

Mitigating Fiduciary Risk and Litigation



Joshua S. Rubenstein
Partner



Bonnie Lynn Chmil
Partner



American Heart Association.

Professional Advisor Network

***2024 NYC Trusts & Estates
Conference***

Katten

KattenMuchinRosenman LLP

Agenda

- Drafting and executing documents in a way to protect against litigation – Joshua S. Rubenstein
- Administering trusts and estates in a way to protect against litigation – Bonnie Lynn Chmil
- Best internal practices – Bonnie Lynn Chmil
- Trusts & Estates Litigation strategies – Bonnie Lynn Chmil
- Using Tax Planning to Resolve Trusts and Estates Controversies – Joshua S. Rubenstein

A background image showing a small green plant with three leaves growing out of a tall stack of silver coins. The scene is set against a light, hazy background with some foliage at the bottom. A horizontal dotted line is positioned above the main title.

Drafting and Executing Documents in a Way to Protect Against Litigation

Joshua S. Rubenstein

Katten
Katten Muchin Rosenman LLP

Drafting and Executing Documents in a Way to Protect Against Litigation

- Exculpatory clauses
- Conflict waivers
- Recognizing disparate treatment and warning family
- Conducting execution ceremonies
- Memorializing execution ceremonies
 - In terrorem clauses
 - Wills vs. Trusts vs. Testamentary Substitutes

Exculpatory Clauses

- General duties of trustee:
 - to administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent terms of governing instrument dictate otherwise;
 - to know the terms of the governing instrument and to administer trust or estate in accordance thereto;
 - to invest and manage property held in a fiduciary capacity in accordance with care, skill, prudence and diligence;

Exculpatory Clauses continued

- General duties of trustee continued:
 - to know your beneficiary and become familiar with her or his needs;
 - to be in compliance with tax laws;
 - to communicate with beneficiaries and to maintain good records to fulfill duty to account;
 - to avoid conflict of interest;
 - see *O'Reilly v U.S. Bank*, 412 S.W.3d 400 (Mo. App. 2013) – case which is illustrative of good trustee practices and responsibilities.

Exculpatory Clauses continued

- Parameters to Limit Fiduciary Liability
 - Limitations on liability permitted but trustee still required to adhere to highest fiduciary standards and should not be lulled into complacency by its inclusion in document;
 - Trend is to view exculpatory clauses with a critical eye, particularly in case of professional trustee;
 - Exculpatory clauses not effective to relieve fiduciary who commits an intentional breach of trust, who acts with gross negligence, in bad faith or with reckless indifference to the interest of the beneficiary (mention recent change in law)

Exculpatory Clauses continued

- Parameters to Limit Fiduciary Liability
 - Testamentary documents – cannot attempt to exonerate testamentary trustee/executor from liability for failure to fulfill fiduciary duties as a matter of public policy and law. EPTL §11-1.7;
 - Previously, limitations on liability were permitted in inter-vivos trust documents but trustee still required to adhere to highest fiduciary standards and should not be lulled into complacency by its inclusion in document;
 - In August 2018, EPTL §11-1.7 was amended to extend statutory limitation on trustee exoneration to inter-vivos trust documents

Exculpatory Clauses continued

- Parameters to Limit Fiduciary Liability continued
 - Trend in NY and elsewhere is to view exculpatory clauses with a critical eye, particularly in case of professional trustee;
 - Exculpatory clauses cannot relieve fiduciary who acts in bad faith or gross negligence.

Conflict Waivers

- Duty of loyalty to all beneficiaries;
- Fiduciary should be familiar with terms of governing instrument, including any self-dealing provisions, facts and circumstances surrounding relationships among beneficiaries;
- If perceive conflict, obtain waiver of conflicts – waiver must fully disclose element of conflict to be effective;

Conflict Waivers continued

- If in drafting stage, anticipate potentials for conflict to avoid allegations of self-dealing that are viewed as breaches of fiduciary duty:
 - provide for ability to hire and retain own firm and to be compensated for services rendered;
 - provide for ability to invest in own funds as well as those of any bank/trust company affiliate;
 - provide for ability to hold concentrated positions and to not diversify investments;
 - provide for ability to be compensated in accordance with published rates periodically in effect, unless another arrangement is agreed upon.

Recognizing Disparate Treatment and Warning Family

- In counseling families, need to be sensitive to treatment among family members:
 - identify and be sensitive to impact on disparate treatment
 - economic impact
 - property distributed outright or held in trust
 - appointment of individual fiduciaries

Recognizing Disparate Treatment and Warning Family continued

- counsel and advise on how disparity may be realized and perceived
 - encourage communication among family members and family meetings
 - consider letter to be opened upon death
 - consider letter of wishes
 - consider in terrorem clause for states where it is enforceable
- outline letter or other written communication should clearly highlight differences for consideration.

Conducting Execution Ceremonies

- observe formalities of execution;
- engage in discussions to confirm capacity and knowledge of event;
- if fear claim of undue influence or other contest issue, insist on meeting solely with client and insist that others leave the room.

