

Of Minds and Money

The Donald Sterling Case and Mental Capacity



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Rochelle (“Shelly”) Sterling, wife of Los Angeles real estate mogul and billionaire Donald Sterling, made headlines in May when she argued to a probate court that her husband was mentally incapacitated — a charge he vehemently denied. The court’s decision had great implications for the Los Angeles Clippers, a 44-year-old professional basketball franchise held in a revocable trust for which both the Sterlings were co-trustees.

The ensuing legal battle brought to light an important question all wealthy individuals should address: What happens when you lose capacity to make sound decisions regarding your wealth? In this estate planning update, we explore the legal nuances of mental capacity through the lens of the Sterling case and offer practical tips on how to establish a clear plan in the event one’s cognitive abilities decline.

Background: The Makings of a Legal Battle

When Donald and Shelly Sterling initially set up a lifetime revocable trust, they funded it with all of their assets, including a controlling stake in the L.A. Clippers professional basketball club, and named themselves co-trustees and primary beneficiaries.

After Donald, 80, made racially insensitive comments in a taped conversation that was released to the public in April 2014, the National Basketball Association penalized him with a \$2.5 million fine and a lifetime ban. The NBA also announced that it would consider forcing Donald to sell the team. Donald vowed not to sell the Clippers, which he had owned since 1981.

Around the same time, Shelly, 79, had Donald evaluated by two independent doctors, who found that Donald suffered from diminished cognitive ability. According to the terms of the Sterling Family Trust, this finding disqualified Donald from serving as a co-trustee, making Shelly the sole trustee. In that role, Shelly had exclusive power to make decisions regarding the trust’s assets — including the Clippers. Acting quickly, Shelly negotiated a \$2 billion sale of the Clippers to former Microsoft CEO Steve Ballmer through a blind auction.

Donald protested the sale, claiming that he was not mentally incapacitated and that Shelly failed to follow the proper protocol in having him evaluated. As a result, he argued, she was *not* the sole trustee and did *not* have the authority to execute the sale without his consent. He then revoked the trust on June 9, presumably in an attempt to regain control over his interest in the team.

The case went to probate court, where the judge heard testimony and arguments regarding several issues, including whether:

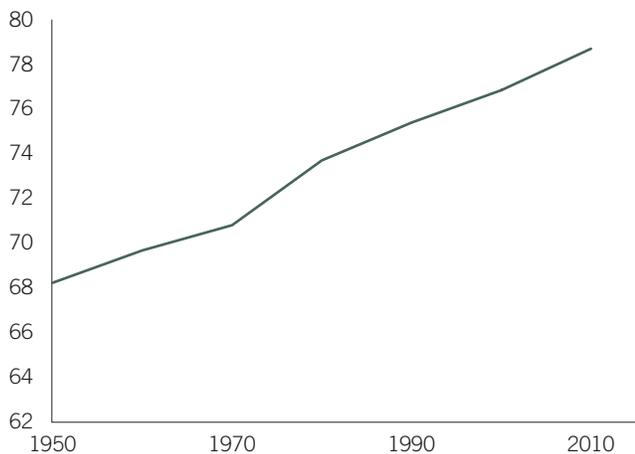
- 1) Donald was properly removed as trustee based on a finding of mental incapacity under the terms of the Sterling Family Trust.
- 2) Shelly had the authority to sell the Clippers to Steve Ballmer.
- 3) Any sale of the Clippers could proceed if Donald decided to appeal the ruling.

On July 28, Los Angeles County Superior Court Judge Michael Levanas ruled in favor of Shelly on all of these issues, and concluded that the sale of the Clippers could proceed even in light of any pending appeal. On August 12, Ballmer became the official new owner of the Clippers.

Incapacity and Estate Planning

This case highlights an issue that has become increasingly common with people living longer (Exhibit 1). At some point in our lives, any of us, or a family member, may become unable to manage financial or personal affairs because of age, accident, or a health problem. According to the National Institute on Aging, the occurrence of Alzheimer's disease doubles every five years beyond age 65, and more than half a million people under 65 have some form of dementia. The prevalence of degenerative brain disease is only expected to increase in the coming years (Exhibit 2).

Exhibit 1: People Are Living Longer
Life Expectancy, United States, 1950-2010



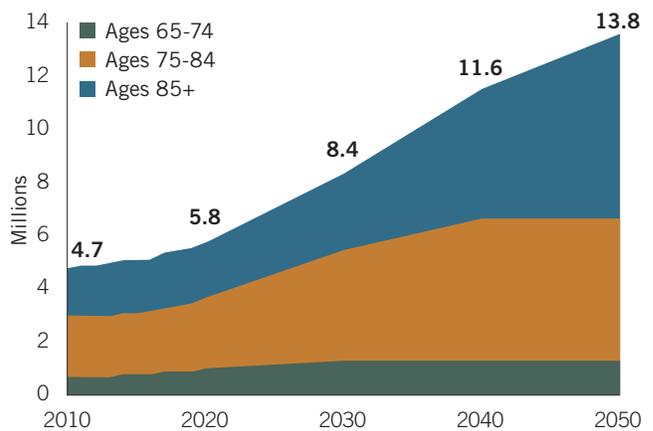
Source: Center for Disease Control

What Is Mental Capacity?

Mental capacity is the ability to make sound financial and personal decisions on your own. The definition of *incapacity* varies from state to state and can also be governed by a legal document such as a living trust or a power of attorney.

There are also different levels of mental cognition required for *testamentary* capacity (capacity to make a will or a lifetime gift), in which you need to understand only the nature of your property and family,

Exhibit 2: Projected Incidence of Alzheimer's in U.S.



