

3-27-2008

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Nevada Law Journal

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Recommended Citation

Gaylord, Tanya, "Summary of In re Orpheus Trust, 124 Nev. Adv. Op. No. 16" (2008). *Nevada Supreme Court Summaries*. Paper 448.
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In re Orpheus Trust,
124 Nev. Adv. Op. No. 16 (March 27, 2008)¹

WILLS, TRUSTS AND ESTATES

Summary

Appeal from a district court order denying a special trustee's proposed distribution adjustments in a trust administration matter.

Disposition/Outcome

Reversed and remanded to the district court for a determination of whether the appointed special trustee appropriately analyzed the proposed adjustment using the factors set forth in NRS 164.795(2).

Factual and Procedural History

The Orpheus Trust is a nontestamentary trust domiciled in Nevada. Trustee Gordon Getty is the sole income beneficiary of the trust and controls 60 percent of the trustee votes. Respondent Andrew Getty, Gordon's son, is one of the four contingent remainder beneficiaries of the trust. Andrew is also the president and shareholder of A. Rork Investments, Inc., which is a cotrustee of the Orpheus Trust and controls 10 percent of the trustee votes. In November 2004, over Andrew's objections, the trustees of the Orpheus Trust petitioned the district court to appoint a special trustee to adjust between principal and income. The district court appointed appellant Whittier Trust Company as special trustee in February 2005.

In September 2005, Whittier filed a petition for approval of an adjustment between principal and income for the 2004 trust year. The petition indicated that, in 2004, the trust experienced a net return of 14.77 percent of the fair market value of trust assets, while income payable to Gordon amounted to only 2.59 percent of the trust assets. Therefore, Whittier proposed that Gordon receive a net adjustment of 1.20 percent of the fair market value of the trust assets. Andrew objected to the adjustment, arguing that Whittier could not make a "retroactive" adjustment between principal and income for 2004.

After hearing arguments, the district court denied Whittier's petition, reasoning that Whittier could only adjust between principal and income accrued from its date of appointment. In a subsequent order denying Whittier's motion for reconsideration, the district court also determined that Whittier did not comply with all requirements of NRS 164.795(1) and (2) in analyzing the proposed adjustment. Whittier appealed arguing that the proposed adjustment between principal and income accrued during 2004 was not barred as a "retroactive" adjustment. Whittier also contended that it appropriately analyzed the propriety of the adjustment using the factors set forth in NRS 164.795(2) in recommending the adjustment.

¹ By Tanya Gaylord.

Discussion

In this appeal, the Nevada Supreme Court considered an issue of first impression under Nevada law: whether a special trustee's power to adjust amounts of trust income and principal distributed to a trust income beneficiary and the trust corpus may be exercised with respect to principal and income accrued before the special trustee's appointment. The Court concluded that because the power to adjust is a corrective power, a special trustee may adjust between principal and income accrued in the year immediately preceding its appointment.

Power to correctively adjust principal and income pursuant to NRS 164.795

The trustees of the Orpheus Trust are bound by the standards of the Uniform Prudent Investor Act, which Nevada adopted in 2003. Pursuant to this Act, a trustee is required to devote a portion of trust principal to income-producing investments for the benefit of the trust income beneficiary, while any appreciation in principal would revert to the trust corpus for the benefit of the remainder beneficiaries.² However, in 2003, the Nevada Legislature enacted NRS 164.795(1), a new provision of the Uniform Principal and Income Act, which allows trustees, otherwise unable to impartially and fairly treat both principal and income beneficiaries, to "adjust" between the amounts of trust principal and income distributed to the income beneficiary and the trust corpus. According to the comments to the Principal and Income Act, the primary purpose of this adjustment provision is to free trustees from the traditional obligation to invest in a minimum threshold of income-producing assets.³