Memorializing execution ceremonies

- develop habit of recording basic information surrounding execution;
- conform documents, letter to client to establish execution formalities;
- if fear of litigation, prepare detailed memo addressing client's capacity, formalities of execution and identifying those present during execution ceremony.
 - Video recording execution ceremony – pros and cons



Administering Trusts and Estates in a Way to Protect Against Litigation

Bonnie Lynn Chmil

Communications with Beneficiaries



- Increase in surcharge litigation against fiduciaries arising from increase in:
 - Transfers of wealth in trust
 - Expectations of beneficiaries
 - Volatility of investments
 - New trust companies with less experience
 - Fiduciary litigation bar

Communications with Beneficiaries

- Risk of litigation rises where fiduciary does not sufficiently communicate with beneficiaries.
- Unfamiliarity with trust administration process and lack of control over money may lead to beneficiaries' fear and anxiety.
- Open disclosure of information can support defense that fiduciary's actions were taken in good faith.
- Fiduciaries who fail to communicate or conceal information from beneficiaries viewed with suspicion by beneficiaries and by courts.

Communications with Beneficiaries

- Fiduciaries have duty to communicate with beneficiaries.
- Extent of duty to disclose determined by combination of terms of governing instrument and state law. Other factors: nature of beneficiary's interest, beneficiary's age, capacity and sophistication and nature of trust assets and transactions.
- State law is inconsistent. Creates fiduciary and administrative problems for trustees that operate in multiple jurisdictions.

Communications with Beneficiaries



- New York statutory law.
 - Little statutory guidance exists.
 - SCPA 2308(4), 2309(4) and 2312(6) require that trustees provide certain information to beneficiaries when commissions are involved.
 - Before retaining its annual commissions, trustee must provide certain beneficiaries with statement showing:
 - ❖ principal assets on hand, and
 - ❖ at least annually, all receipts of income and principal during relevant period including any commission retained and calculation of commissions.
 - SCPA 2306. Even if trustee not retaining annual commissions, must furnish annual statement to beneficiary who requests it.

Communications with Beneficiaries

- SCPA 2102(1). Permits beneficiary to bring proceeding to require fiduciary to supply information concerning assets or affairs of estate relevant to beneficiary's interest when fiduciary has failed to comply with written request.
- New York approach consistent with Second Restatement:
 - Trustee has duty upon request of beneficiary to provide at reasonable times complete and accurate information as to nature and amount of property and to allow beneficiary to review trust accounts and related documents.

Communications with Beneficiaries

- Third Restatement takes rather different approach.
 - Requires fiduciaries to notify beneficiaries of status as beneficiaries and to keep fairly representative beneficiaries informed of significant developments regarding trust and its administration.
 - “Fairly representative” beneficiaries:
 - those who currently are entitled or eligible to receive income or principal from trust and
 - those who would receive income or principal if current beneficiaries’ interests or trust terminated.

Communications with Beneficiaries

- Governing instrument will contain guidance as well – may call for contact and communications with beneficiaries.
 - Discretionary power to distribute income or principal.
 - May contain guiding principles.
 - Trustee may consider outside resources – income, assets, liabilities.
 - May contain guidelines for distributions to beneficiaries, e.g., may require gainful employment, distributions for education, health, starting business, maintain lifestyle, etc.
 - May contain “best interests” provisions, allowing trustee to withhold distribution in best interests of beneficiary.
 - Trustee needs to know if guidelines are met.

Communications with Beneficiaries

- Example of potential liability for failure to communicate.
 - Margesson v. Bank of New York, 738 N.Y.S. 2d 411 (3rd Dept. 2002).
 - Trust held large concentrations of highly appreciated stocks. Because of tax liability sale would bring, understanding was that stocks would not be sold unless necessary. Bank's investment officer nevertheless sold portion of stocks without communicating with income beneficiary or administrative officer. Income beneficiary personally liable for more than \$22,000 in capital gains tax.
 - Unhappy income beneficiary sued bank. Bank asserted their sale diversified portfolio in accordance with prudent investor rule. Even if bank complied with prudent investor rule, triable issue of fact existed as to whether bank breached its fiduciary duty by failing to communicate in light of understanding that stock would not be sold unless necessary.

Communications with Beneficiaries



- Suggestions:
 - Make introduction to beneficiaries early.
 - Explain trust administration process in general to help beneficiaries develop realistic expectations.
 - Answer basic questions about trust terms and give beneficiaries overview of conditions for distributions.

Communications with Beneficiaries

- Suggestions continued
 - Consider an in person meeting with beneficiaries.
 - ❖ If counsel attends, advise beneficiaries that counsel represents bank and cannot give beneficiaries legal advice.
 - ❖ Informed beneficiaries may not feel need for their own counsel.
 - Consider introductory letter to beneficiaries to notify them of bank's appointment as trustee, provide contact information, and provide overview of trust administration process.

Communications with Beneficiaries

- Identify all permissible beneficiaries.
 - Get to know beneficiaries' personal circumstances.
 - Monitor events that may modify existing duties or trigger new duties. Births, deaths, marriages, birthdays, graduations.
- Provide copy of governing instrument.
 - Depending on terms of governing instrument and state law, beneficiary may be entitled to copy of entire document.
 - At very least, beneficiaries have right to see enough of document to protect interests.

