NEW YORK STATE BAR ASSOCIATION

TRUSTS AND ESTATES LAW SECTION

Spring Meeting 2019

Trusts: Who and What Should You Trust?

NAPLES, FLORIDA | May 16 - 19, 2019

Ritz-Carlton Beach Resort
280 Vanderbilt Beach Road

www.nysba.org/TRUSSP19

Trusts: Who and What Should You Trust?

Trusts and Estates Law
Section Spring Meeting 2019

May 16 - 19, 2019

The Ritz-Carlton Beach Resort

Naples, Florida

Thank You! This program is made possible by the generous donation of time and expertise by members and volunteers. Thank you to our volunteers—and to you, for choosing NYSBA Programs.

This program is offered for educational purposes. The views and opinions of the faculty expressed during this program are those of the presenters and authors of the materials, including all materials that may have been updated since the books were printed or distributed electronically. Further, the statements made by the faculty during this program do not constitute legal advice.

Copyright © 2019
All Rights Reserved
New York State Bar Association

MCLE INFORMATION

Program Title: **Trusts and Estates Law Section Spring Meeting 2019**
Dates: May 16-19, 2019 Location: Naples Florida

Evaluation: https://nysba.co1.qualtrics.com/jfe/form/SV_42UM60nnZxSx9Up
This evaluation survey link will be emailed to registrants following the program.

Total Credits: **Up to 9.0 New York CLE credit hours**

Credit Categories:
2.5 in Skills; 4.5 in Areas of Professional Practice;1.0 Ethics and Professionalism
Optional Surrogates Session: 1.0 in Skills

This course is approved for credit for **all attorneys both experienced and newly admitted**. (admitted to the New York Bar for less than two years).

Attendance Verification for New York MCLE Credit

In order to receive MCLE credit, attendees must:

1) **Sign in** with registration staff

2) Complete and return a **Verification of Presence form** (included with course materials) at the end of the program or session. For multi-day programs, you will receive a separate form for each day of the program, to be returned each day.

Partial credit for program segments is not allowed. Under New York State Continuing Legal Education Regulations and Guidelines, credit shall be awarded only for attendance at an entire course or program, or for attendance at an entire session of a course or program. Persons who arrive late, depart early, or are absent for any portion of a segment will not receive credit for that segment. The Verification of Presence form certifies presence for the entire presentation. Any exceptions where full educational benefit of the presentation is not received should be indicated on the form and noted with registration personnel.

Program Evaluation

The New York State Bar Association is committed to providing high quality continuing legal education courses, and your feedback regarding speakers and program accommodations is important to us. Following the program, an email will be sent to registrants with a link to complete an online evaluation survey. The link is also listed above.

Additional Information and Policies

Recording of NYSBA seminars, meetings and events is not permitted.

Accredited Provider

The New York State Bar Association's **Section and Meeting Services Department** has been certified by the New York State Continuing Legal Education Board as an accredited provider of continuing legal education courses and programs.

Credit Application Outside of New York State

Attorneys who wish to apply for credit outside of New York State should contact the governing body for MCLE in the respective jurisdiction.

MCLE Certificates

MCLE Certificates will be emailed to attendees a few weeks after the program, or mailed to those without an email address on file. **To update your contact information with NYSBA**, visit www.nysba.org/MyProfile, or contact the Member Resource Center at (800) 582-2452 or MRC@nysba.org.

Newly Admitted Attorneys—Permitted Formats

In accordance with New York CLE Board Regulations and Guidelines (section 2, part C), newly admitted attorneys (admitted to the New York Bar for less than two years) must complete **Skills** credit in the traditional live classroom setting or by fully interactive videoconference. **Ethics and Professionalism** credit may be completed in the traditional live classroom setting; by fully interactive videoconference; or by simultaneous transmission with synchronous interactivity, such as a live-streamed webcast that allows questions during the program. **Law Practice Management** and **Areas of Professional Practice** credit may be completed in any approved format.

Tuition Assistance

New York State Bar Association members and non-members may apply for a discount or scholarship to attend MCLE programs, based on financial hardship. This discount applies to the educational portion of the program only. Application details can be found at www.nysba.org/SectionCLEAssistance.

Questions

For questions, contact the NYSBA Section and Meeting Services Department at SectionCLE@nysba.org, or (800) 582-2452 (or (518) 463-3724 in the Albany area).

THANK YOU TO OUR SPONSORS

FARRELLFRITZ
ATTORNEYS

BROWN
BROTHERS
HARRIMAN

HIGHTOWER
RDM FINANCIAL GROUP

Beller Smith
Attorneys at Law

GRASSI & CO.
ACCOUNTANTS & SUCCESS CONSULTANTS®

citi®
Private Bank

NORTHERN TRUST

EMPIRE
VALUATION CONSULTANTS

TRISTAR
COURT REPORTING INC.

PHILLIPS

FIRST REPUBLIC
PRIVATE WEALTH MANAGEMENT

THANK YOU TO OUR EXHIBITORS

Appraisers & Planners Inc.

Art Peritus LLC

Doyle

Citi Private Bank

Empire Valuation Consultants

InterActive Legal

Kravit Estate Appraisals

MPI – Management Planning Inc.

RDM Financial Group at High Tower

Sigma Valuation Consulting Inc.

Sterling Foundation Management

Valbridge Property Advisors

Willamette Management Associates

UPCOMING CLE PROGRAMS

Trusts & Estates Law Section and Elder Law Section Joint Fall Meeting
Thursday and Friday, October 23 - 25, 2019 | The Gideon Putnam | Saratoga Springs
Information: www.nysba.org/TRUS

17th Annual Sophisticated Trusts & Estates Institute (CLE)
Friday, November 8, 2019 | The Crowne Plaza Times Square | NYC

Trusts & Estates Law Section 2020 Annual Meeting
Wednesday, January 29, 2020 | The New York Hilton Midtown | NYC

Trusts & Estates Law Section Spring 2020 Meeting
Thursday - Sunday, April 29 - May 3, 2020 | Kimpton Hotel Van Zandt | Austin, TX
Information: www.nysba.org/TRUS

SCHEDULE OF EVENTS

Thursday, May 16

11:00 a.m. – 6:00 p.m. **Registration** – Ballroom Foyer

12:00 – 2:00 p.m. **Executive Officers' Meeting** – Coquina Sands

2:00 – 5:00 p.m. **Executive Committee Meeting** – Estuary

6:00 – 7:30 p.m. **Welcome Cocktail Reception** – North Beach
Unwind in your resort wear and sandals on the beautiful white sand beach at the water's edge.

Specialty Cocktail Silver Sponsor: **BELLER SMITH**

Reception Sponsor: **FIRST REPUBLIC PRIVATE WEALTH MANAGEMENT**

7:30 p.m. **Dinner on Your Own**

Friday, May 17

7:45 a.m. – 12:45 p.m. **Registration** – Ballroom Foyer

8:00 – 8:50 a.m. **Committee Breakfast Meetings** – Port Royal

8:00 – 9:00 a.m. **Continental Breakfast and Exhibitors** – Ballroom Foyer
Open to all registered attendees including spouses and guests. Grab a bite and visit with our exhibitors. Coffee will be available throughout the morning.

8:55 a.m. – 12:45 p.m. **MCLE General Session** – Ritz-Carlton Ballroom

Audio Visual Silver Sponsor: **CITI PRIVATE BANK**

8:55 – 9:10 a.m.

NYSBA Welcome
Michael Miller, Esq.
President

Trusts and Estates Law Section Welcome
Robert M. Harper, Esq.
Section Chair

Program Introductions
Angelo M. Grasso, Esq.
Program Co-Chair

Sponsor Acknowledgments
Darcy M. Katris, Esq.
Sponsorship Chair

9:10 – 10:00 a.m. **Doing Well by Doing Good: Fiduciary Investing with Purpose**
Can fiduciaries earn high returns on investment, while also achieving positive social results? We will examine the legal rules applicable to fiduciaries making investment decisions and the advent of socially responsible investments.

Panelists:

Natalia Murphy, Esq.
Head of Trust and Wealth Planning for North America
Citi Private Bank
New York City

Raymond Joseph
Global Head of Portfolio Solutions
Citi Investment Management
Citi Private Bank
Stamford, CT

10:00 – 10:50 a.m. **Minimizing Trustee Risk**
Although trustees are not guarantors of trust performance, trustees' actions can expose them to litigation and, ultimately, liability. This presentation will concern strategies that trustees can employ in order to minimize the risk that they have to surcharges for their administration of trusts, including but not limited to the tension that exists between trust beneficiaries, the tools that are available to trustees in catering to those interests, and drafting strategies that provide protection to trustees. This session will prove to be invaluable to attorneys who advise trustees with respect to the administration of trusts and counsel who defend trustees in litigation concerning such administration.

Speaker:

Elisa Shevlin Rizzo, Esq.
Northern Trust
New York City

10:50 – 11:05 a.m. **Refreshment Break with Exhibitors** – Ballroom Foyer

11:05 – 11:55 a.m.

Using Trusts to Resolve Litigation
Disputes involving trusts present unique challenges, including sensitive family dynamics, high financial stakes, and complex procedural, legal, and tax issues. Trust law has evolved to offer various options for resolving disputes and preserving the purpose of the trust and the grantor's intent. Aside from strictly legal considerations, however, it is important for attorneys to draft flexible trust instruments, trustees to stay current with the needs of beneficiaries, and to act promptly when altered circumstances necessitate a modification to the trust. Topics to be explored include decanting, trust situs, trust protectors, and both drafting and procedural considerations.

Speaker:

Hon. Acea M. Mosey
Erie County Surrogate's Court
Buffalo

11:55 a.m. – 12:45 p.m.

Florida Trust Considerations for the New York Practitioner
With no state income or estate tax, and with warmer temperatures during the cold winter months, Florida has always been an attractive destination for New Yorkers, and it is common for a New York practitioner to encounter an existing Florida trust or a client who wants to establish one. This presentation will flag some of the unique features of Florida trust law that differ from New York trust law, from annual accounting requirements to the impact of homestead laws on trusts. The presentation will also include drafting tips and suggest methods for anticipating and tackling hot button issues.

Panelists:

Amy B. Beller, Esq.
Beller Smith
Boca Raton, FL

Michael S. Schwartz, Esq.
Curtis, Mallet-Prevost, Colt & Mosle LLP
New York City

Afternoon At Your Leisure – See Activities Pages 9 & 10

2:00 – 4:00 p.m.

Doubles Tennis Tournament – Tennis Center
Har-Tru® clay courts; court shoes required. Preregistration required. Must be 18 or older. $60.00 per person.

Tennis Chair: **Julie Min Chayet, Esq.**, U.S. Trust, Bank of America Private Wealth Management, Weston, CT

6:00 – 9:00 p.m.

Reception And Dinner – Center Court
Enjoy sweeping views of the Gulf of Mexico from this stunning location.
Music by David Bach Quartet. Children's Dinner in Plaza III.

Reception Silver Sponsor: **NORTHERN TRUST**

Dinner Silver Sponsor: **GRASSI & COMPANY**

Entertainment Silver Sponsor: **RDM FINANCIAL GROUP AT HIGHTOWER**

Dinner Wine Sponsors: **RDM FINANCIAL GROUP AT HIGHTOWER AND TRISTAR COURT REPORTING**

Saturday, May 18

7:30 a.m. – 12:45 p.m. **Registration** – Ballroom Foyer

8:00 – 9:00 a.m.

Continental Breakfast and Exhibitors – Ballroom Foyer
Open to all registered attendees including spouses and guests. Grab a bite and visit with our exhibitors. Coffee will be available throughout the morning.

8:00 – 8:50 a.m.

