysis.

These emotional reactions are normal. The trick is to face them. Once you do, they become less scary and you can think more clearly. You can move out of denial to problem solving to finding a solution.

The process takes time. You will go through a cycle - having an emotional reaction, dealing with it, attempting to solve the problem, finding a solution - again and again.

**Write it down:** Writing moves you out of paralysis. Without judgment, write down the feelings you are experiencing, e.g. “I am ashamed.” “I am afraid.” “I am angry.” “I am sad.”

Then write down your scary thoughts, e.g., “I am embarrassed to ask for help.” “I have a hard time accepting that this is real.” “I am feeling lost - I don’t know where to turn.” “I fear that I will be homeless.” “I have let my spouse down and I fear the loss of his/her love.” “I fear the loss of my reputation.”

Now write down ten possible solutions or steps to solutions, no matter outlandish they may seem, e.g.:

1. Call my lawyer/accountant/appropriate advisor.

2. What do others think possible solutions are? Search the internet; go to the library.

3. Whom do I know who has gone through this?

4. With whom can I talk about this? Make a list.

5. To whom can I turn for help and support?

6. What are my assets and income?

7. What are my liabilities and expenses?

8. Can my kids help reduce my expenses by taking out loans on their cars and college tuitions, etc.?

9. Make of list of 10 tasks (phone calls, setting up appointments, filling out documents, etc.) that need to be completed each morning.

10. Check off each task of as you do it. Put the uncompleted tasks on tomorrow’s list.

11. Write these lists more than once, until you can’t think of any more emotions or possible steps.

**Share the information:** Talk about the situation with your family, your friends and those you trust. Of course it will not be easy to admit that you’ve failed - you may have been rash, ignored warning signs and taken unwise or extreme risks which have now placed you and your loved ones in danger. Even so, give them the information that you have and listen to what they have to say. It is only when you do so, that you will be open to their responses, including ideas for possible strategies and solutions.

The most important part of getting through this is knowing that you are not in this alone, that you’re in a partnership. In fact, the strength of partnership is the single most determinative factor in your ability to navigate the course.

**Pay attention to your physical, mental and spiritual health:** We all know that extreme stress - and sudden money loss certainly comes under that category - can take a toll on one’s physical health. This is an excellent time to see your physician. Tell him what you’re going through and get a check up. Get regular exercise, which, in addition to keeping you in shape is an excellent stress buster. Eat a healthy diet and take time to relax, in whatever way is appropriate for you - meditating, walking your dog or reading an absorbing book.

Your mental health is equally as important. If you’re emotions are getting the best of you, (and it’s both likely and natural that they are) consult a trained psychologist who can not only help you sort out your present thoughts and feelings, but can also explain to you how any shame or anger which you may have experienced in past situations are being triggered once again.
by this present crisis. The combination of present emotions and those triggered from the past can be paralyzing. Dealing with past events will make it easier for you to move forward.

Don't underestimate the power of spiritual counseling, even if you have never sought that advice before. Part of getting through this is forgiving yourself. You may need help doing that. A priest, rabbi or minister or other spiritual/religious advisor can help you navigate the storm. In addition to offering you wisdom and virtue, a spiritual advisor can help you deal with the impact that your actions have had on those you love and those that depend on you.

**Assemble a team:** Putting together a team of financial and legal advisors will put you in a state of readiness to face the dragon.

The best lawyer for this situation may not be the one you normally deal with. A good general lawyer may be part of the solution but a specialized lawyer is essential. If you have creditor/bankruptcy issues, find a lawyer who specializes in that. If the crisis might lead to divorce, consult a divorce lawyer. If back taxes are involved, consult with someone who deals with the Internal Revenue Service. If you have been sued or must sue, consult with a litigation specialist or mediator.

If you were diagnosed with a serious illness, you would not consult with one physician to find a treatment. Similarly, if you are in the middle of a financial/business crisis you should not consult with one attorney. Interview several lawyers and pay them for their time. You will learn a lot in every two or three hour block. Most importantly, you will find the people with whom you are comfortable, whom you trust and to whom you can tell anything without feeling judged.

Your team should also include an accountant, financial planner, banker and credit specialist.

Keep in mind who would be the best candidates and how to find them. It is important that at least one of the persons on the team be totally independent from the crisis.

As you interview potential candidates for your team, you will begin to acknowledge the depth of the crisis and to confront reality. You will find that people who know that you are in crisis will seek you out. Friends who you never dreamed would care that much show up. Those who step up and support you may not be who you would have expected. Don't turn them down. Think about whether they would be right to talk to and lean on. There may be a very good reason they are showing up now. Be open.

Building your support network plan will not only put you in a state of readiness, it will also ensure that you won't fall into a crevice.