Source: Alzheimer's Association

and *contractual* capacity, a much higher standard whereby you understand the nature of more complex proceedings like legal and financial decisions.

Three Key Documents

The best way to plan for incapacity is through the use of three documents:

- a durable power of attorney for legal and financial decisions,
- a power of attorney for healthcare decisions, and
- a living trust.

Without these documents in place, no one has legal authority to handle your financial affairs if you are incapacitated, unless they bring the matter to court (a time-consuming and costly action). Even after a court appoints someone, the court can require the person to report periodically on the incapacitated person's financial and personal affairs.

Each of these documents can be important in establishing how incapacity is determined and who may make certain decisions. Different people or the same people may serve in the following roles:

Durable power of attorney. The durable power of attorney allows the designated agent to make legal and financial decisions for the incapacitated person

(e.g., signing tax returns, paying bills, transferring assets into a living trust). It typically goes into effect when signed and delivered to the agent, and is “durable” because it remains effective beyond the person’s incapacity.

Healthcare power of attorney. The healthcare power of attorney allows the appointed person to make healthcare and medical decisions for the incapacitated person (such as life-sustaining measures, consent to surgical procedures, or organ donation). This document should also be accompanied by a waiver of the privacy requirement mandated by the Health Insurance Portability and Accountability Act (HIPAA) to allow the agent access to pertinent medical information.

Living trust. In most states — including California, where the Sterlings live — the living trust is the core of an estate plan. It is a receptacle for all of a person’s assets, which makes for easier administration during the person’s lifetime and for the effective disposition of those assets upon death. At Bessemer, we recommend that a living trust be funded at the very least with a person’s liquid or financial assets, which can be used to pay expenses at death. The person can revoke or amend the trust during his or her lifetime as long as he or she has capacity. When someone loses capacity, the designated individual or corporate successor trustee then manages the assets during the person’s lifetime according to the terms of the trust.

In most families, the need to determine whether a trustee of a living trust is legally incapacitated never arises. Many trustees whose mental faculties deteriorate may still be able to recognize that someone else is in a better position to handle financial affairs. In those cases, a trustee can simply resign the trusteeship and other decision-making roles and allow successors to take over. The need for one or more doctors to certify that the trustee is incapacitated would arise only in a contentious situation, where, for example, the trustee refuses to step down or where children disagree about their parent’s state of mind.

Planning for Incapacity

To adequately address the issue of incapacity, consider incorporating the following steps in your estate plan:

- 1) Work with your Bessemer legacy planner and attorney to review your existing estate planning documents (such as trusts and wills) to make sure they contain the proper mental incapacity provisions.** Although it may be needed only in a dispute, it is important to define mental incapacity, who is authorized to determine it, and who will make decisions for you when you cannot.
- 2) Review your healthcare power of attorney to ensure that it still complies with your wishes.** If you don’t have a power of attorney for healthcare decisions, put one in place.
- 3) Review your durable power of attorney documents to confirm the right person is designated to make financial decisions on your behalf for any assets not held in a revocable trust.** In nominating a power of attorney, be sure to choose someone who is not only trustworthy and understands your intentions well, but has the wherewithal to make decisions that could require a sophisticated understanding of finances.

The Sterling Family Trust

In the Sterlings’ case, both Donald and Shelly were named as the initial trustees of their living trust. The trust provided that, if one of them died or became incapacitated, the other would become sole trustee. The Sterlings’ trust also said that a trustee would be deemed incapacitated if two doctors confirmed it.

When they established their living trust, Shelly and Donald did their best to protect themselves from any future incapacity. If either was no longer competent to serve as trustee, the trust allowed for the person to be removed without court intervention. The Sterlings also waived their HIPAA privacy rights for this reason. Although no one could have anticipated the events as they occurred, the trust *did* operate as they intended: It protected the trust assets from being squandered or mismanaged.

If the Clippers hadn't been placed in a living trust, a probate court may have still determined Donald's incapacity, but the time it would have taken for the family to go to court could have substantially diminished the value of the Clippers. In this case, time was of the essence. To avoid having the NBA auction off the Clippers, it's likely Shelly needed to broker the sale of the team. The \$2 billion price tag she secured represented the most ever paid for an NBA franchise (Exhibit 3). Moreover, when Donald revoked the trust in June, it prompted several banks that had lent roughly \$500 million to the trust to call their loans. Therefore, Shelly's advisors argued, if the \$2 billion deal were to fall through, the trust could be forced to sell the Clippers at a fire-sale price to raise the funds to pay off this debt. This emphasis on acting quickly as fiduciary to take advantage of an extraordinary offer was perhaps one of the most

important factors behind maximizing the sale of the Clippers — and mitigating the damage caused by Donald's behavior.

Choosing a Trustee

One of the most important decisions in establishing or administering the living trust is designating the successor trustee — an individual or corporate trustee that takes over when the current trustee can no longer do so. If a friend, business associate, professional advisor, or family member is named as an individual trustee, that person should be responsible, have good judgment, and have the time to supervise the trust assets. If such a person is not available, a corporate trustee may be appropriate. Corporate trustees have durability and the ability to deliver objective, solution-oriented advice tactfully and dispassionately. Their expertise on matters such as trust administration, investments, and estate law — and their experience mediating disputes between beneficiaries — often places them in a better position to make difficult decisions and handle the complexities of managing the trust assets. In many cases, a grantor may choose to have an individual and corporate trustee work together, with the individual providing oversight and perspective on family dynamics.

For more information, please contact your Bessemer Client Advisor or a member of Bessemer's estate planning team.

Exhibit 3: Highest Sale Prices for NBA Teams

\$ millions



Source: Forbes

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