Optional Session: Breakfast with the Surrogates – Port Royal
Successful Strategies for Securing the Removal of a Trustee
Inherent tension exists between trust beneficiaries and the trustees who manage the assets in which the beneficiaries are interested, and, in some cases, the extent to which the beneficiaries have access to those assets. Our esteemed panel of current and former Surrogate's Court judges will address how best to successfully seek removal of trustees, and how to defend trustees in removal proceedings. Given the wonderful Surrogates who will be participating, this presentation promises to be an informative, entertaining discussion of successful strategies that can be employed in removal proceedings.

Panelists:

Hon. John M. Czygier, Jr.
Former Surrogate
Suffolk County Surrogate's Court
Riverhead

Hon. Peter J. Kelly
Queens County Surrogate's Court
Jamaica

Hon. Stacy L. Pettit
Albany County Surrogate's Court
Albany

Hon. Margaret C. Reilly
Nassau County Surrogate's Court
Mineola

9:00 a.m. – 12:45 p.m. **MCLE General Session** – Ritz-Carlton Ballroom

Audio Visual Silver Sponsor: **CITI PRIVATE BANK**

9:00 – 9:10 a.m.

Program Introductions
Brian P. Corrigan, Esq.
Program Co-Chair

Sponsor Acknowledgements
Darcy M. Katris, Esq.
Sponsorship Chair

9:10 – 10:00 a.m.

Constitutional Considerations in the State Taxation of Trusts
This presentation will cover the constitutional considerations and practical implications of trust situs, with a focus on determining the tax situs of non-grantor trusts. These issues will be discussed both broadly and specifically as they relate to planning in New York, and will include case study examples relevant for the New York practitioner when trust planning under the relevant New York statutes.

Speaker:

Toni Ann Kruse, Esq.
McDermott Will & Emery
New York City

10:00 – 10:25 a.m.

Trusts Go To Washington: North Carolina Dept. of Revenue v. Kaestner Family Trust
In January 2019, the United States Supreme Court granted North Carolina's petition for certiorari on the question of whether the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency. This presentation will discuss the arguments made by all interested parties, the oral argument at the Supreme Court, and the potential consequences of the Supreme Court's decision.

Speaker:

Angelo M. Grasso, Esq.
Greenfield Stein & Senior, LLP
New York City

10:25 – 10:40 a.m. **Refreshment Break with Exhibitors** – Ballroom Foyer

10:40 – 11:55 a.m.

The Anatomy of a Trust Contest
The panel of speakers will discuss the key differences between a trust contest and a will contest, including the governing law and what grounds may exist to bring a trust contest. Topics to be explored include subject-matter jurisdiction, pre-trial discovery, motion practice, evidentiary considerations, and the trial of a trust contest.

Panelists:

Hon. Vincent W. Versaci
Schenectady County Surrogate's Court
Schenectady

Gary B. Freidman, Esq.
Greenfield Stein & Senior, LLP
New York City

Frank T. Santoro, Esq.
Farrell Fritz, P.C.
Uniondale

11:55 a.m. – 12:45 p.m.

Avoiding Conflicts Among Trust Clients (Ethics Credit)
This presentation will discuss the various types of proceedings in which conflicts of interest most often arise in the Surrogate's Courts, including trust-related litigation, and will review the relevant New York Rules of Professional Conduct governing conflicts involving current clients (i.e., representation of multiple parties), former clients, and potential clients.

Panelists:

Hon. Theresa B. Whelan
Suffolk County Surrogate's Court
Riverhead

Eric W. Penzer, Esq.
Farrell Fritz, P.C
Uniondale

SCHEDULE OF EVENTS

Afternoon At Your Leisure – See Activities Pages 9 & 10

1:00 – 4:15 p.m.	**Private Docent Led Tour Of The Revs Institute, 2500 Horseshoe Drive, Naples** Founded in 2008 by Miles Collier whose father and uncle are credited with introducing sports car racing in the early 30's to the US. Includes Collier's extensive private collection and the collection of a family friend, Briggs Swift Cunningham. Bugattis, Ferraris – one of the best private collections of vintage automobiles in the World. Very limited tickets. Price includes transportation: $50 per person. Preregistration required. Meet in lobby at 1:00 p.m. sharp to catch shuttle for museum.
1:30 – 5:30 p.m.	**Golf At Tiburón Gold Course, 2620 Tiburón Drive** Tiburón is home to the LPGA Tour's CME Group Tour Championship and the PGA TOUR's QBE Shootout and is consistently rated among the top 20 golf facilities in Florida by Golf Digest and GOLF Magazine. Designed by Greg Norman. $205 per person. Fee includes: greens fees, golf cart and box lunch. Preregistration required. For golf club rentals, call (239) 593-2201.
Golf Chair:	**Magdalen Gaynor, Esq.**, Law Offices of Magdalen Gaynor, White Plains
7:00 p.m. – 10:00 p.m.	**Cocktail Reception & Dinner At The Fairways At The Ritz-Carlton Golf Club, 2600 Tiburon Drive** Shuttles will depart from Beach Club Lobby starting at 6:30 p.m.
Platinum Dinner Sponsor:	**FARRELL FRITZ P.C.**
Reception Sponsor:	**PHILLIPS AUCTION HOUSE**
Entertainment Sponsor:	**EMPIRE VALUATION**

Sunday, May 19

7:00 – 10:00 a.m.	**Checkout**

Lawyer Assistance Program 800.255.0569

Q. What is LAP?

A. The Lawyer Assistance Program is a program of the New York State Bar Association established to help attorneys, judges, and law students in New York State (NYSBA members and non-members) who are affected by alcoholism, drug abuse, gambling, depression, other mental health issues, or debilitating stress.

Q. What services does LAP provide?

A. Services are **free** and include:

- Early identification of impairment
- Intervention and motivation to seek help
- Assessment, evaluation and development of an appropriate treatment plan
- Referral to community resources, self-help groups, inpatient treatment, outpatient counseling, and rehabilitation services
- Referral to a trained peer assistant – attorneys who have faced their own difficulties and volunteer to assist a struggling colleague by providing support, understanding, guidance, and good listening
- Information and consultation for those (family, firm, and judges) concerned about an attorney
- Training programs on recognizing, preventing, and dealing with addiction, stress, depression, and other mental health issues

Q. Are LAP services confidential?

A. Absolutely, this wouldn't work any other way. In fact your confidentiality is guaranteed and protected under Section 499 of the Judiciary Law. Confidentiality is the hallmark of the program and the reason it has remained viable for almost 20 years.

Judiciary Law Section 499 Lawyer Assistance Committees Chapter 327 of the Laws of 1993

Confidential information privileged. The confidential relations and communications between a member or authorized agent of a lawyer assistance committee sponsored by a state or local bar association and any person, firm or corporation communicating with such a committee, its members or authorized agents shall be deemed to be privileged on the same basis as those provided by law between attorney and client. Such privileges may be waived only by the person, firm or corporation who has furnished information to the committee.

Q. How do I access LAP services?

A. LAP services are accessed voluntarily by calling **800.255.0569** or connecting to our website **www.nysba.org/lap**

Q. What can I expect when I contact LAP?

A. You can expect to speak to a Lawyer Assistance professional who has extensive experience with the issues and with the lawyer population. You can expect the undivided attention you deserve to share what's on your mind and to explore options for addressing your concerns. You will receive referrals, suggestions, and support. The LAP professional will ask your permission to check in with you in the weeks following your initial call to the LAP office.

Q. Can I expect resolution of my problem?

A. The LAP instills hope through the peer assistant volunteers, many of whom have triumphed over their own significant personal problems. Also there is evidence that appropriate treatment and support is effective in most cases of mental health problems. For example, a combination of medication and therapy effectively treats depression in 85% of the cases.

Personal Inventory

Personal problems such as alcoholism, substance abuse, depression and stress affect one's ability to practice law. Take time to review the following questions and consider whether you or a colleague would benefit from the available Lawyer Assistance Program services. If you answer "yes" to any of these questions, you may need help.

1. **Are my associates, clients or family saying that my behavior has changed or that I don't seem myself?**
2. **Is it difficult for me to maintain a routine and stay on top of responsibilities?**
3. **Have I experienced memory problems or an inability to concentrate?**
4. **Am I having difficulty managing emotions such as anger and sadness?**
5. **Have I missed appointments or appearances or failed to return phone calls? Am I keeping up with correspondence?**
6. **Have my sleeping and eating habits changed?**
7. **Am I experiencing a pattern of relationship problems with significant people in my life (spouse/parent, children, partners/associates)?**
8. **Does my family have a history of alcoholism, substance abuse or depression?**
9. **Do I drink or take drugs to deal with my problems?**
10. **In the last few months, have I had more drinks or drugs than I intended, or felt that I should cut back or quit, but could not?**
11. **Is gambling making me careless of my financial responsibilities?**
12. **Do I feel so stressed, burned out and depressed that I have thoughts of suicide?**

There Is Hope

CONTACT LAP TODAY FOR FREE CONFIDENTIAL ASSISTANCE AND SUPPORT

The sooner the better!

1.800.255.0569

NEW YORK STATE BAR ASSOCIATION

Join Our Section

☐ As a NYSBA member, **PLEASE BILL ME $40 for Trusts and Estates Law Section dues.** (law student rate is $5)

☐ I wish to become a member of the NYSBA (please see Association membership dues categories) and the Trusts and Estates Law Section. **PLEASE BILL ME for both.**

☐ I am a Section member — please consider me for appointment to committees marked.

Name ____

Address ____

____

City ________________ State _____ Zip ________________

The above address is my ☐ Home ☐ Office ☐ Both

Please supply us with an additional address.

Name ____

Address ____

City ____________________ State _____ Zip ____________

Office phone (_______) ____________________________

Home phone (_______) ____________________________

Fax number (_______) ____________________________

E-mail address _____________________________________

Date of birth _______ /_______ /_______

Law school ____

Graduation date ____________

States and dates of admission to Bar: __________________

Please return this application to:
MEMBER RESOURCE CENTER,
New York State Bar Association, One Elk Street, Albany NY 12207
Phone 800.582.2452/518.463.3200 • FAX 518.463.5993
E-mail mrc@nysba.org • www.nysba.org

Join a Trusts and Estates Law Section Committee(s)

Please designate in order of choice (1, 2, 3) from the list below, a maximum of three committees in which you are interested. You are assured of at least one committee appointment, however, all appointments are made as space availability permits.

___ Charitable Planning (TRUS1100)
___ Continuing Legal Education (TRUS1020)
___ Diversity (TRUS2800)
___ Elderly and Disabled (TRUS1700)
___ Estate and Trust Administration (TRUS1400)
___ Estate Litigation (TRUS1200)
___ Estate Planning (TRUS1300)
___ International Estate Planning (TRUS1600)
___ Legislation and Governmental Relations (TRUS1030)
___ Life Insurance and Employee Benefits (TRUS1800)
___ Membership and Law Students (TRUS1040)
___ Multi-State Practice (TRUS2400)
___ Newsletter and Publications (TRUS1900)
___ New York Uniform Trust Code (TRUS2900)
___ Practice and Ethics (TRUS2100)
___ Surrogates Court (TRUS2200)
___ Taxation (TRUS2300)
___ Technology in Practice (TRUS2500)

2019 ANNUAL MEMBERSHIP DUES

Class based on first year of admission to bar of any state.
Membership year runs January through December.