**Act:** Armed with your support system, it is time to face the tough decisions and implement a plan. Even though you will still feel shame, anger, guilt, etc. do it anyway. With your team of advisors, write a business/financial plan outlining where you are now and how you will get where you need to be. Organizing your journey into discreet steps will make it less overwhelming and will make it easier to deal with the psychological issues as they arise.

In order to avoid falling back into the same hole, put safeguards in place. Choose your partners wisely, assess your risks for trouble and be aware of warning signs.

At the same time, be willing to make mistakes. It is far better to make errors of commission than to remain stuck in denial. If you get stuck, take simple physical actions, like cleaning your house, office or garage, which will clear your mind and help you feel like you are doing something positive. Above all, move forward.

Once you take action, the fog will begin to clear. As you are able to deal with the crisis and accept the necessary solutions, you will also deal with your emotions more effectively. You will discover who your friends are and why they are your friends. Your beliefs about the situation will change. And your sense of self will improve.

Be prepared to repeat these steps, (starting with the second one - acknowledging your emotions) more than once. As you do, you will find yourself moving in an upward, transformational spiral, continually making better and wiser choices, and coming closer and closer to resolution. Your plan and your solutions will continue evolve to a new place on your map, with new circumstance and new friends. As the situation resolves and transforms, continue to focus on the future. The progress you discover will be its own reward.

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Surviving Madoff

Families who were betrayed will need help beyond legal and financial advice

By Tom Davidow

Fear over market fluctuations had already set in. The US was reeling from the consequences of the sub prime debacle. For some, Bernard Madoff’s larceny the last straw. The suicide of German billionaire Adolf Merckle and the apparent suicide of R. Thierry Magon de la Villehuchet, founder of Access International Advisors, make two things clear: First, financial loss is a psychological loss as well.

Mr. Merckle and De la Villehuchet’s suicides were two examples of the level of anger that accompanies such a devastating loss – suicide is anger turned inward. Secondly, individuals and their families who were betrayed by Madoff’s Ponzi Scheme are going to need help beyond legal and financial advice.

Coping with the long term psychological impact will be much harder than making the necessary life style adjustments. Financial loss is not just about money. It is about losing what that money represents — self-esteem stature in one’s community; and a change in identity from winner to loser, from financial genius to fool, from being in control to being a victim, from being secure to being vulnerable, from feeling safe to feeling afraid, and, most of all, from being someone who trusts his or her environment to someone who is no longer able to rely upon it.

Navigating Grief
In order to absorb and adjust to the reality of financial loss,
Denial has passed, family members share an all-consuming rage, accompanied by shame, self-incrimination and thoughts of revenge. As daily life changes, every necessary adjustment stimulates that rage and sense of having been violated. They are driven to create situations or ways of thinking that will somehow assuage their pain and provide some form of relief. Some members give themselves permission to have those powerful feelings, but resist acting on them; others repress them and become depressed, sleeping or eating too much or too little.

Although irritability is inevitable and can strain relationships, family members should trust that their relationships are strong enough to sustain the weight of the burdens placed upon them. They need to be aware of their emotions, and rather than attempting to work through them by themselves, they need to share their rage, sadness, humiliation, and fears with one another.

Loss Can be Expressed in Different Ways
Members of the same family will respond to loss in different ways. For the most part, the senior generation will figure out the money aspect, but the emotional response will be a kind of what Sigmund Freud called melancholia, similar to the mental state of those who go through divorce. They will experience the loss of relationships (the most dramatic example being those who were close to Madoff).

While they go through their own feelings, it is also crucial that they include the next generation in the new reality. Although it is normal for parents to try to protect their children from the vulgarities of life — and wealthy parents generally have the means to do so — protecting them too much can keep them from learning skills. Not involving them in this situation will significantly delay their ability to adjust and, more importantly, will insult them. They will feel marginalized, as though they cannot be trusted with emotional burdens.

The Madoff betrayal also forces wealthy parents to face their greatest fear — that they haven’t prepared the next generation for self-reliance and a productive life. And in fact, the younger generation may or may not be prepared for life without financial security. However, this is not the time to protect them from reality. Children know when something is wrong. Their fantasies are usually more awful than reality. Until they have been tested, children’s strengths remain unknown. In reality, young adults and children have a tendency to rise to the occasion when family matters are involved.

The best way to address feelings is to gather with family and friends who are not judgmental, with whom one feels safe, and whom one can trust. Spending time with each other and

one must go through a grieving process. Elisabeth Kubler–Ross’s well known description of the five psychological stages that accompany the loss of a loved one applies to any significant loss.

Denial: “I feel fine. This can’t be happening to me.”
Anger: “Why me? This isn’t fair.”

Bargaining: “I’ll do anything to have things return to normal.”

Depression: “I’m so sad. Why bother doing anything?”

Acceptance: “It’s going to be okay. I can’t fight it. I might as well deal with it.”