Although NRS 164.795 allows for adjustment by a special trustee, the statute is ambiguous as to whether the power to adjust is prospective only or whether it may be exercised retroactively. Applying the rules of statutory construction, the Nevada Supreme Court concluded that, read together, the provisions of NRS Chapter 164 clarify the meaning of NRS 164.795 and that a special trustee may, at a minimum, make a corrective adjustment between principal and income accrued in the year immediately preceding its appointment. In practice, the determination of whether an adjustment between principal and income distributions is necessary often requires a review of data related to trust investments and returns at the close of the year. NRS 164.795(1) allows a trustee to exercise the power to adjust whenever (1) the trustee manages trust assets as a prudent investor, (2) the terms of the trust require distribution of income to an income beneficiary, and (3) the trustee is unable to otherwise comply with NRS 164.720's fairness mandate. Comments by the drafters of the Principal and Income Act also indicate that the power to adjust may be exercised correctively, after the trustee has an opportunity to review trust data and trustee investment decisions for the immediately preceding year.

In this case, the trustees of the Orpheus Trust sought to appoint Whittier as a special trustee in November 2004. Several months after its appointment in February 2005, Whittier submitted a proposed adjustment between principal and income accrued during 2004 for the district court's approval. However, the district court denied Whittier's petition to approve the adjustment, reasoning that NRS 164.795 does not allow for "retroactive" adjustment. This was error. Even though Whittier was not appointed until 2005, the existing trustees, including Gordon, were already bound to act as prudent investors and had the power to invest using a total return strategy during 2004. As provided by the terms of the Orpheus Trust, the trustees were also required to

² See generally Unif. Principal and Income Act § 104 cmt. (amended 1997), 7A U.L.A. 436-37 (2006).

³ *Id.*

distribute trust income to Gordon and after reviewing trust data for the 2004 year, Whittier determined that an adjustment was necessary.

Because all three requirements to make an adjustment under NRS 164.795 were satisfied and because Whittier was appointed in early 2005 and sought an adjustment between principal and income accrued in the immediately preceding year, the Nevada Supreme Court concluded that the proposed adjustment did not constitute an impermissible “retroactive” application of NRS 164.795.

Analysis of adjustment under NRS 164.795(2)

Once a trustee determines that an adjustment between principal and income may be necessary pursuant to NRS 164.795(1), then NRS 164.795(2) requires the trustee to consider a variety of factors in determining the propriety and the amount of any proposed adjustment.⁴ Once the trustee has determined that an adjustment is necessary, NRS 164.725(2) provides that the trustee may provide notice of the proposed action to any interested beneficiary. If no beneficiary objects, the trustee may take the proposed action, but if a beneficiary objects to the proposed action, then the trustee may petition the district court for an order to take the proposed action.⁵ Once the trustee has submitted its proposed adjustment to the district court, a beneficiary may oppose the action in district court and under NRS 164.725(7), “[t]he burden is on the beneficiary to prove that the proposed action should not be taken or should be modified.”

Here, Andrew properly objected to Whittier’s notice of proposed adjustment and opposed Whittier’s subsequent petition for approval of the proposed adjustment. However, it was Andrew’s burden to demonstrate that Whittier’s proposed adjustment was not proper. By making a determination that Whittier did not appropriately analyze the factors provided in NRS 164.795(2) without the benefit of a hearing or briefing by the parties, the district court failed to hold Andrew to his proper burden of proof under NRS 164.725(7).

Conclusion

The Nevada Supreme Court concluded that the power to adjust between trust principal and income set forth in NRS 164.795 is a corrective power, which may be exercised with respect to principal and income accrued in the year immediately preceding a special trustee’s appointment. The Court remanded the case to the district court for further proceedings to determine whether the special trustee appropriately analyzed the factors listed in NRS 164.795(2).

⁴ These factors are: the nature, purpose and expected duration of the trust; the intent of the settlor; the identity and circumstances of the beneficiaries; the needs for liquidity, regularity of income, and preservation and appreciation of capital; the assets held in the trust, the extent to which the assets consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property, the extent to which an asset is used by a beneficiary, and whether an asset was purchased by the trustee or received from the settlor; the net amount allocated to income under the other provisions of NRS 164.780 to 164.925, inclusive, and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available; whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit him from invading principal or accumulating income, and the extent to which he has exercised a power from time to time to invade principal or accumulate income; the actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and the anticipated tax consequences of an adjustment. NRS 164.795(2)

⁵ NRS 164.725(7).