ACTIVE/ASSOCIATE IN-STATE ATTORNEY MEMBERSHIP	
Attorneys admitted 2011 and prior	$275
Attorneys admitted 2012-2013	185
Attorneys admitted 2014-2015	125
Attorneys admitted 2016 - 3.31.2018	60

ACTIVE/ASSOCIATE OUT-OF-STATE ATTORNEY MEMBERSHIP	
Attorneys admitted 2011 and prior	$180
Attorneys admitted 2012-2013	150
Attorneys admitted 2014-2015	120
Attorneys admitted 2016 - 3.31.2018	60

OTHER	
Sustaining Member	$400
Affiliate Member	185
Newly Admitted Member*	FREE

DEFINITIONS

Active In-State = Attorneys admitted in NYS, who work and/or reside in NYS
Associate In-State = Attorneys not admitted in NYS, who work and/or reside in NYS
Active Out-of-State = Attorneys admitted in NYS, who neither work nor reside in NYS
Associate Out-of-State = Attorneys not admitted in NYS, who neither work nor reside in NYS
Sustaining = Attorney members who voluntarily provide additional funds to further support the work of the Association
Affiliate = Person(s) holding a JD, not admitted to practice, who work for a law school or bar association
*Newly admitted = Attorneys admitted on or after April 1, 2018

TABLE OF CONTENTS

Doing Well by Doing Good: Fiduciary Investing with purpose 1
Panel: Natalia Murphy, Esq., Raymond Joseph

Minimizing Trustee Risk 11
Speaker: Elisa Shevlin Rizzo, Esq.

Using Trusts to Resolve Litigation 97
Speaker: Hon. Acea M. Mosey

Florida Trust Considerations for the New York Practitioner 171
Panelists: Amy B. Beller, Esq., Michael S. Schwartz, Esq.

Breakfast with the Surrogates Successful Strategies for Securing the Removal of a Trustee 215
Panelists: Hon. John M. Czygier, Hon. Peter J. Kelly,
Hon. Stacy L. Pettit, Hon. Margaret C. Reilly

Constitutional Considerations in the State Taxation of Trusts 225
Speaker: Toni Ann Kruse, Esq.

Trusts Go To Washington: North Carolina Dept. of Revenue v. Kaestner Family Trust 245
Speaker: Angelo M. Grasso, Esq.

The Anatomy of a Trust Contest 469
Panelists: Hon. Vincent W. Versaci, Gary B. Freidman, Esq.
Frank T. Santoro, Esq.

Avoiding Conflicts Among Trust Clients 645
Panelists: Hon. Theresa B. Whelan, Eric W. Penzer, Esq.

Speaker Biographies 717

Doing Well by Doing Good: Fiduciary Investing with Purpose

Natalia Murphy, Esq.
Citi Private Bank, NYC

Raymond Joseph
Citi Private Bank, Stamford, CT

Private Bank

Doing Well by Doing Good

Investing with Purpose

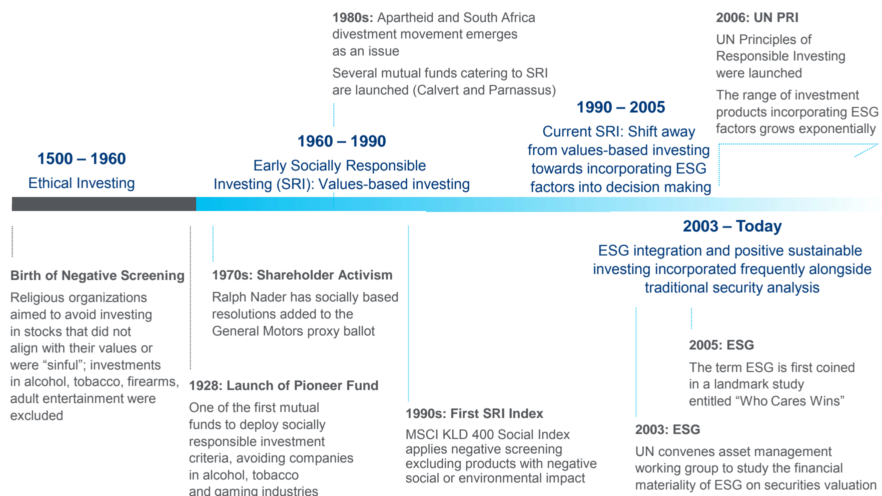
May 17, 2019

Natalia Murphy
Head of Trust and Wealth Planning for North America

Ray Joseph
Global Head of Portfolio Solutions
Citi Investment Management

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

Evolution of sustainable investing



1500 – 1960
Ethical Investing

Birth of Negative Screening
Religious organizations aimed to avoid investing in stocks that did not align with their values or were "sinful"; investments in alcohol, tobacco, firearms, adult entertainment were excluded

1928: Launch of Pioneer Fund
One of the first mutual funds to deploy socially responsible investment criteria, avoiding companies in alcohol, tobacco and gaming industries

1960 – 1990
Early Socially Responsible Investing (SRI): Values-based investing

1970s: Shareholder Activism
Ralph Nader has socially based resolutions added to the General Motors proxy ballot

1980s: Apartheid and South Africa divestment movement emerges as an issue

Several mutual funds catering to SRI are launched (Calvert and Parnassus)

1990 – 2005
Current SRI: Shift away from values-based investing towards incorporating ESG factors into decision making

1990s: First SRI Index
MSCI KLD 400 Social Index applies negative screening excluding products with negative social or environmental impact

2003 – Today
ESG integration and positive sustainable investing incorporated frequently alongside traditional security analysis

2003: ESG
UN convenes asset management working group to study the financial materiality of ESG on securities valuation

2005: ESG
The term ESG is first coined in a landmark study entitled "Who Cares Wins"

2006: UN PRI
UN Principles of Responsible Investing were launched

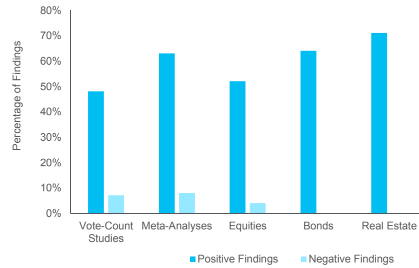
The range of investment products incorporating ESG factors grows exponentially

The case for sustainable investing

Citi Private Bank reviewed an analysis of the results of more than 2,000 different academic studies carried out since the early 1970s

- Over half of these studies found a positive correlation between companies that score well when evaluated based on factors that align with environmental, social and governance (ESG) principles and corporate financial performance
- Less than 10% identified a negative relationship between high scoring ESG factors and corporate financial performance
- Companies that scored well when evaluated based on ESG factors typically had better financial results than companies with lower ESG scores

Companies that adhere to high ESG standards tend to have stronger financial performance



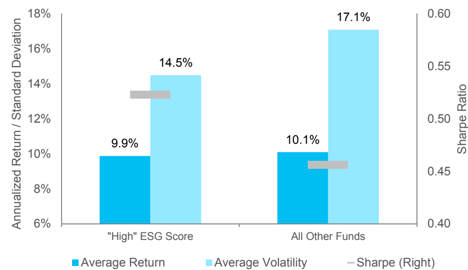
Source: Friede, Busch, and Bassen; ESG and financial performance, 2015. **Past performance is no guarantee of future returns.** Real results may vary. Note: The results shown towards the left are based on 723 vote-count studies and 1,214 meta-analyses. The asset class results towards the right involve 334 vote-count studies of which 36 pertain to bonds and 7 to real estate. Vote-count studies assign findings into significant positive, negative and non-significant categories. Meta-analyses involve econometric reviews. Please see Glossary for definitions.

Environmental, social and governance (ESG) principles should not be the only consideration when making an investment decision. Selecting investments based on ESG principles will not guarantee positive future returns. There can be no assurance that any Socially Responsible Investing (SRI) screening process will achieve its goals or that an investment will not incur losses.

The case for sustainable investing

When compared to traditional managers, ESG-focused managers had comparable returns with lower risk, resulting in superior risk-adjusted returns between January 2010 through December 2018

Mutual funds with high ESG scores delivered better risk adjusted returns
January 1, 2010 – December 31, 2018



Source: Morningstar; January 1, 2010 – December 31, 2018. **Past performance is not indicative of future results.** Office of the Chief Investment Strategist, Citi Private Bank. We used data on 528 US equity funds with data back to 2010 from the Morningstar database. Of these, 58 were assigned to the high ESG score universe based on Morningstar's methodology; all others totaled 470 funds. We compared the high ESG funds and all others on an equal-weighted basis for return and standard deviation. The Sharpe ratios shown were calculated on the aggregated returns and standard deviations. Sharpe ratio is the measure of risk-adjusted return of a financial portfolio. A portfolio with a higher Sharpe ratio is considered superior relative to its peers.

Environmental, social and governance (ESG) principles should not be the only consideration when making an investment decision. Selecting investments based on ESG principles will not guarantee positive future returns. There can be no assurance that any Socially Responsible Investing (SRI) screening process will achieve its goals or that an investment will not incur losses.

Opportunities today

Sustainable investing does not require you to sacrifice returns nor is it a philanthropic endeavor

Today's approach may enhance investment returns for our clients

HISTORICAL MODEL	TODAY	
LIMITED FINANCIAL BENEFIT	FOCUS ON FINANCIAL BENEFIT	PLUS A SOCIAL BENEFIT
Responsible **Socially Responsible Investing (SRI)** negatively screens firms based on adherence to accepted environmental, social and governance (ESG) principles	**Sustainable** Evaluates firms on adherence to accepted **ESG** principles	**Impact** Investments with an **intended focus** on positive ESG impact typically seeking to achieve a societal benefit as well as a financial return, resulting in double-bottom line reporting[1]

[1]Measuring performance in terms of profit/loss as well as in positive social impact.
Environmental, social and governance (ESG) principles should not be the only consideration when making an investment decision. Selecting investments based on ESG principles will not guarantee positive future returns. There can be no assurance that any Socially Responsible Investing (SRI) screening process will achieve its goals or that an investment will not incur losses.

5 Private Bank

1/20 – CI012873496

State of the industry

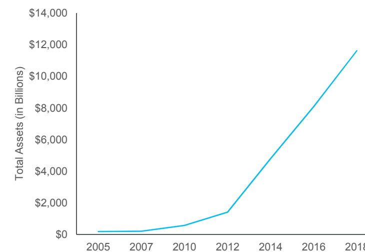
DEMAND FOR SUSTAINABLE INVESTING BUILDS GLOBALLY

Growth of Sustainable Investment Assets by Region 2014-2016[1]

Region	2014 ($B)	2016 ($B)	Growth over Period	Compound Annual Growth Rate
Europe	10,775	12,040	11.7%	5.7%
US	6,572	8,723	32.7%	15.2%
Canada	729	1,086	49.0%	22.0%
Australia/New Zealand	148	516	248.6%	86.4%
Asia	52	526	911.54%	218.05%
Total	**18,276**	**22,891**	**25.3%**	**11.9%**

…AND INVESTMENT OPTIONS ARE EXPANDING RAPIDLY

Growth of ESG Incorporation by US Money Managers 2005-2018[2]



[1] Source: 2016 Global Sustainable Investment Review, *GSIA;* Asset values are expressed in billions. GSIA uses an inclusive definition of sustainable investing, without drawing distinctions between this and related terms such as responsible investing and socially responsible investing. These are collectively referred to as sustainable investing.
[2] Source: Report on US Sustainable, Responsible and Impact Investing Trends 2018, US SIF Foundation.