Communications with Beneficiaries

- Provide required information (notices of withdrawal rights, annual statements, schedules K-1).
- Provide reasonably requested information in timely fashion.
- Inform beneficiaries of fiduciary actions that affect their interests.
- Inform beneficiaries of material facts necessary for them to protect their interests.

Communications with Beneficiaries

- Seeking beneficiaries' advance approval of fiduciary action can be risky.
 - Beneficiary's consent in writing helps to fend off future objection. Beneficiary's withholding of consent should not be veto power over fiduciary's ability to act.
 - If beneficiary objects to proposed action, consider seeking guidance from court.
- Inform beneficiaries of material facts relating to transaction in which trustee has personal interest.

Communications with Beneficiaries

- Limitations on duty to disclose.
 - Confidential financial or medical information of other trust beneficiaries
 - Information regarding negotiations for purchase or sale of trust assets
 - Privileged information

Communications with Beneficiaries

- Limitations concerning revocable trusts.
 - Trustee's duty to report is limited to settlor.
 - Presumptive remainder beneficiaries have no interest in trust until irrevocable (e.g., by settlor's death or incapacity). No obligation to inform remainder beneficiaries of trust and/or administration until then.

Communications with Beneficiaries

- One Kentucky case held that trustee of revocable trust had duty to keep beneficiaries informed of trust and administration. *JP Morgan Chase Bank NA v. Longmeyer*, 275 S.W.3d 697 (Ky. 2009).
 - Bank’s notification to charities that they were originally named as beneficiaries in revocable trust and later removed complied with fiduciary duty.
 - Kentucky amended statute. While trust revocable and settlor has capacity, trustee’s duties to inform and account to beneficiaries extends only to settlor.

Communications with Beneficiaries

- In New York, remainder beneficiaries lack standing to object to any trust transactions that occurred during settlor's life.
 - If remainder beneficiary establishes that non-settlor trustee acted improperly during settlor's life without settlor's approval or ratification, remainder beneficiary may object.

Communications with Beneficiaries

- Uniform Trust Code
 - As of yet, Illinois and New York have not adopted UTC.
 - UTC adopts Third Restatement approach regarding disclosure.
 - Section 813 imposes duties to provide information to beneficiaries. Some duties extend only to “qualified beneficiaries,” which generally means current or permissible beneficiaries of income or principal, successor beneficiaries and presumptive remainder beneficiaries but not contingent remainder beneficiaries.

Communications with Beneficiaries

- UTC duties:
 - Keep qualified beneficiaries reasonably informed about administration of trust and of material facts necessary for them to protect interests.
 - Respond promptly to beneficiary's request for information related to administration of trust.
 - Provide copy of trust instrument on request.
 - Notify qualified beneficiaries of acceptance and of trustee's name, address, and telephone number.

Communications with Beneficiaries

- UTC Duties continued
 - Within 60 days after date trustee acquires knowledge of creation of irrevocable trust, or date trustee acquires knowledge that formerly revocable trust has become irrevocable, notify qualified beneficiaries of trust's existence, of identity of settlor or settlors, of right to request copy of trust instrument, and of right to trustee's report.
 - Notify qualified beneficiaries in advance of any change in method or rate of trustee's compensation.
 - Send current beneficiaries of income or principal, and other qualified or nonqualified beneficiaries who request it, at least annually and at termination of trust, report of trust property, liabilities, receipts, and disbursements, including source and amount of trustee's compensation, listing of trust assets, and, if feasible, their respective market values.

Communications with Beneficiaries

- Beneficiaries may waive right to reports and withdraw waivers.

Communications with Beneficiaries



- UTC also offers trustee's tools for managing risk.
 - Gives trustees ability through disclosure to shorten statute of limitations on surcharge action from five years to one year.
 - If trustee adequately discloses existence of potential claim and informs beneficiary of time allowed for bringing claim, beneficiary has one year from disclosure to bring claim.
 - Adequate disclosure requires trustee to provide sufficient information so that beneficiary knows of potential claim or should have inquired into its existence.
 - One-year statute of limitations does not begin to run against beneficiary who waived report or has not been sent report.
 - If one-year statute of limitations does not apply, beneficiary must bring claim within five years after first to occur of removal, resignation, or death of trustee, termination of affected beneficiary's interest in trust, or termination of trust.

Fiduciary Accountings



- Fiduciaries have obligation to account. SCPA Article 22.
 - In case of trustees, in addition to annual statements distributed in connection with receipt of annual commissions.

Fiduciary Accountings

- Judicial or non-judicial.
 - If judicial, account prepared on judicial schedules and presented to court with petition.
 - Judicial settlement serves interests of both fiduciary and beneficiary in that it provides full disclosure of fiduciary's financial transactions and, upon issuance of a decree, fiduciary is released from liability for those transactions.
 - If non-judicial, account may be on judicial schedules or may consist of collection of account statements, income tax returns, etc. Beneficiaries sign Agreement Settling Account or Receipt and Release Agreement.

Fiduciary Accountings

- Account must be complete and cover all transactions during accounting period. More comprehensive disclosure, better protection trustee will have. Sending beneficiary periodic account statements, copies of checks or other evidence of receipts and disbursements will not suffice.
- Judicial account can be voluntary (SCPA 2208) or compulsory (SCPA 2205 and 2206).