These stages do not always follow a pattern. Nor does one go linearly from one to the next, but rather back and forth between them as he or she grapples with the powerful feelings stirred up by loss. For now, let us focus on the first two stages, which, because events are so recent, are the most relevant.

The first response to loss is a flurry of behaviours similar to those associated with an emergency or serious injury. One deals with the immediate necessities and reaches out for as much information as possible. Until the reality of the loss/trauma sinks in, one remains in a state of denial/shock. Once
talking to each other is nurturing and eases the feelings of isolation; it allows the process of healing to begin.

Stress can be debilitating, so find ways to distract oneself. Exercise is an excellent way to manage and deal with stress. Concentrate on the basics. Put one foot in front of other. Long journeys begin with the first step.

The Role of the Professional Advisor
Although lawyers, accountants and asset managers have always witnessed the inner workings of family dynamics and challenges, they are often reluctant to get involved with the family dynamic and/or to recommend that their clients seek outside resources. Lacking a sense of permission to do so, they don’t want to be intrusive or risk their relationships with their clients.

However, when professional advisors have a front row seat to scenarios in which families struggle with severe financial and psychological challenges, I suggest that it is part of their responsibility to address those circumstances which have a profound effect on family members’ psychological health. A holistic/multi disciplinary approach allows professional advisors to help client families place the rage into a larger context. It will not only improve their client’s judgment, it will make the advisors more effective.

Although families betrayed by Madoff offer the most dramatic examples of the psychological impact of financial loss, there are millions of other families who share some of the same feelings and challenges. Madoff and others who took advantage of their clients, or who did not do their jobs adequately, have created a crisis of trust. It is difficult for a society to function well without trust. Everyone facing severe financial loss is going through the same stages of grief described by Kubler-Ross. They all need to pay attention to their moods, to attach those moods to the stages described and to remain aware of what part of the spectrum they are experiencing.

There is hope on the other side. Powerful and successful families have accumulated their wealth not by accident, but as a consequence of their intelligence and values. Yes, many families and members of the next generation will have to start again.

But the way forward begins with the awareness and implementation of the same value system which created the family’s wealth and success in the first place. Many high net worth families recognize their legacies lie not in their money, but in their value systems. That is why so many of them are philanthropic.

It will be a long journey back. It may take one or more generations to finally return. But the quicker that journey begins the better.

My message to the families is to seek help if you feel you are getting bogged down. My message to professionals is to take a holistic approach and to incorporate other skill sets when necessary. There are resources all over the country.
With collapse of financial institutions should trusted advisor become trustee?

Proceed with care before nominating a trusted advisor to a position of fiduciary responsibility

By Patricia M. Annino, George Burns and Thomas D. Davidow

It seems that every day another major financial institution crashes with little warning to the public, high-net-worth family or business owner.

In many cases, the relationship between that financial institution and the family has been in place for decades.

Businesses and individuals have been lent money by the financial institution, which has served as trustee and provided wealth counsel.

With the shifting of positions within financial institutions and the financial institutions shifting themselves, the key relationship officers may be gone. There is no certainty of what the future holds, yet the family needs, in spite of this uncertainty, to make decisions as to how its wealth will be handled and who should take on the trustee/fiduciary role at death.

With so much shifting sand in the financial services marketplace, that key family member may now rethink whether the trusted family adviser - the lawyer, accountant or CFO - should now be the trustee.

After sharing business and family issues for decades, as well as a common perspective, it is natural for a trusted adviser and his client to develop a personal relationship that extends beyond their professional one. It is understandable, in that case,
for the client to name his trusted adviser in his estate plan as his trustee. The client wants the trustee to guard a whole host of goals and dreams that go beyond the preservation of the assets and wealth.

The client/donor believes that his trusted adviser understands him; that he has the wisdom to incorporate the donor’s most important values, spoken and unspoken.

However, the dual responsibility of the adviser/trustee can blur the parameters of those roles and may have legal, financial and psychological ramifications. Indeed, the hybrid nature of the adviser/trustee’s role offers both advantages and disadvantages, risks and opportunities.

When the client becomes disabled or dies, the adviser serves as a trustee with fiduciary responsibilities to the trust and its beneficiaries. Even though the trusted adviser/trustee should give credence to the founder’s intent, the trusted adviser must switch his duty and loyalty from the founder to the trust, where the standard for decision-making is significantly different from that of the trusted adviser.

The founder can do anything he wants with his own assets, business and money. He can take risks. If his net worth or income declines, it is his responsibility, and he deals with the consequences.

When the trusted adviser takes over, the problems exacerbate. As a fiduciary, the trusted adviser cannot take that same level of risk, since it is not his money, assets or income. As trustee, he is obligated to preserve it for the beneficiaries. He therefore cannot act in the same role as the founder, or even in the same role he had as the trusted adviser to the founder.