6 Private Bank

1/20 – CI012873496

Why this is possible today

Technology and innovation are strengthening investment processes and adding new dimensions to the evaluation of investment opportunities

Advancements in technology

Data availability

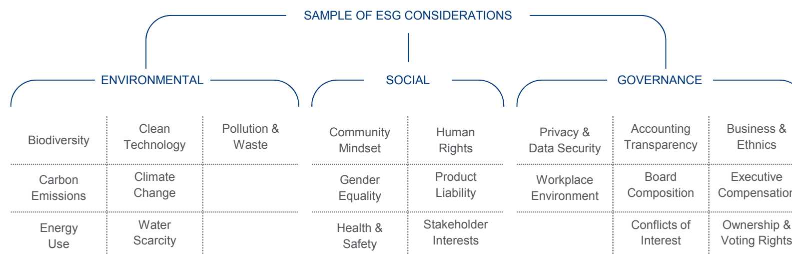
Information advantage

Adding value via favorable ESG factors

How it makes an impact

The explicit incorporation of environmental, social or governance criteria and considerations into investment decision making seeks to advance positive change around a wide range of issues

Investors who attribute value to companies that manage their businesses sustainably can help influence and transform how companies behave over time

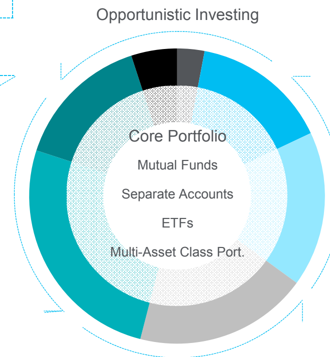


Multiple dimensions of sustainable investment management

ESG investing adds a new dimension to how investment firms work with clients to understand their goals and objectives

This framework provides comprehensive portfolios designed to deliver capabilities in asset allocation, manager selection and portfolio construction

Positioning a diversified **core** portfolio of skillful managers paired with customized structures, complemented with **opportunistic** investments, provides the potential to align personal values while seeking enhanced returns and diversification in a risk managed framework



There can be no assurance that due diligence, manager selection and risk monitoring processes will achieve their goals and that any portfolio or fund will not incur losses. Diversification does not ensure against loss.

Sustainable Investing and Fiduciary Duty

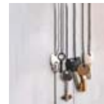
Duties that affect fiduciary investment decision-making

Duty of Obedience

- Fiduciary must comply with the terms of the governing instrument
- Does the governing instrument have specific instructions regarding investment decision making?

Duty of Impartiality

- Fiduciary must treat present and future beneficiaries impartially
- This duty is particularly important in multi-generational trusts



Duty of Loyalty

- Fiduciary acts in the sole interests of beneficiaries and may not consider fiduciary's personal interests in making decisions for beneficiaries
- Fiduciary's decisions about investments must be consistent with the interests of beneficiaries

Duty of Care/Prudent Investor Rule

- Fiduciary has a duty to manage assets with reasonable care, skill and caution
- This duty is expressed in the Prudent Investor Rule, NY EPTL 11-2.3

NY Prudent Investor Act, EPTL 11-2.3

Conduct, not performance

Exercise reasonable care, skill and caution in relation to investments
- Standard of prudence

Evaluate portfolio as a whole
- Each investment cannot be viewed in isolation
- Trade off between risk and return

Diversify
- Minimize investment risk
- Avoid concentrated positions

Evaluate trust purposes and beneficiaries' needs
- Term and purpose
- Time horizon
- Current beneficiary income needs & principal distribution requirements
- Tax considerations for trust and/or for income beneficiaries/remaindermen
- Volatility of portfolio/risk tolerance
- Legal and other special considerations

Incur reasonable and appropriate costs only

Duty of Loyalty

Comment to § 5 (Loyalty) of Uniform Prudent Investor Act (1995)

"No form of so-called 'social investing' is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries – for example, by accepting below-market returns -- in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause."

Restatement (Third) of Trusts (2007)

§ 78, Comments & Illustrations f.
Adds language from UPIA and comments, "Not surprisingly, considerable disagreement continues about what loyalty should require in this context." The comment cites articles in the context of pension plans and references § 90

§ 90, Comments & Illustrations c. General requirements of loyalty and impartiality
"Thus, for example, in managing the investments of a trust, the trustee's decisions ordinarily must not be motivated by a purpose of advancing or expressing the trustee's personal views concerning social or political issues or causes. Such considerations, however, may properly influence the investment decisions of a trustee to the extent permitted by the terms of the trust or by consent of the beneficiaries."

2018 Amendments to Delaware Prudent Investor Act

12 Delaware Code § 3302 Degree of care; authorized investments

"(a) … when considering the needs of the beneficiaries, the fiduciary may take into account the financial needs of the beneficiaries *as well as the beneficiaries' personal values, including the beneficiaries' desire to engage in sustainable investing strategies that align with the beneficiaries' social, environmental, governance or other values or beliefs of the beneficiaries."*

12 Delaware Code § 3303 Effect of provisions of instrument

" (a) Notwithstanding any other provision of this Code or other law, the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any laws of general application to fiduciaries, trusts and trust administration, including, but not limited to, any such laws pertaining to:

. . .

(4) *The manner in which a fiduciary should invest assets, including whether to engage in 1 or more sustainable or socially responsible investment strategies, in addition to, or in place of, other investment strategies, with or without regard to investment performance …"*

Implementation of Sustainable Investing?

Fiduciary Discretion

Directed Trusts

Important Information

In any instance where distribution of this communication ("Communication") is subject to the rules of the U.S. Commodity Futures Trading Commission ("CFTC"), this communication constitutes an invitation to consider entering into a derivatives transaction under U.S. CFTC Regulations §§ 1.71 and 23.605, where applicable, but is not a binding offer to buy/sell any financial instrument.

All views, opinions and estimates expressed in this communication (i) may change without notice, and (ii) may differ from those views, opinions and estimates held or expressed by Citigroup or other Citigroup personnel. Recipients of this communication should obtain advice based on their individual circumstances from their own tax, financial, legal and other advisors before making an investment decision, and only make such decisions on the basis of the investor's own objectives, experience and resources.

Citi Private Bank ("CPB") is a business of Citigroup Inc. ("Citigroup"), which provides its clients access to a broad array of products and services available through bank and non-bank affiliates of Citigroup. Not all products and services are provided by all affiliates or are available at all locations. In the US, investment products and services are provided by Citigroup Global Markets Inc. ("CGMI"), member FINRA and SIPC, and Citi Private Advisory, LLC ("Citi Advisory"), member FINRA and SIPC. CGMI accounts are carried by Pershing LLC, member FINRA, NYSE, SIPC. Citi Advisory acts as distributor of certain alternative investment products to clients of Citi Private Bank. CGMI, Citi Advisory and Citibank, N.A. are affiliated companies under the common control of Citigroup.

Outside the US, investment products and services are provided by other Citigroup affiliates. Investment Management services (including portfolio management) are available through CGMI, Citi Advisory, Citibank, N.A. and other affiliated advisory businesses. These Citigroup affiliates, including Citi Advisory, will be compensated for the respective investment management, advisory, administrative, distribution and placement services they may provide.

Citi Investment Management ("CIM") is a business unit of Citigroup Inc. that conducts investment management services out of Citibank N.A. and certain branches and other affiliates, including Citi Advisory and CGMI.

Glossary

Meta-Analysis: A meta-analysis is a statistical analysis that combines the results of multiple scientific studies. The basic tenet behind meta-analyses is that there is a common truth behind all conceptually similar scientific studies, but which has been measured with a certain error within individual studies.

Vote-Count Study: Vote counting is a simple but limited method for synthesizing evidence from multiple evaluations, which involves simply comparing the number of positive studies (studies showing benefit) with the number of negative studies (studies showing harm).

Views, opinions and estimates expressed herein may differ from the opinions expressed by other Citi businesses or affiliates, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice, and are subject to change without notice based on market and other conditions. Citi is under no duty to update this document and accepts no liability for any loss (whether direct, indirect or consequential) that may arise from any use of the information contained in or derived from this Communication.

Strategies and investments involve risk and may not perform as described, may not be suitable for every investor, and may have eligibility requirements that must be met prior to investing.

For US clients, trust services are provided by one of the following entities: Citibank, N.A., Citicorp Trust South Dakota or Citicorp Trust Delaware, N.A. For clients who are neither residents nor citizens of the US, trust services are provided by one of the following entities: Cititrust Private Trust (Cayman) Limited, Cititrust Private Trust Zurich GmbH, Cititrust (Bahamas) Limited, Cititrust (Cayman) Limited, Cititrust (Jersey) Limited, Cititrust (Singapore) Limited, Cititrust (Switzerland) Limited or Citicorp Trust Delaware, N.A. The service providers are referred to collectively as Citi Trust. Cititrust (Jersey) Limited, whose contact details are P.O. Box 728, 38 Esplanade, St. Helier, Jersey JE4 8ZT, Channel Islands, telephone number +44 1534 608000, is licensed by the Jersey Financial Services Commission for the conduct of Trust Company Business.

1/20 – CI012873496

Important Information

Custody services are provided by Citibank, N.A.

Citigroup Inc. and its affiliates do not provide tax or legal advice. To the extent that this material or any attachment concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Any such taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

© 2019 Citigroup Inc., All Rights Reserved. Citi, Citi and Arc Design and other marks used herein are service marks of Citigroup Inc. or its affiliates, used and registered throughout the world.

www.citiprivatebank.com

1/20 – CI012873496

Minimizing Trustee Risk

Elisa Shevlin Rizzo, Esq.
Northern Trust, NYC

MINIMIZING FIDUCIARY RISK ---

COMMON-SENSE ADVICE FROM A CORPORATE TRUSTEE

New York State Bar Association
Trusts & Estates Section Spring Meeting
May 16-19, 2019
Naples, FL

Elisa Shevlin Rizzo
Senior Legal Counsel and Senior Fiduciary Officer
The Northern Trust Company

NTAC:3NS-20

CONTENTS

I. INTRODUCTION 5

II. FIDUCIARY DUTIES 5

A. Duty of Loyalty 7

B. Duty of Care 8

C. Duty of Impartiality 9

D. Duty to Inform and Account 10

E. Duty to Prudently Invest Trust Assets 12

1. Prudent Investor Rule 12

2. New York Prudent Investor Act 13

3. Standard of Process, Not Performance 14

4. Intersection of Investments and Impartiality 14

5. Balancing Competing Interests 15

III. COMMON GROUNDS FOR AN ALLEGATION OF FIDUCIARY LIABILITY 19

A. Breaches of the Duty of Loyalty 19

1. Overview 19

2. "No Further Inquiry" Rule 20

3. Purchase/Sale of Trust Property To/From the Trustee 20

4. Investment of Trust Assets in Property Owned by the Trustee 22

5. Indirect Self-Dealing 24

6. Co-Mingling Trust Property 27

7. Beneficiary as Trustee 29

8. Using Trust Property to Discharge a Trustee's Personal Obligations 31

9. Excessive Compensation 34

10. Defenses to a Breach of the Duty of Loyalty 38

11. Remedies/Damages for Breach 38

B. Breaches of the Duty of Care 39

1. Negligence in the Investment/Sale of Trust Property 39

2. Improper Delegation to Co-Fiduciaries 40

C. Investment Issues 42

1. Standard of Conduct 42

2. Diversification Cases 43

3. Effect of Retention Clauses 49

4. Consent of Settlor and/or Beneficiaries as Bar to Cause of Action 51

D. Difficulties with Discretion 52

1. Determination of Settlor's Intent 53

2. Judicial Review 53

3. Understanding Common Discretionary Standards 54

4. Purely Discretionary Trusts 57

5. Consideration of Other Resources 57

6. Unequal Distributions 58

7. Process and Procedures 59

E. Failures to Communicate 61

1. Selective Provision of Information 62

2. Failure to Stay Informed About a Beneficiary's Needs 62

3. Silent Trusts? 63

4. Communication in Action 63

F. Effect of Exoneration Clauses 64

IV. CONCLUSION 65

MINIMIZING FIDUCIARY RISK–
COMMON-SENSE ADVICE FROM A CORPORATE TRUSTEE

Elisa Shevlin Rizzo[1]

I. INTRODUCTION

Being named as an executor or trustee is an honor that should not be taken lightly. Unfortunately, many individuals named to these trusted roles do not have a clear understanding of the duties, responsibilities and potential risks that serving as a fiduciary entails. As fiduciary litigation becomes increasingly common, assuming a position as executor or trustee is not for the faint of heart.

This outline will explore the basic fiduciary duties owed by an executor or trustee, some of the potential pitfalls that may lead to litigation and a few best practices from a professional fiduciary.