Fiduciary Accountings



- Judicial account may be necessary:
 - Other issues exist that must be determined by court, e.g., elective share, kinship, claims of creditors, claims of fiduciary, construction or reformation of governing instrument.
 - Beneficiaries include minors or others under disability.
 - Beneficiaries refuse to provide fiduciary with informal release.

Fiduciary Accountings



- Executors ordinarily account at conclusion of estate administration.
- Trustees account when trust is terminated or when they cease to serve.

Fiduciary Accountings



- Although not required by SCPA, where trusts are managed over lengthy period, trustees can and should account periodically.
 - Rule of thumb, at least every ten years.
 - Longer fiduciary waits to account, greater likelihood that:
 - memories fade;
 - bank personnel with historical knowledge may leave; and/or
 - records become unavailable.

Fiduciary Accountings

- Waiver of account permitted. Efficacy of waiver and release depend on whether obtained fairly by fiduciary. Fiduciary must show beneficiary was made aware of nature and legal effect of waiver and release. May require evidentiary hearing. Matter of Bronner (Mella, S.).
 - Waivers of duty to account in governing instrument ineffective in New York.

Fiduciary Accountings



- Fiduciary seeking to obtain release and waiver is engaged in self-dealing.
 - Fiduciary must provide full disclosure to beneficiary of facts of situation and legal rights of beneficiary.
 - Fiduciary must negative fraud by positive misrepresentation or concealment, or duress or undue influence, or by other unfairness.

Fiduciary Accountings

- Mere absence of misrepresentation, fraud, or undue influence not sufficient to insulate release from subsequent attack. Fiduciary must affirmatively demonstrate that beneficiaries were made aware of nature and legal effect of transaction in all particulars. *Birnbaum v Birnbaum*, 117 AD2d 409, 416 (4th Dep't 1986).
- Statute of limitations to compel accounting is six years:
 - From date fiduciary openly and unequivocally repudiates will/trust. *Matter of Barabash*, 31 NY2d 76 (1972).
 - In case of resignation of trustee, from date trusteeship is turned over to successor trustee. *Matter of Spallholz; Tydings v Greenfield, Stein & Senior, LLP*.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Bank acting as fiduciary.
 - Bank and beneficiary end up in litigation.
 - Beneficiary demands all communications with counsel.
 - Protected by attorney/client privilege?
 - It depends.
 - ❖ State and federal law is inconsistent.
 - ❖ Very important to safeguard privilege.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- What is the attorney/client privilege?
 - Oldest and most established evidentiary privilege known to law
 - Protects confidential communications between client and attorney from being disclosed to others.
 - Rooted in common law.
 - Privilege promotes effective representation – allows client to speak fully and freely to counsel, knowing counsel will not expose confidences.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- In New York, codified in CPLR 4503.
 - Factors set forth by New York Court of Appeals for determining whether privilege applies:
 - Attorney-client relationship.
 - Communication.
 - Made in confidence.
 - For purpose of obtaining or providing legal assistance.
 - Party asserting privilege bears burden of proof.
 - Trial court determines whether privilege applies.
 - Statute is strictly construed because privilege is limitation on truth-seeking process.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

■ Exceptions

- Engagement letters, invoices, information regarding fee arrangements, payment of fee, fact of communication, fact of consultation, dates legal services performed.
- Communications of non-legal character or unrelated to engagement.
- Business advice or negotiations.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Exceptions continued
 - Fiduciary exception.
 - Created by English courts in mid-19th century.
 - Fiduciaries may not assert attorney-client privilege against beneficiaries with respect to advice regarding trust administration.
 - Represents minority view.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Theories for applying fiduciary exception vary.
 - ❖ Real clients theory.
 - Communications with counsel ultimately benefit beneficiaries.
 - Use of trust funds to pay attorney’s fee “significant factor.”
 - ❖ Obligation to furnish full and complete information regarding trust.
 - ❖ “Good cause” theory.
 - If beneficiary demonstrates “good cause,” the court will weigh competing factors for and against privilege and determine whether to override.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- New York initially recognized fiduciary exception, applying “good cause” theory. *Hoopes v. Carota*, 142 AD2d 906 (3rd Dept 1988), aff’d 74 NY2d 716 (1989).

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- In concluding good cause existed, court looked to following factors:
 - ❖ Beneficiaries directly affected by decision made on counsel's advice.
 - ❖ Information sought highly relevant to issue of whether trustee's actions respecting were in furtherance of interests of beneficiaries or interests of trustee.
 - ❖ Communications related to prospective actions, not past actions.
 - ❖ Beneficiaries' claims of trustee's self-dealing and conflict of interest were colorable and information was relevant and specific.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Trustee made no showing of any factors which would militate in favor of applying privilege to information sought.
- ❖ Trustee did not show advice sought in individual capacity and at own expense as defensive measure regarding potential litigation with beneficiaries.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Amendment of CPLR 4503 to eliminate fiduciary exception.
 - ❖ In absence of agreement to contrary:
 - Beneficiary is not client of attorney for personal representative.
 - Existence of fiduciary relationship does not waive privilege.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Courts have held that statutory amendment does not cover trustees of lifetime trusts.
- Proposed amendments of OCA Advisory Committee to correct oversight not yet adopted.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Tips to Protect Privilege:
 - Ask counsel to review rules of particular state with respect to privilege and fiduciary exception. Do relevant jurisdictions (there may be more than one) recognize fiduciary exception? Forewarned is forearmed.
 - Consider separate counsel to defend against claims of beneficiaries.
 - If not using separate counsel, fiduciary should make clear that advice is sought in personal capacity to defend against claims of beneficiaries.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Tips to Protect Privilege:
 - Have counsel open new matter and separately record time spent for bank in personal capacity.
 - Consider pay out of pocket for services to defend against claims of beneficiaries and seek reimbursement after dispute is resolved.
 - When sending correspondence, avoid combining personal matters with fiduciary matters.
 - When sending correspondence, follow usual safeguards. Use a legend such as “Confidential-Privileged Attorney-Client Communication.”