If you sincerely believe you can make the greatest contribution by assuming the dual role of adviser and trustee, then take it on; otherwise do not. There are other ways to contribute.

For example, the founder may not be operating his business strictly with a standard of profitability. He may be making business decisions for other reasons. He may be employing friends, keeping on older employees who are no longer productive but who were loyal to him during his lifetime, or running a division of the company because he has fun with it, regardless of the economic consequences of that decision.

The problem is intensified if one of those non-productive employees is a family member who may also become a beneficiary of the trust. When the trusted adviser takes over, he cannot maintain those decisions or take those same risks.

The combination of dealing with the disability or death of a friend and significant client, switching roles, understanding the risks and navigating the family issues is a Molotov cocktail - and where the trouble begins.

It’s not necessarily a bad idea; however, the trusted adviser/trustee, or any trustee who is handling the wealth that is not his own family’s, will have to deal with whatever heartache his friend/donor left behind.

It can be gratifying work to earn fees while helping families in a significant way. The problem arises when one has to deal with a set of circumstances that might impact die family and succeeding generations.

**Transference and Counter-transference**

As a fiduciary, you have the authority of your professional expertise and you have power. While the authority of your professional expertise can have a salutary effect on the individual and the system, the authority of power re-creates transference — the original power and control struggles that parents and children face in one form or another all their lives.

It also re-creates or stimulates the fiduciary’s own issues. When that transference/counter-transference is positive, it works well for all concerned. When there is a negative transference (family members complaining about the adviser/trustee to each other) or negative counter-transference (the adviser cannot stand one or more of the family members), the adviser is in the muck.

While it is important that your relationship with the donor/founder be respected and that your influence be real, it is equally important to have a structure that will balance your authority as trustee/fiduciary. Otherwise, the consequences of the psychological dynamics of transference/counter-transference will impact everybody in the system.

**What to Do**

1. If you are a trusted adviser, seriously consider whether you want to take on the “mess.” The family may be better served by a dispassionate third party, leaving you to continue in your role as trusted adviser and to maintain your authority as wise counsel, a role in which you might best serve the family. If you sincerely believe you can make the greatest contribution by assuming the dual role of adviser and trustee, then take it on; otherwise do not. There are other ways to contribute.

2. If you do decide to take on the role of trustee, make sure that everybody in the family knows it and can give at least tacit approval.

3. Develop a resource with whom you can discuss the many dilemmas you face. Get your own trusted adviser. Remember, though, that one factor that may have led to
your considering assuming your dual role is the savings in adviser fees that might be achieved. That advantage diminishes the more reliance you place on your own advisers.

4. Understand that you will never figure it out by yourself. Given the principle of transference/counter-transference, it is very easy to get lost in the dynamics. It is important that you choose another professional with whom you can sort out your thoughts and ideas.

5. Consider serving as a co-trustee, rather than a sole trustee. Partnering with a financial institution that serves as a professional trustee can be an important buffer with tremendous resources. Established trust services with decades of experience have dealt with any issue you may face many times before and will be less burdened by the emotional connection you have to your founder.

6. If you decide to take on the role, review the legal documents before you agree to serve in that capacity to be sure you understand the scope of your responsibilities, are comfortable with the investment and business risks that are associated with the trust assets, have the right to resign, determine who would appoint a successor in your stead, the grounds by which you may be removed as trustee, how you will be compensated, the language by which you will be liable for your actions or inactions, and the right to seek reimbursement from the trust for your legal fees and expenses. Remember in particular to check your insurance and indemnification arrangements. A lawyer-trustee, for example, presents a mixed professional role to his or her insurer; do not assume that a lawyer’s errors and omissions policy covers trustee functions.

7. If the estate plan includes “riskier assets,” such as a closely held business, encourage the founder to understand that, after his death or disability, the fiduciary has risk in operating the business that the founder did not have. Make sure that the founder’s intent is clearly stated in the document, and the risks associated with serving as trustee are covered in the document. If, for example, the founder wishes the trustee to hold the business as a trust asset, the document should not only state that, but also state (assuming it is the founder’s intent) that he understands the risks associated with that decision, and the trustee is authorized to maintain it even if it is not a productive asset, or declines in value or does not produce income. It can also be helpful to have the founder’s intent expressed in an outside “Mission Statement” that the trustee can use as guidance and can show to beneficiaries who may put pressure on the trustee to change the direction of the trust (for example, to force the sale of a business or to lay off key employees).

At its best, the advisor/trustee role is greater than the sum of its parts. Your ultimate decision will turn on a combination of intellectual analysis and simple emotional response, Your head may tell you that there’s danger and confusion ahead, but your heart may say that you are the best person to chart the future course of the founder’s family and business.

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