II. FIDUCIARY DUTIES

By its very terms, a trust is a fiduciary relationship. The role of a fiduciary is a challenging one which may involve managing the trust on behalf of multiple parties with different or competing interests.[2] But what exactly does that mean? Developing a strong understanding of a fiduciary's duties and responsibilities is the first key step in minimizing fiduciary risk.

The simplest definition of a trust is that it is a legal arrangement where one (the fiduciary) holds legal title to property for the benefit of another (the beneficiary). It is the relationship between the fiduciary, the beneficiary and the settlor's intent that is key. The Restatement (Third) of Trusts defines the term "trust" as "a fiduciary relationship with respect to property, arising from a manifestation of *intention* to create that relationship and subjecting the person who holds title to the property to *duties* to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee."[3]

Because of the very special nature of the trust relationship, fiduciaries are held to the highest standard of conduct under the law. As Justice Cardozo famously stated in Meinhard v. Salmon:

> *"Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."*[4]

Not only is the fiduciary held to a heightened standard of conduct, but the fiduciary also owes certain duties to the trust beneficiaries. Breaches of these duties, whether intentional or unintentional, may result in litigation. Any individual or corporate fiduciary must take steps to ensure that these fundamental fiduciary duties are met.

A. Duty of Loyalty

The duty of loyalty is the core of all fiduciary relationships. It is well-settled that "a fiduciary owes a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect."[5] This duty is absolute and may not be waived.[6]

The duty of loyalty requires that the fiduciary administer the estate or the trust solely in the interest of the beneficiaries.[7] This duty, which is also sometimes referred to as the "sole interest rule," means that the fiduciary must place the interests of the beneficiaries ahead of the fiduciary's own interests, as well as the interests of other parties.

In keeping with this duty, the fiduciary must avoid all actual and potential conflicts of interest. A fiduciary may not enter into any transaction directly with the trust or estate and must also avoid any transactions which would benefit the trustee or a closely related person or entity, directly or indirectly.[8] In addition, the trustee must deal with beneficiaries fairly and communicate to the beneficiaries all material facts that the trustee knows or should know in connection with the matter.[9]

The rationale underlying the rule against self-dealing was summarized by the New York Court of Appeals as follows:

> *"The rule is founded in the highest wisdom. It recognizes the infirmity of human nature, and interposes a barrier against the operation of selfishness and greed. It discourages fraud by taking away motive for its*

> *perpetration. It tends to insure fidelity on the part of the trustee, and operates as a protection to a large class of persons whose estates . . . are intrusted to the management of others."*[10]

B. <u>Duty of Care</u>

In addition to the duty of loyalty, a fiduciary has a duty to administer the estate or the trust and to carry out the settlor's intentions as expressed in the governing instrument in good faith, with reasonable skill, care and caution.[11] The fiduciary must employ the degree of care that a prudent person of discretion and intelligence in such matters would exercise in the fiduciary's own affairs.[12]

In addition, a fiduciary who holds himself or herself out as having special skills, must employ those skills or run the risk of surcharge.[13] With regard to corporate fiduciaries, Section 11-2.3(b)(6) of the New York Estates, Powers & Trusts Law ("EPTL") specifically requires a bank, trust company or other paid investment professional that is serving in a fiduciary capacity to exercise such diligence in investing and managing trust assets as a prudent investor having special skill would do.

Traditionally, the duty of care prohibited a trustee from delegating functions related to the administration of the trust that the trustee could reasonably be expected to perform. However, in recent years that rule has shifted. Today, particularly with regard to the investment of trust assets, the law imposes a duty to delegate if the trustee does not have the

requisite skill or experience. The delegation of a trustee's investment or management responsibilities still requires the trustee to exercise care, skill and caution in selecting a suitable delegee, establishing the scope and terms of the delegation, overseeing the exercise of the delegated function and managing costs.[14] In addition, New York law permits co-trustees to delegate amongst one another, especially where one trustee has an expertise in a particular aspect of the trust management. However, a trustee who delegates administrative functions to a co-fiduciary is not relieved from the duty to exercise oversight responsibility.[15]

C. <u>Duty of Impartiality</u>

The duty of impartiality requires a trustee to treat beneficiaries equitably, if not equally, while taking into account the terms and purposes of the trust. In all facets of trust administration, including distribution decisions, investment decisions and communication with beneficiaries, the trustee must consider not only the interests of the current beneficiaries, but also the remainder beneficiaries.

A trustee must be careful to not favor one beneficiary or one class of beneficiaries over another unless such priority is clearly stated in the governing instrument.[16] However, even when the governing instrument does authorize giving preference to one beneficiary over others, the trustee must be certain to exercise that preference only in furtherance of the settlor's intentions.[17]

The duty of impartiality is "especially robust" where the trustee also has a beneficial interest in the trust.[18] According to one distinguished commentator, "the duty of impartiality regulates trustee/beneficiary conflicts when the trust terms create a conflict that abridges the sole interest rule."[19]

D. Duty to Inform and Account

The trustee also has a duty to provide information about the trust and to account to the beneficiaries. This common law duty has steadily expanded over the years.[20] While under the Restatement (Second) of Trusts, a trustee had no affirmative duty to provide information to a beneficiary except under limited circumstances, the more modern view is that the trustee must provide sufficient information about the trust assets and administration to enable the beneficiaries to protect their interests in the trust.[21]

Today, in most jurisdictions, a trustee has an affirmative duty to keep the beneficiaries reasonably informed about the trust administration and of the material facts required for them to protect their interests.[22] As one court has noted "even in the absence of a request for information, a trustee must communicate essential facts, such as the existence of the basic terms of the trust. That a person is a current beneficiary of a trust is indeed an essential fact."[23]

Under New York law, a trustee must provide certain information to the current income beneficiaries and to any other beneficiary interested in the income or principal of the trust

upon request or else forgo annual commissions. A trustee may retain annual commissions provided that the trustee gives the income beneficiaries an annual statement that details the principal on hand, all receipts of income and principal, any commissions retained and the basis upon which the commissions were calculated.[24] A trustee who takes annual commissions without providing the required reports may be ordered to repay the commissions plus 9% interest.[25] Furthermore, a proceeding may be commenced against a fiduciary who has failed to provide information to compel the fiduciary to supply information including the assets and affairs of the trustee.[26]

At the same time, a trustee also owes a duty of confidentiality to the beneficiaries and must not share personal and financial information with others. "[T]he trustee's duty of loyalty carries with it a related duty to avoid unwarranted disclosure of information acquired as trustee whenever the trustee should know that the effect of disclosure would be detrimental to possible transactions involving the trust estate or otherwise to the interest of the beneficiaries."[27]

E. Duty to Prudently Invest Trust Assets

A trustee also has the duty to prudently invest trust property.

1. Prudent Investor Rule

The law regarding a trustee's duty with regard to trust investments has evolved significantly over time from the old "legal list" and Prudent Man rules to today's Prudent Investor Rule. While, "[f]or more than one hundred years, protecting trust principal while generating the highest possible income marked the fundamental purpose of fiduciary investment standards,"[28] today the law regarding trust investment has shifted to a more holistic view.[29]

The Prudent Investor Rule, as promulgated under the Restatement (Third) of Trusts and the Uniform Prudent Investor Act ("UPIA"), made five fundamental changes to the standards for prudent trust investing:

- Investments are to be judged as a part of the total portfolio rather than investment by investment;
- The trustee's central consideration in investing trust assets is the tradeoff between risk and return;
- No category of investments is per se imprudent -- any investment may be made so long as it plays an appropriate role in achieving the risk and reward objectives for the trust and meets the other requirements for prudent investment;
- Diversification is an integral part of the definition of prudent investment; and
- Delegation of investment management functions is expressly permitted.[30]

A trustee must invest and manage trust assets as a prudent investor would by considering the purposes, terms, distribution requirements and other facts and circumstances particular to the trust.[31] In so doing, the trustee is required to exercise reasonable care, skill and caution and to develop an overall investment strategy that incorporates risk and return objectives reasonably suited to the trust.[32] A trustee's investment decisions are not considered in isolation, but rather in the context of the trust portfolio as a whole.[33]

2. New York Prudent Investor Act

The New York Prudent Investor Act is embodied in EPTL § 11-2.3. Very generally, a trustee has a duty to invest and manage property held in a fiduciary capacity in accordance with the prudent investor standard, except as otherwise provided by the express terms and provisions of a governing instrument.[34] Among the circumstances that a trustee must consider in investing and managing trust assets are:

- the size of the portfolio;
- the nature and estimated duration of the fiduciary relationships;
- the liquidity and distribution requirements of the governing instrument;
- general economic conditions;
- the possible effect of inflation or deflation;
- the expected tax consequences of any investment decision or strategy and of distributions of income and principal; and
- the role that each investment or course of action plays in the overall portfolio.[35]

In addition, the trustee must adhere to the general fiduciary duties of loyalty and impartiality, must act prudently with regard to the delegation of investment management and in the selection and supervision of agents and incur only reasonable and appropriate costs.[36]

3. Standard of Process, Not Performance

In determining whether a trustee has complied with this fiduciary duty, the court looks at the trustee's overall process around investments. "[T]he test is prudence, not performance, and therefore evidence of losses following the investment decision does not, by itself, establish imprudence."[37] Rather, the court must view a fiduciary's actions in totality and "in light of the history of each individual investment."[38]

4. Intersection of Investments and Impartiality

In investing trust assets, the trustee must also adhere to the general duty of impartiality and balance the interests of current and remainder beneficiaries.[39] With regard to trust investments, the duty of impartiality requires the trustee to take into account the financial situations and risk tolerance of the beneficiaries and develop an appropriate investment strategy.

The shift to total return investing made balancing the beneficiaries' competing interests challenging for a trustee. The trustee must balance the competing interests of all of the current beneficiaries, as well as the remainder beneficiaries in a fair and reasonable manner.[40] The

beneficiaries may have different levels of risk tolerance and have differing expectations with regard to income versus capital growth.

Investment decisions can be all the more difficult when the trust has multiple current beneficiaries. In the context of a sprinkle trust for multiple beneficiaries, "[t]he divergent economic interest of trust beneficiaries give rise to conflicts of interest of types that simply cannot be prohibited or avoided in the investment decisions of typical trusts."[41] Put simply, an investment strategy that is appropriate for one beneficiary may not meet the needs of another beneficiary.