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Tips to Protect Privilege:
 - Do not waive privilege.
 - Do not include third parties not covered by privilege.
 - Do not copy others on replies to emails.
 - Do not forward emails with counsel to third parties.
 - Do not disclose privileged communications to one beneficiary, as may constitute waiver as to all.
 - Waiver may extend to other documents protected by privilege relating to same subject.

Preserving Attorney-Client Privilege vis-a-vis Beneficiaries

- Tips to Protect Privilege:
 - If third party (e.g., accountant) intended to be covered by privilege because work is integral to legal representation, have attorney engage third party.
 - Make clear to the beneficiaries that bank's counsel represents bank only and not beneficiaries.
 - Refrain from use of term “trust counsel,” which may be confusing.
 - If necessary, suggest that beneficiaries engage their own counsel.



Best Internal Practices

Bonnie Lynn Chmil

Best Internal Practices

- Internal and external use of e-mail
- Internal and external use of meeting memos – level of detail
- Building and preserving a good record
- Documenting best practices
 - Reviewing marketing materials for consistency with practice
- Monitoring employee conversations with beneficiaries during litigation
- Rogue employees

Why Should You Preserve a Good Record?

- It is your duty as a fiduciary to keep a full and accurate record
 - In re JP Morgan Chase Bank, N.A., 981 N.Y.S.2d 636 (Sup. Ct. Monroe County 2013)
 - *In re Garson*, 793 N.Y.S.2d 397 (1st Dept. 2005)
 - *In re Brown*, 697 N.Y.S.2d 838 (Sup. Ct. Queens County 1999)
 - *In re Feinberg's Estate*, 196 N.Y.S.2d 393 (Sur. Ct. N.Y. County 1959)
- 20 years later, memories will blur
- In absence of a good record, all presumptions and doubts are resolved against the fiduciary
 - *Matter of Dumont*, 791 N.Y.S.2d 868 (Sur. Ct. Monroe County 2004)

Account Initiation

- Start with good preparation and planning
 - obtain waivers, releases and indemnification from beneficiaries for actions of prior trustee
 - review trust documents to know primary purpose, duration, standards for distributions, trustee resignation, succession, power to change/remove trustee, what law governs, directions for investing, protection of trustee, retention of professionals
 - advise beneficiaries of key trust provisions at outset
 - ascertain facts about your beneficiary and document it – beneficiaries' needs, risk tolerance, life events that may affect beneficial interest such as births, adoptions, marriages, graduations, attaining a certain age

Account Initiation Continued

- put system in place to account for receipts, disbursements, investments, distributions, principal and income allocations
- establish procedures regarding review process – quarterly, annual, etc.
- establish procedures regarding distributions - frequency, documentation, discretion, whether to require formal requests, communications of denials, whether need to consider other resources of beneficiary
- determine whether to provide formal or informal accountings, the frequency of accountings, and whether to seek court and beneficiary approval

Trust Administration

- Thoroughly document decisions regarding:
 - distributions
 - investment strategy
 - initiation or termination of investments
 - hiring/firing of investment managers and other professionals
 - principal and income allocations
 - expenses
 - receipts and disbursements
 - verbal communications with beneficiaries
 - periodic reviews

Trust Administration continued

- Obtain written approval from co-fiduciaries for all key decisions
- Prepare memos of relevant meetings. The goal is to create a record, not a transcript. Minutes should capture
 - date, time and place of meeting
 - attendees
 - matters discussed
 - any decisions made or actions taken

Trust Administration continued

- Keep your beneficiaries informed
 - provide status letters at regular intervals
 - inform them of all major decisions
 - establish open lines of communication (but proceed with caution) – you are a fiduciary, not a friend

Trust Administration continued

- Mind your manners with email
 - every non-privileged email is discoverable
 - emotions get lost in translation and words are misunderstood
 - don't vent, pass judgment, vacillate, rebuke or criticize
 - think before you write

Trust Administration continued

- Make sure that marketing materials, investment policy statements and other such materials are current regarding standard investment practices
 - update materials regularly to reflect current practice
 - document when and why you vary from standard practices
- If litigation is anticipated or ensues, establish a protocol for communications with the beneficiaries
 - limit direct communications with beneficiaries to routine trust administration matters
 - involve counsel with communications concerning the litigation or relating to the subject matter of the claims



Trusts & Estates Litigation Strategies

Bonnie Lynn Chmil

Trusts & Estates Litigation Strategies

A background image showing a small green plant with three leaves growing out of a tall stack of silver coins. The scene is set against a light, hazy background of trees and a sky.

- Fiduciary duty to beneficiaries suing you
- Fiduciary duty to beneficiaries dragged into the litigation
- When to go to court affirmatively
- Whether and when to ask for advice and direction
 - Preserving payment of fees by trust or estate
- Allocating fees

Fiduciary duty to beneficiaries suing you

- Fiduciary duties continue through thick and thin, even after being sued by your beneficiaries.
 - No one likes to be sued, and the natural reaction toward your adversary is to attack.
 - But, do so strategically, and do not get blinded by your animosity toward your beneficiaries.
 - A sure way to turn a winning case into a loser is by breaching your fiduciary duty in retaliation for being sued.

Fiduciary duty to beneficiaries dragged into the litigation

- A fiduciary cannot seek retribution against its beneficiaries. Indeed, the fiduciary must treat its beneficiaries with extra care during litigation.
- Bending over backwards to avoid the appearance of retaliation might inadvertently harm the “good” beneficiaries.

Fiduciary duty to beneficiaries dragged into the litigation continued

- Balance the competing interests of the “good” and “bad” beneficiaries.
 - This too is a minefield where you may inadvertently turn a meritless claim against you into a winning one.
 - Thoughtfully exercise your discretion.
 - Carefully document the reasons for your decision.
 - Do not forget to protect yourself against currently friendly beneficiaries because you are so preoccupied with the enemy beneficiaries.
- Get sued for doing the right thing and not the wrong thing. It is much easier to defend against the dissident beneficiaries in this situation.

When to go to court affirmatively

- A court will not exercise its discretion for yours. The fiduciary has a role to play – to exercise its best judgment – and the court will not absolve you of this obligation.
 - Indeed, go into court on a matter that can be resolved by an exercise of discretion, no matter how thorny, and the response you will likely get is “do your job.”
 - Worse, the fees incurred in the action will not be reimbursable by the estate or trust.

When to go to court affirmatively cont.

- But, when faced with an issue that cannot be fully resolved simply by exercising your best judgment, go to court!
- A fiduciary may commence an “advice and direction proceeding” asking the court to resolve a preliminary issue before the fiduciary can exercise its judgment.
 - In New York, this is provided for by statute.
 - SCPA Section 2107
 - Allowed in “extraordinary circumstances”
 - In other states it is either statutory or available under common law.

When to go to court affirmatively cont.

- What types of action rise to the level of an advice and direction proceeding?
 - Unavoidable self-dealing
 - Section 2107 includes complex valuation issues and tax elections.
- Substantial compliance with a court's advice and direction will insulate the fiduciary from liability if the fiduciary's action is subsequently challenged by the beneficiary.

Allocating fees

- This is an extremely important question.
 - Indeed, beating back your beneficiary on the merits but at your own expense turns a win into a loss.
 - Accordingly, a fiduciary needs to ensure defense of its conduct at the expense of the trust or estate.
- In New York, a fiduciary can pay defense costs directly from the assets controlled by the fiduciary without prior court approval.
 - But legal fee expenditures are always at the discretion of the court, which can order subsequent disgorgement.
 - Make certain to carefully document legal fee expenses.

Allocating fees cont.

- Fee affidavit (In re Potts, 213 A.D. 59 (1925)).
 - Reasonable amount of hours incurred?
 - Varies with complexity of the matter.
 - Varies with amount of dollars at stake.
 - Reasonable hourly rate?
 - Court will reimburse for expertise.
 - Hire a fiduciary litigator.

Allocating fees cont.

- In some states, must seek court approval for ongoing legal fees.
 - A fiduciary may also be faced with a motion from the beneficiary/adversary seeking to halt the payment of ongoing legal fees from *corpus*.
 - In general, the ongoing payment of legal fees will be permitted absent a preliminary showing of likely breach by the fiduciary.

Allocating fees cont.

- Regardless of venue or procedural posture, all legal fee expenditures will be subject to disgorgement if the fiduciary is ultimately found to have engaged in undisclosed self-dealing or some other per se breach.
 - Absent such a finding, even a losing fiduciary may have its legal fees covered, but only at the court's discretion
 - SCPA 2110 is the New York statute permitting a court to set the compensation of attorneys.
 - Not limited to victors
 - Carefully mapping litigation strategy can help ensure reimbursement of legal fees to the fiduciary from the estate or trust.

A background image showing a small green plant with three leaves growing out of a tall stack of silver coins. The scene is set against a light, hazy background of trees. A horizontal dotted line is positioned above the main title.