5. Balancing Competing Interests

The UPIA and New York law give trustees two tools by which they can better balance the divergent needs of income and remainder beneficiaries while still investing for total return: the power to adjust and the unitrust conversion.[42]

a) Power to Adjust

The "power to adjust," embodied in EPTL § 11-2.3(b)(5), permits a trustee to adjust between income and principal if the trustee determines that, in light of its investment decisions and the consideration of other factors, that such an adjustment would be fair and reasonable to all of the beneficiaries.[43] Generally speaking, before a trustee can exercise the power to adjust, three conditions must be satisfied:

- The trust must be invested as a prudent investor would invest (ie. invested for total return);
- The terms of the governing instrument must describe the amount that may/must be distributed by referring to trust income; and
- The trustee must determine that the trustee is otherwise unable to administer the trust impartially based on what is fair and reasonable to all beneficiaries (unless the governing instrument clearly expresses the settlor's intent for the trustee to favor one or more beneficiaries over the others).[44]

In determining whether and to what extent the power to adjust should be exercised, a fiduciary may consider a number of factors including: (i) the settlor's intent as expressed in the governing instrument; (ii) the assets held in the trust; (iii) the extent to which an asset is used by a beneficiary; (iv) whether an asset was purchased by the trustee or received from the settlor; (v) the net amount allocated to income under the Principal and Income Act; (vi) the increase or decrease in the value of the principal assets; and (vii) to what extent the terms of the trust give the fiduciary the power to invade principal or accumulate income and the extent to which the fiduciary has previously exercised those powers.[45]

The statute provides some limitations on the power to adjust.[46] A trustee may not make an adjustment: (i) over a charitable trust; (ii) that changes the amount payable to a beneficiary as a fixed fraction or fixed annuity amount; (iii) from any amount that is permanently set aside for charity unless the income is also earmarked for charity; (iv) if possessing the power would cause the individual to be treated as the grantor for income tax purposes; (v) that would cause the assets to be includible in the estate of an individual who has the power to remove and

replace trustees and such assets would not otherwise be included if the individual did not have the power to adjust; or (vi) that would potentially cause the trust to be considered as an available asset for the purposes of determining an individual's eligibility for public benefits assistance.[47] Notably, the power to adjust may not be exercised by a trustee who is a current or remainder beneficiary or who would benefit, directly or indirectly, by the adjustment.[48]

b) Unitrust Election

EPTL § 11-2.4 allows trustees to elect to treat a trust to a unitrust so as to create a reasonable income stream and to invest the trust assets for growth without regard to whether individual investments are productive of income. Alternatively, the court may, upon the petition of the trustee or a beneficiary and notice to all interested parties, may direct that the trust be converted to a total return unitrust.[49]

In determining whether to make the unitrust election, the trustee must consider the nature, purpose and expected duration of the trust, the settlor's intent, the needs of the beneficiaries and the nature of the assets held in the trust. If the trustee elects to have this section apply, he must give notice of the election to the creator of the trust (if living), all persons interested in the trust and to the court that has jurisdiction over the trust.[50] In the first year that the trust is treated as a unitrust, the unitrust amount based on the net fair market value of the trust calculated as of the beginning of the year, while in subsequent years, the

unitrust amount is calculated on a rolling average so to smooth out the effects of market volatility.[51]

In Matter of Estate of Ives, the court directed the trustee to treat a testamentary credit shelter trust as a unitrust.[52] The governing instrument gave the trustee the power to invade trust principal as needed for the beneficiary's support and maintenance in her accustomed standard of living. The court determined that the decedent's primary intent had been to provide for his wife, the income beneficiary, and that her income was insufficient to provide for her needs. By converting to a unitrust, the beneficiary's income would reasonably be expected to nearly double. Last, the remainder beneficiaries had no present need for distributions from the trust and would not be adversely impacted by the unitrust conversion.[53] Under these circumstances, the court approved the conversion.

Used properly, the power to adjust and the unitrust conversion can aid a fiduciary in making appropriate distributions to the current beneficiaries while still preserving the corpus for the remainder beneficiaries and investing for total return in accordance with the prudent investor rule employed today.

III. COMMON GROUNDS FOR AN ALLEGATION OF FIDUCIARY LIABILITY

Fiduciaries who fail to comply with the basic fiduciary duties described above are at risk.

A. Breaches of the Duty of Loyalty

1. Overview

Many fiduciary litigation cases involve breaches of the duty of loyalty. As one commentator has noted, "[t]he duty of loyalty is . . . not the duty to resist temptation but to eliminate temptation, as the former is presumed to be impossible."[54] However, the case law indicates that eliminating all temptation is sometimes easier said than done.

Breaches of the duty of loyalty frequently involve self-dealing transactions, but breaches can take other forms as well. Oftentimes, duty of loyalty issues arise simply as a result of the settlor's choice of trustee. For example, a trustee who is also one of multiple beneficiaries may find himself/herself in a conflicted situation where the duty of loyalty may be inadvertently breached. Another common situation is where the trustee is an officer or director of a company in which the trust is invested.[55] Transactions between the trust and members of the individual trustee's family or affiliates of a corporate trustee may also give rise to a breach of the duty of loyalty.

2. “No Further Inquiry” Rule

A trustee must understand that the duty of loyalty is a rule of “uncompromising rigidity” and a breach of this duty generally cannot be overcome by any amount of good faith.[56] Rather, the New York courts apply the “no further inquiry” rule to a transaction that involves a conflict of interest between the trustee and the trust.[57] This rule prohibits a fiduciary from profiting from any self-dealing transaction entered into without prior consent or approval from a court or the trust beneficiaries.[58] Any such transaction is voidable by the beneficiaries regardless of whether the terms were reasonable or in the best interests of the beneficiaries.[59] Furthermore, the fiduciary is held per se liable simply upon a showing that the fiduciary had a personal interest in the transaction.[60] The “no further inquiry rule” applies in all self-dealing transactions and whenever the trustee’s personal interests are “substantially affected.”[61] Whether the transaction involved fair and reasonable terms or compensation is immaterial.[62]

3. Purchase/Sale of Trust Property To/From the Trustee

The purchase of trust assets for the fiduciary’s own use or the sale of a fiduciary’s own assets to the trust constitutes a breach of the duty of loyalty.[63] These types of situations involve a direct conflict of interest and should be strictly avoided.

In re Kilmer’s Will is a good example of the prohibition on self-dealing and the “no further inquiry rule” in action.[64] There, the co-executors sought to sell certain commercial real

estate in order to raise case for the payment of estate taxes. Although the property had been properly appraised and marketed, the executors had only received one lowball bid. One of the executors believed that he could arrange for the property to be sold to another bidder and he offered to match the purchase price if the potential new buyer did not materialize. When the third party declined to purchase the property, the executor purchased the property from the estate in accordance with his guarantee. Later, some of the beneficiaries sought to void the transaction. Although the court found that there was "no doubt" that the sale was free of any ulterior motive, it refused to uphold the sale. The court reasoned:

> *The law does not stop to inquire whether the contract of transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case.*

Practical Pointers: The law does not easily forgive the self-dealing trustee. The potential purchase or sale of property in which the trustee has an interest is perhaps the clearest of all self-dealing transactions.

- A fiduciary should avoid any and all situations where the fiduciary may be find itself on the other side of the table in any transaction with the trust or the estate that the fiduciary is charged with administering;
- If the fiduciary cannot be dissuaded from entering into a direct transaction with the estate or trust, full disclosure should be made and consents should be obtained from all beneficiaries; and
- The fiduciary may also seek court approval before entering into any such transaction.

4. Investment of Trust Assets in Property Owned by the Trustee

Another common situation is where the trustee invests trust assets in property that is owned by the trustee or in which the trustee or a closely related person or entity has an interest. Generally, this would be an impermissible act of self-dealing. However, the courts have held that the conflict may be waived by an express provision in the trust instrument or with the consent of the settlor or beneficiaries.

One recurring fact pattern that is often the subject of litigation is the purchase or retention of shares of the corporate fiduciary's own stock. While investment in the stock of the corporate fiduciary is generally prohibited by the duty of loyalty as it is considered to be an impermissible act of self-dealing,[65] this general rule may be overridden by a provision in the governing instrument expressly authorizing the purchase.[66]

In City Bank Farmers Trust Co. v. Cannon, the court found that the settlor's actions in approving the retention of the corporate trustee's own stock estopped the remainder beneficiaries from later objecting .[67] The facts were as follows:

In 1926, the settlor, Mary E. Cannon, created a revocable trust for her lifetime benefit and named Farmer's Loan Trust Company as trustee. Under the terms of the governing instrument, the settlor was to receive all of the trust income during her lifetime and she

retained the power to amend or revoke the trust at will. Upon her death, the remainder was to be divided into equal shares and held in further separate trusts for each of her five children.

The trust was funded with cash and securities, including 300 shares of National City Bank stock. The governing instrument authorized the trustee to retain securities for "so long as it may deem proper" and to sell and reinvest the proceeds in the trustee's discretion.

At some point during the settlor's lifetime, the trustee, Farmer's Loan and Trust, became affiliated with National City Bank and the trustee, with the settlor's knowledge and consent, exchanged the shares of National City Bank initially held in the trust for new shares which reflected the trust's interest in the newly affiliated entity. In addition, over time, the settlor approved of continued investment in National City Bank stock and resisted sales.

Many years later, the trustee sought to settle its account. The guardian ad litem for the infant remainder beneficiaries raised objections and sought to surcharge the trustee for losses incurred in connection with the retention of National City Bank stock.

The court noted that "[u]ndivided loyalty is the supreme test unlimited and unconfined by the bounds of classified transactions."[68] While the retention of the National City Bank stock might, in another case, be a breach of the duty of loyalty, in the instant case, the court held that the actions of the settlor estopped any beneficiary, including the remainder beneficiaries, from objecting to the retention of the National City Bank shares. Since the settlor had reserved the

right to "exercise all of the powers of ownership insofar as the trust was concerned," the settlor's actions in approving the exchange of the original shares in National City Bank for shares carrying a beneficial interest in the trustee and opposing any sale of the new shares estopped the remainder beneficiaries form later objecting. "The donor approved the investments and their retention in advance with full knowledge of the resulting divided loyalty and of her own power to remove the trustee or otherwise revoke or amend the trust."[69]

<u>Practical Pointers</u>: At a minimum, trustees who have or who are considering investing trust assets in an entity in which the trustee has an interest should tread very carefully. Before taking any further steps, the trustee should:

- Review the governing document to determine whether such investment would be permitted under the terms of the trust;
- Disclose the potential investment to the beneficiaries; and
- Obtain the written consent of the settlor (if living) and the beneficiaries or the court.
- Unless court approval was obtained, the consent of the interested parties should be periodically reviewed and ratified.
- Furthermore, the trustee should continue to monitor the investment even if judicial approval or consent has been obtained.

5. <u>Indirect Self-Dealing</u>

The duty of loyalty bars not only "blatant self-dealing," but also requires the trustee to avoid situations where the trustee's personal interest conflicts with the interest of the beneficiaries."[70] As noted above, a trustee is strictly prohibited from engaging in any transaction that might directly or indirectly benefit the fiduciary, directly or indirectly.[71] It is in

these "indirect" self-dealing situations that an unsuspecting fiduciary may find itself inadvertently breaching the duty of loyalty.

Matter of Rothko is illustrative.[72] When Mark Rothko, the abstract expressionist painter, died in February 1970, 798 paintings composed the primary asset of his estate. Rothko's Will was admitted to probate in April and letters testamentary were issued to three individuals, Bernard Reis, Theodoros Stamos and Morton Levine. The executors acted quickly to arrange for the sale of the paintings and, within a three week period, they contracted to sell all of the paintings to two affiliated entities, Marlborough AG and Marlborough Gallery, Inc. Pursuant to the first contract, the executors sold 100 canvases to be selected by Francis K. Lloyd (a powerful art dealer who effectively controlled both Marlborough entities) to Marlborough AG for the sum of $1.8M payable over a 12 year period of time without interest. The remaining paintings were consigned to Marlborough Gallery upon terms that were very favorable to the gallery.[73]

Rothko's daughter, Katie Rothko, brought suit to remove the executors, rescind the contracts and enjoin the galleries from selling the paintings. Joining in the petition were the guardian for Rothko's son, Christopher, and the New York Attorney General, on behalf of the Mark Rothko Foundation. They also sought damages for breach of fiduciary duties.

The Surrogate found that numerous conflicts of interests existed. First, in addition to being a co-executor of the estate, Bernard Reis was a director, secretary and treasurer of the Marlborough Gallery. The second co-executor, Theodoros Stamos, was himself an artist under contract to Marlborough who benefited personally by currying favor with Marlborough through the arrangement with the estate. Last, while the third co-executor, Morton Levine, had no direct conflicts of interest, he was not only aware of Reis' position with Marlborough but also believed Stamos was seeking personal advantage with regard to the contracts.

The court held that the executors had breached their duty of loyalty to the estate. The Surrogate's Court quoted City Bank Farmers Trust Co. v Cannon:

> *"The standard of loyalty in trust relations does not permit a trustee to create or to occupy a position in which he has interests to serve other than the interest of the trust estate. Undivided loyalty is the supreme test, unlimited and unconfined by the bounds of classified transactions."*[74]

While the executors' conduct did not amount to direct self-dealing as in the case of buying or selling estate assets directly to/from an executor, the court held that the executors had indirectly benefited themselves to be the equivalent of self-dealing. Reis had prioritized his own status and financial interests through the sales of his and his family's art collection through Marlborough over the financial interests of the estate. Stamos acted in a self-serving manner and negligently in light of his knowledge of Reis' position with Marlborough. Last Levine failed

to exercise the ordinary prudence required in the performance of the fiduciary obligations he assumed.