Using Tax Planning to Resolve Trusts and Estates Controversies

Joshua S. Rubenstein

Using Tax Planning to Resolve Trusts and Estates Controversies

- Reformation
- Construction
- Disclaimers
- Decanting
- Tax treatment of settlements



Income and Transfer Taxes



- Income Taxes (historically 40% at federal level) – revenue oriented
 - Individual
 - Fiduciary
 - Gifts, Legacies and Distributions – generally tax exempt, except:
 - Income in respect of a decedent (IRD)
 - Distributable net income (DNI)
 - Gifts to employees
- Deductions
 - Charitable – subject to percentage cap of adjusted gross income (AGI)
 - Business – subject to percentage floor of AGI
 - Administration – subject to percentage floor of AGI or not
- State and local taxes

Income and Transfer Taxes



- Transfer Taxes (historically 55% at federal level) – policy oriented; applicable to gratuitous transfers
 - Gift Taxes – tax exclusive
 - Estate Taxes – tax inclusive
 - Generation Skipping Transfer (GST) Taxes
 - Direct Skips – tax exclusive
 - Taxable Distributions and Terminations – tax inclusive
 - Deductions
 - Marital – unlimited
 - Charitable – unlimited

Income and Transfer Taxes



- Deductions continued
 - Debts/Claims – limited only by reasonableness, but must be supported by consideration
 - Administration expenses – limited only by reasonableness, but may be subject to percentage floor of AGI on fiduciary income tax return
 - Exclusions
- Options for Where to Claim Deductions
 - Estate Tax Return
 - Fiduciary Income Tax Return
 - Decedent's Final Income Tax Return
- State and local taxes
- Prospects for Tax Reform

Correcting Tax Problems in Wills and Trusts

- Reformation Proceedings – to correct errors
 - Charitable Gifts – Federally sanctioned (IRC 2055(e)(3))
 - GST Gifts – Federally sanctioned (Reg. 26.2654-1(b)(ii), e.g. to split trusts)
 - Qualified Domestic Trusts (QDOT's) – Federally sanctioned (IRC 2056(d)(5)(A))
 - Qualified Terminable Interest Trusts (QTIP's) – not Federally sanctioned
 - 9100 Relief – generally for botched elections
 - Other – Commissioner v. Estate of Bosch, 387 U.S. 456 (1967) – in the absence of a determination by the state's highest court, only “proper regard,” not finality, should be given to interpretations by state courts, provided it was entered by a court in a bona fide adversary proceeding.

Correcting Tax Problems in Wills and Trusts continued

- Construction Proceedings – to resolve ambiguities
 - Patent
 - Latent
 - Tax Apportionment Clauses -- presumed intent to minimize taxes
- Qualified Disclaimers
 - Disqualifying Dispositions
 - Disqualifying Powers
- Nonqualified Disclaimer
- Resignation of Disqualified Trustees
- Decanting

Correcting Tax Problems in Wills and Trusts

- Beneficiary Powers of Appointment
- Expanding Special Powers of Appointment
- Amending or Revoking Irrevocable Trusts
- Trust Splitting
- Litigation Settlements
 - Probate Contests – can often substantially rewrite wills (e.g., convert bequests from in trust to outright)
 - Elective Share Contests
 - Contested Accountings

Correcting Tax Problems in Wills and Trusts continued

- Contests involving conflicting agreements
 - Separation agreements
 - Prenuptial agreements
 - Shareholder/partnership agreements
- In Terrorem Clause Contests
- Private Letter Rulings
 - Pros – certainty
 - Cons – delay; possible negative results

Correcting Tax Problems in Wills and Trusts continued

- Marital Deduction (IRC 2056)
 - Interest must “pass from” the decedent
 - Property must be included in gross estate
 - Property must “pass to” the surviving spouse
 - Cannot be a “terminable interest,” unless statutorily excepted
- Charitable Deduction (IRC 2055)
 - Interest must “pass from” the decedent
 - Property must be included in gross estate
 - Property must “pass to” charity
 - Contest must be bona fide

Tax Treatment of Settlements

- Marital Deduction – diversion of property from spouse increases taxes (and perhaps interest and penalties)
- Charitable Deduction – diversion of property from charity increases taxes (and perhaps interest and penalties)
- Gift Tax Concerns – values of interests cannot change measurably (Reg. 25.2512-8).

Tax Treatment of Settlements continued



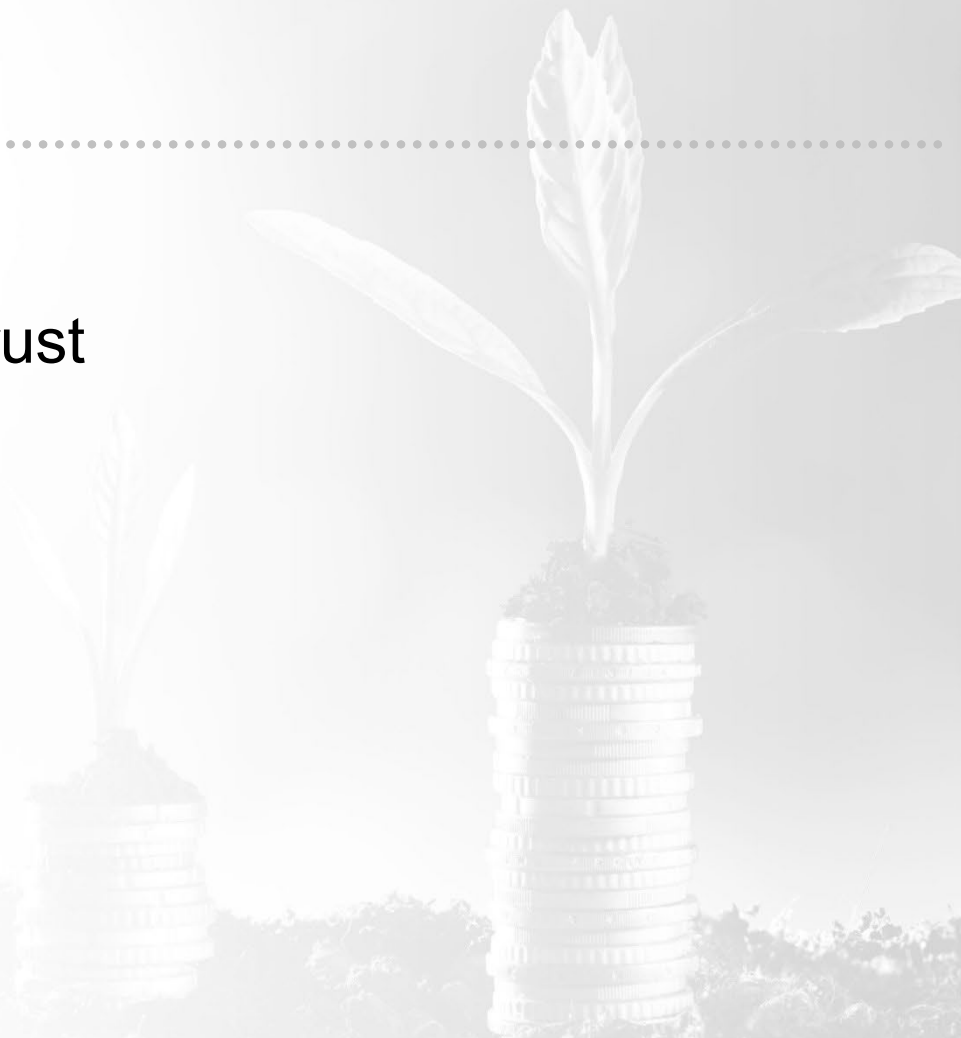
- Income Tax Concerns – IRC 102(a) exempts gifts and inheritances, except
 - Income from gifts and inheritances
 - Gain on conversion or deemed conversion
 - Compensation
 - Damages
 - Services
- IRD
- DNI – N.B. periodic payments

Tax Treatment of Settlements continued

- Legal Fees
 - Fiduciary's fees – generally deductible by estate or trust
 - Beneficiary's fees
 - Generally not deductible by estate or trust, except
 - ❖ Probate Contests
 - ❖ Construction Proceedings
 - May or may not be deductible by beneficiary
 - Must be reasonable – U.S. v. White, 853 F.2d 107 (2d Cir. 1988)

Strategies

- Establish consideration
- Claims against estate or trust
 - Value high
 - Post-death events
- Claims by estate or trust
 - Value low
 - Risk of litigation discount
 - Post-death events



Strategies continued

- Enhance tax advantaged trusts
 - Estate Tax Exempt
 - Credit shelter trust
 - Trusts not in gross estate
 - Estate Tax Deferred – marital trusts
 - GST Exempt
 - Zero inclusion ratio
 - Grandfathered

Strategies continued

- Consider possible benefits of contribution
- Transfer debt to lower generations
- Create more funds through substantive state election
- Discount long-term notes
- Deduct payments to children
- Buy back from charity
- Characterization of transfers as gifts vs. loans
- Circular 230
- Caution

Katten Locations

CHARLOTTE

550 South Tryon Street
Suite 2900
Charlotte, NC 28202-4213
+1.704.444.2000 tel
+1.704.444.2050 fax

CHICAGO

525 West Monroe Street
Chicago, IL 60661-3693
+1.312.902.5200 tel
+1.312.902.1061 fax

DALLAS

2121 North Pearl Street
Suite 1100
Dallas, TX 75201-2591
+1.214.765.3600 tel
+1.214.765.3602 fax

LONDON

Paternoster House
65 St Paul's Churchyard
London EC4M 8AB
United Kingdom
+44 (0) 20 7776 7620 tel
+44 (0) 20 7776 7621 fax

LOS ANGELES – CENTURY CITY

2029 Century Park East
Suite 2600
Los Angeles, CA 90067-3012
+1.310.788.4400 tel
+1.310.788.4471 fax

LOS ANGELES – DOWNTOWN

515 South Flower Street
Suite 4150
Los Angeles, CA 90071-2212
+1.213.443.9000 tel
+1.213.443.9001 fax

NEW YORK

50 Rockefeller Plaza
New York, NY 10020-1605
+1.212.940.8800 tel
+1.212.940.8776 fax

ORANGE COUNTY

100 Spectrum Center Drive
Suite 1050
Irvine, CA 92618-4960
+1.714.966.6819 tel
+1.714.966.6821 fax

SHANGHAI

Suite 4906 Wheelock Square
1717 Nanjing Road West
Shanghai 200040
P.R. China
+86.21.6039.3222 tel
+86.21.6039.3223 fax

WASHINGTON, DC

1919 Pennsylvania Avenue NW
Suite 800
Washington, DC 20006-3404
+1.202.625.3500 tel
+1.202.298.7570 fax

Katten refers to Katten Muchin Rosenman LLP and the affiliated partnership as explained at katten.com/disclaimer.

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

Katten

Katten Muchin Rosenman LLP

www.katten.com