As the Rothko case illustrates, the fiduciary need not directly profit from a transaction in order for the court to find that the fiduciary has breached the duty of loyalty by self-dealing. Indirect benefit is sufficient grounds for a court to find a breach to have occurred.

Practical Pointers: Before engaging in any transaction with or on behalf of a trust, the fiduciary should:

- Identify any existing or potential conflicts of interest;
- Seek reasonable alternatives; and
- If no reasonable alternatives exist, seek the consent of all interested parties and/or court approval before proceeding

6. Co-Mingling Trust Property

Co-mingling trust property with the fiduciary's own property is a serious breach of the duty of loyalty and may be cause for removal of the fiduciary.

EPTL § 11-1.6(a) provides in pertinent part:

> *Every fiduciary shall keep property received as fiduciary separate from his individual property. He shall not invest or deposit such property with any corporation or other person doing business under the banking law, or with any other person or institution, in his own name, but all transactions by him affecting such property shall be in his name as fiduciary. . .*

The statute contains an exception which allows banks or trust companies to hold securities in the name of a nominee[75]

Commingling is not excused by the fiduciary's good faith or lack of intent to cause harm to the trust estate. If a trustee co-mingles trust fund with the trustee's own personal assets, the entire amount becomes subject to the trust and the beneficiary's equitable right of recovery is not destroyed, even if it becomes impossible to specifically identify the trust property.[76]

In In re Coe's Will, the Surrogate's Court noted: "EPTL § 11-1.6 makes it very clear that a fiduciary must segregate assets it holds as a fiduciary from that of its individual property."[77] Accordingly, it held that the fiduciary could not hold estate assets in an account which also included his personal property.

Practical Pointers: In order to ensure that the fiduciary does not inadvertently co-mingle estate or trust assets with the fiduciary's personal assets, the fiduciary should be certain to:

- Establish one or more dedicated investment management accounts for assets that have been transferred to the trust or the estate;
- Retitle any real estate in the name of the trust or the estate;
- Ensure that all necessary steps have been taken to transfer any interest in a closely-held companies from the name of the settlor or decedent to the trust or the estate; and
- Keep trust assets separate from the settlor or trustee's own assets.

7. Beneficiary as Trustee

Another common factor in cases involving a breach of the duty of loyalty is the interested trustee. As noted above, the duty of loyalty requires a fiduciary to act solely in the interests of the beneficiaries. But how does this duty square with a fiduciary who also has a beneficial interest in the trust?

Arguably, the settlor who has named a beneficiary as a trustee has waived any conflict of interest and has decided that "the advantages of having that person serve outweigh the risk of harm."[78] In most cases, the conflicted trustee serves without issue but "[i]n the rare case in which the conflicted trustee does seek improper advantage, the law responds by enforcing a fairness norm, derived from the duty of loyalty, called the duty of impartiality, which places the trustee 'under a duty to the successive beneficiaries to act with due regard to their respective interests.'"[79]

How and why an interested fiduciary exercises discretion is critical in determining whether a breach has occurred. In Matter of Jacob Heller, the court considered whether interested trustees were permitted to make a retroactive unitrust election which had the effect of indirectly benefitting the trustees in their position as remainder beneficiaries.[80] The trust in question was created by the settlor, Jacob Heller, for his wife, Bertha. The governing instrument provided that all income was to be distributed to Bertha during her lifetime, with

the remainder passing to his two children, Herbert and Alan. Jacob died in 1986 and following the death of the initial trustee in 1997, Herbert and Alan became successor co-trustees.

In 2003, Herbert and Alan, in their capacity as co-trustees, elected under EPTL 11-2.4 to retroactively convert the trust to a unitrust. As a result, Bertha's income dropped dramatically.[81] Bertha's daughter brought a proceeding on her mother's behalf seeking an order to annul the unitrust election and to remove the trustees. The Surrogates' Court granted a portion of the relief sought by annulling the retroactive effect of the unitrust election but denied the rest of the motion. The Appellate Division reversed that portion of the lower court ruling that annulled the retroactive application of the unitrust election and affirmed the rest of the order.

On appeal to the Court of Appeals, Bertha's daughter argued that the trustees should be barred from making the unitrust election because they were also remainder beneficiaries of the trust and that a retroactive unitrust election was improper. The Court of Appeals compared the power to adjust statute, EPTL 11-2.3(b)(5) which specifically prohibited an interested trustee from exercising the power to adjust with the unitrust statute, EPTL 11-2.4 and concluded that the legislature did not intend to prohibit interested trustees from making the unitrust election.

Determining that the interested trustees had a fiduciary obligation to protect the interest of all beneficiaries and their course of action was not prohibited by the applicable

statute, the court affirmed their action. The trustees owed fiduciary obligations not only to the income beneficiary, but to the remainder beneficiaries as well. In the court's view, the fact that the trustees' personal interests happened to align with the interests of the remainder beneficiaries did not relieve the trustees of their duties to them nor did it lead the court to the conclusion that interested trustees should be prohibited from electing unitrust treatment in all cases. Rather, the court determined that a unitrust election which directly or indirectly benefits the trustee should be scrutinized by the court, with an emphasis on the process and fairness of the trustees' election.

Practical Pointers: Beneficiaries who are also serving as fiduciaries should be especially careful in the exercise of their fiduciary duties.

- The fiduciary should read the governing instrument carefully to determine the bounds of the fiduciary's discretion. What power(s) is the interested fiduciary prohibited from exercising? Will the exercise of the power directly or indirectly benefit the fiduciary?
- The interested fiduciary should keep careful records and document the process employed with regard to both investment decisions and distribution decisions.

8. Using Trust Property to Discharge a Trustee's Personal Obligations

The use of trust assets to discharge the fiduciary's personal obligations is generally a breach of the duty of loyalty.

However, the New York courts take a nuanced view, as Matter of Wallens illustrates.[82] There, the court was called upon to consider whether the trustee breached his fiduciary duties to the beneficiary of the trust with regard to certain distributions made for the beneficiary's education and medical expenses. The facts were as follows:

In 1992, the testator, Burton Wallens, executed a Last Will and Testament that created a trust for the benefit of his granddaughter, Maggie, and named Charles Wallens, the testator's son and Maggie's father, as a co-trustee. The other co-trustee was the testator's cousin. The Will authorized the trustees to distribute income and principal for Maggie's "proper support, maintenance, education and general welfare" as the trustees deemed advisable. The trust was scheduled to terminate when Maggie reached age 30 and any remaining trust assets were to be distributed to her outright.

Several years after the Will was executed, but prior to the testator's death, Maggie's parents divorced. The separation agreement required Charles to pay for Maggie's private school and college or university tuition, as well as any of Maggie's uninsured medical and dental expenses.

The testator died in 1997. Once the trust was funded, the co-trustees made distributions from Maggie's trust to pay for her private school education expenses. By August, 2000, Maggie was residing with her father and the court relieved him from his child support

obligations and ordered that the trust be used for her college expenses. In 2003, Maggie petitioned the court to compel her father (who was by then acting as the sole trustee) to account. Maggie objected to the payment of her private school and certain health care expenses from the trust and argued that the separation agreement required her father to pay such expenses from his personal assets rather than from the trust for Maggie's benefit.

The Surrogates' Court sustained the objections with regard to the payment of her private school and certain health expenses, but rejected Maggie's objections regarding the payment of her college tuition from the trust. On appeal, the Appellate Division dismissed the objections, concluding that Maggie's father, in his capacity as trustee, did not engaged in self-dealing or a breach of his fiduciary obligations. Upon remittal the Surrogate's Court approved the accounting.

The case was appealed again and the Court of Appeals concluded that an evidentiary hearing should be held in order to determine whether Maggie's father, exercised his fiduciary discretion in good faith with respect to Maggie's interest. Although both the Appellate Division and the Court of Appeals held that the education and medical expenses at issue fell within the standards for which distributions could be made from the trust, the Court of Appeals concluded that "even when the trust instrument vests the trustee with broad discretion to make decisions regarding the distribution of trust funds, a trustee is still required to act reasonably and in good

faith in attempting to carry out the terms of the trust."[83] Because Maggie's father, as trustee, had failed to obtain court permission to distribute trust funds for her private school and health care expenses, the court ordered that a hearing be held to determine whether the expenditures were made in good faith and in furtherance of the beneficiary's best interests.

9. Excessive Compensation

Excessive compensation is another fertile ground for fiduciary litigation.

While fiduciaries are generally entitled to be compensated for their services, compensation is generally limited to such amounts as is provided by statute, in some states, or by "reasonable" compensation in others.[84] In addition, fiduciaries are also entitled to be reimbursed for expenses incurred in connection with the administration of the trust or estate. However, the taking of excessive compensation is a breach of the duty of loyalty.

A fiduciary who is performing multiple services to the estate or trust must be mindful of this rule. If the fiduciary's services overlap with one another and there are multiple layers of fees, the fiduciary may be found to be in breach. This principle is illustrated in two cases involving the estates of fairly high-profile decedents: Doris Duke and Dr. Robert Atkins.

In Matter of Duke, the court found that the individual coexecutor of the estate of Doris Duke had wasted estate assets by virtue of taking a substantial salary and "lavish fringe benefits" for his services as a "live in" employee.[85] The fiduciary in question was the

decedent's former butler, Bernard Lafferty. The court found that Lafferty lived as if the estate properties were his own, rather than as a household employee. The court found no justification for these additional payments and held that the entire arrangement amounted to self-dealing because the arrangement was authorized only by Lafferty and the co-executor who Lafferty had the power to remove and replace.[86]

Unwinding the additional compensation paid to the individual co-trustees of certain trusts created by the late famed diet doctor, Robert Atkins, was much more complicated. In Matter of Atkins, the court was called upon to consider several layers of compensation paid to the trustees for various services including (i) trustee commissions, (ii) a royalty services agreement and (iii) an employment agreement that automatically renewed every 10 years.[87]

When Dr. Atkins died in April of 2003, his estate was valued at several hundred million dollars. Shortly after his death, Dr. Atkins' widow, Veronica, became re-acquainted with D. Clive Metz, an individual who she and Dr. Atkins had met at a Caribbean hotel some years before. Metz quickly ingratiated himself, as well as two of his friends, John J. Mezzanotte (a CPA) and John P. Corrigan (an attorney/CPA), with Veronica.

Over the next few months, the parties entered into several legal, accounting and consulting agreements by which Metz and his friends proffered various services to Veronica personally and to the estate. At the same time, by August 2003, Metz, Mezzanotte and

Corrigan convinced the two fiduciaries named under Dr. Atkins' Will to resign and in early 2004, they were named as co-fiduciaries with Veronica.

Dr. Atkins' Will was silent as to trustee commissions, but did permit his fiduciaries to take "additional reasonable compensation" from the estate and trust for any special or additional services that they were called upon to provide as a result of the interest in Dr. Atkins' business. More agreements were then struck between the new fiduciaries and Veronica including a fee agreement whereby Veronica waived her share of the executors' commissions (resulting in a larger share being paid to the other fiduciaries) and a "royalty services" agreement which granted the co-fiduciaries (through their alter-ego LLC) the exclusive right to oversee Dr. Atkins' publishing and royalty for the next 10 years for a fee of $100,000/month.

For undisclosed reasons, the relationship between Veronica and the three co-fiduciaries soured. In December 2006, her three co-fiduciaries commenced an action against her for breach of the royalty services contract. Several months later, Veronica brought a proceeding in the New York Surrogate's Court seeking the removal of the co-fiduciaries pursuant to SCPA 711.

The court quickly concluded that a prima facie case had been made for removal and then turned to the question of the compensation that had been paid both in the form of trustee commissions and the various side agreements. Looking through the agreements, the

court determined that the payments were not duplicative, but rather, amounted to "triple-dipping" for the same services that should be rendered by them in their fiducary capacity.[88]

While the Atkins case is extreme, it does demonstrate the extent to which the New York courts will look through side or consulting agreements to determine whether the services purportedly provided under those agreements should be properly characterized as part of the fiduciary's duties rather than additional services.

Practical Pointers: A fiduciary who plans to offer additional services to the estate or trust would be wise to:

- Enter into a separate engagement letter detailing the scope of the additional services;
- Document the basis on which compensation is to be calculated, whether statutory or by agreement;
- If compensation is based on hourly rates, maintain separate time records for the time spent on estate or trust administration from time spent on such additional services;
- Maintain copies of any separate fee agreement and provide to beneficiaries upon request;
- Disclose any compensation paid in the trustee's annual statement to beneficiaries; and
- If additional or extraordinary services are to be performed, disclose any additional fees and obtain consent.

10. Defenses to a Breach of the Duty of Loyalty

Generally speaking, a breach of the duty of loyalty cannot be overcome by any amount of good faith on the part of the trustee.[89]

There are few circumstances under which a transaction which otherwise would constitute a breach of the duty of loyalty may be permitted: (i) the governing instrument expressly authorizes the transaction, (ii) a court has approved the transaction; or (iii) the beneficiaries have approved the transaction.[90] However, even if the beneficiaries have consented, a transaction involving self-dealing is voidable if the trustee failed to disclose material facts which the trustee knew or should have known induced the beneficiaries' consent or if the transaction was not fair and reasonable in all respects.[91]

11. Remedies/Damages for Breach

A transaction that has been tainted by a conflict of interest is voidable by the beneficiaries unless they have consented to the transaction. A fiduciary who is found in breach of the duty of loyalty may be forced to rescind the transaction or may be charged for the loss or depreciation in value of trust assets resulting from the breach or for any profits made by the fiduciary that would not have otherwise been made.[92]

B. Breaches of the Duty of Care

1. Negligence in the Investment/Sale of Trust Property

Negligence on the part of the fiduciary may also be grounds for finding a breach of the duty of care. One example is where a fiduciary sells trust or estate property without doing his/her due diligence.

In Matter of Billmyer, the court found an executor who sold the decedent's Brooklyn brownstone valued at appx. $1.5M at a price that was far below market value to have breached his fiduciary obligations.[93] The case arose in the context of the settlement of the executor's final account. The residuary beneficiaries and the NYS Attorney General, as representative of the charitable beneficiaries under the decedent's Will, objected to the account on the basis that the executor was negligent in selling the property at below-market value.

Upon review, the court found that the executor was negligent in several regards: (i) he failed to obtain an appraisal of the property to determine the fair market value, (ii) he hired a real estate agent who was unfamiliar with the area and who failed to actively market the property and (iii) he had no explanation for the subsequent sale of the property for a much higher price.

The court noted that "[a] fiduciary acting on behalf of an estate is required to employ such diligence and prudence to the care and management of the estate assets and affairs as

would prudent persons of discretion and intelligence in their own like affairs."[94] To that end, the executor was required to use good business judgment and was subject to surcharge if the executor acted negligently and imprudently.[95] Finding that the executor was indeed negligent and in breach of his fiduciary obligations to the beneficiaries, the court upheld the ruling of the Surrogate's Court imposing 6% interest upon the surcharge.

<u>Practical Pointers</u>: With regard to the sale or purchase of any property, the trustee should:

- Obtain independent valuations of any closely held, real estate or tangible personal property;
- Gather several (ideally three) independent proposals from any brokers or agents required to sell the property;
- Periodically review the marketing and sales efforts of the agent; and
- Monitor compensation and commission expenses

2. <u>Improper Delegation to Co-Fiduciaries</u>

Another breach of the duty of care, as well as the duty of loyalty, is where the fiduciary has improperly delegated the investment or management of the trust or estate to a co-fiduciary or third party.

Although some jurisdictions, such as Delaware, have adopted statutes allowing for the bifurcation of fiduciary duties between multiple trustees, New York has not yet adopted such a rule. Rather under New York law, unless otherwise specified by the governing instrument, co-fiduciaries must act jointly or, if there are three or more fiduciaries, by majority.[96] If a fiduciary

has reason to know of a co-fiduciary's acts and has assented to or acquiesced in them, the fiduciary is bound by those acts and is jointly liable for them.[97]

A fiduciary who fails to act, due to absence or disability, or a dissenting fiduciary who joins in carrying out the decision of the others and who has promptly expressed his dissent to the co-fiduciaries in writing is protected from liability for the consequences of the majority decision.[98] Likewise, a fiduciary will not be held liable for the actions of another fiduciary if even the exercise of prudent behavior would not have raised any suspicion as to the imprudent or improper acts of the other fiduciary.[99]

However, the law does not protect a fiduciary who has essentially abdicated responsibility to one or more co-fiduciaries.

In Matter of Goldstick, the court was called upon to consider whether a "passive" co-trustee should be surcharged and made to forfeit commissions as a result of the actions of the other co-trustee. The case arose from a proceeding for the settlement of the final account of David Goldstick and Florence Levine, co-trustee of a testamentary and several intervivos trusts created by the late Martin Tananbaum for the benefit of his daughters, Minnie and Barbara. Among other transgressions, the facts indicated that Goldstick had invested over $181,000 of trust funds in various real estate partnerships in which he and certain related parties already had substantial interests. Eventually, these investments yielded over $2,500,000 in profits for

Goldstick and over $160,000 in profits for the trusts. The Surrogate's Court determined that all of the profits were realized in part from self-dealing and surcharged the trustees the full amount realized by Goldstick in both profits and fees.

The Appellate Division overturned the measure of damages but undertook an informative analysis of the responsibility of Levine, as co-trustee. Noting first that a trustee may delegate particular functions to a co-trustee, particularly if the other trustee has special skills or expertise, the court observed that the right to delegate does not permit a trustee to abdicate responsibility to be personally active in the trust administration."[100] The court found that Levine had "shirked her fiduciary responsibility' by deferring absolutely to Goldstick with regard to the real estate investments.

The court then turned to the appropriate measure of damages. The court observed that the general rule under New York law is that a fiduciary is held as much accountable for damages to the trust caused by the fiduciary's negligent inaction as for affirmative wrongdoing.[101]

C. Investment Issues

Investment issues can pose a virtual minefield of risk for the trustee.

1. Standard of Conduct

As noted above, the Prudent Investor Rule requires a standard of conduct from the trustee, not a particular outcome or performance.[102] In determining whether a trustee has

breached the duty to prudently invest trust assets, the court should not review each act in hindsight, but rather, must examine the fiduciary's conduct over the entire course of the investment.[103]

It is important to note that the Prudent Investor Rule is a default rule which may be expanded, modified or eliminated by the terms of the governing instrument.[104] "A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust."[105] However, there is limited protection for a fiduciary who fails to comply with the general duty of due care when investing trust assets or who mishandles concentrated positions.

2. Diversification Cases

Diversification of investments is a key component to the Prudent Investor Rule. Under the New York statute, a trustee must diversify assets "unless the trustee reasonably determines that it is in the interests of the beneficiaries not to diversify, taking into account the purposes and terms and provisions of the governing instrument."[106] The Restatement (Third) and UPIA take similar approaches.[107] In light of the fact that many trusts are funded with a combination of cash, securities and other assets held by the settlor, the trustee is given a reasonable amount of time to review the funding assets and make decisions regarding the retention or sale of trust assets.[108]

Many fiduciary litigation cases involve allegations that the trustee breached the duty to prudently invest trust assets because the trustee failed to diversify the trust portfolio. While some states, such as Delaware, have adopted statutes which specifically provide that the duty to diversify may be waived by express language in the trust instrument, New York does not offer such protection. Despite that fact, many trust instruments governed by New York law include provisions which direct or authorize a trustee to retain particular investments.

a) Diversification Required

In determining whether a fiduciary has acted prudently with regard to the retention of a concentrated position, the courts look at the totality of circumstances.

In Matter of Janes, the New York Court of Appeals held that a trustee was negligent in failing to diversify a concentrated position in Kodak stock.[109] As the facts indicated, the trustee fell down in a number of regards.

Janes involved several trusts created under the Will of Rodney B. Janes, a former NYS Senator and businessman, for the benefit of his wife, Cynthia and certain charities.[110] When the decedent passed away in 1973, over 70% of his estate consisted of 13,232 shares of Kodak stock, then valued at approximately $135 per share. By the time the trustee filed its initial accounting in 1980, the value of the stock had dropped to $47 per share. Objections to the

account were filed by the beneficiary and by the New York State Attorney General on behalf of the charitable beneficiaries.

The trustee argued that New York law did not permit a fiduciary to be surcharged for failure to diversify in the absence of additional elements of "hazard."[111] Rather, since that Kodak was a "blue chip" security, popular with many investment managers and mutual funds, a concentrated investments was, therefore, not imprudent.

The court disagreed. The court first noted that during the period in question, the New York courts followed the prudent person rule which held that "[a] fiduciary holding funds for investment may invest the same in such securities as would be acquired by prudent [persons] of discretion and intelligence in such matters who are seeking a reasonable income and the preservation of their capital."[112] Under that standard, the courts had found in many instances that a fiduciary's retention of a concentrated position was imprudent without any reference to the elements of hazard cited by the trustees.[113]

Rather, retention of Kodak stock was held to be improper for several reasons. First, the fiduciary had failed to consider the investment in relation to the entire portfolio. Second, the annual yield on the Kodak stock was barely 1% and, with Kodak stock comprising over 70% of the trust portfolio, the concentration jeopardized the interests of the income beneficiary and forced her to rely on principal invasions from another trust. Third, and perhaps most

importantly, the trustee failed to exercise due care and the skills it held itself out as possessing as corporate fiduciary. The trustee failed to establish an investment plan, failed to follow its own internal protocols and failed to conduct more than routine analysis of the Kodak concentration over a 7 year period of steady decline the stock's value.[114]

Accordingly, the Court of Appeals held that the fiduciary had acted imprudently. The stock should have been sold back in 1973 when the fiduciary had recommended that some of the shares be sold so as to raise cash for estate taxes. In light of the delay, damages were calculated by determining the value of the lost capital, plus interest.

b) Diversification Not Required

When might diversification not be appropriate?

Despite the general rule favoring diversification, a trustee need not diversify if it determines, in light of the particular facts and circumstances, that diversification is not appropriate.[115] As noted in Matter of Janes, "the very nature of the prudent person standard dictates against any absolute rule that a fiduciary's failure to diversify, in and of itself, constitutes imprudence. . ."[116]

(1) Tax Considerations

Tax considerations are an important element that the trustee must take into consideration when setting investment strategy. One example given in the UPIA as a situation

where diversification would not be required is that of a taxable trust that owns an undiversified concentration in low-basis securities. In such a case, "the tax costs of recognizing the gain may outweigh the advantages of diversifying the holding."[117] Issues which frequently arise in managing trust investments are (i) the cost/benefit of preserving the step-up in basis for low basis assets versus selling and diversifying the trust assets and (ii) the income tax status and residence of the individual beneficiaries.

Margesson v. Bank of New York is a good example of a situation where diversification was not warranted, in a large part because of the negative tax implications that ensued.[118] There, the corporate trustee diversified large positions in very low basis stocks without consulting with the sole income beneficiary and contrary to a longstanding informal understanding that the trust would be managed so as to avoid any unnecessary sales of the stock. At the time of the sale, the sole income beneficiary was 75 years old and the resulting capital gains tax liability, for which the beneficiary was left personally responsible amounted to over $22,000. Not surprisingly, the beneficiary objected and the trustee agreed to resign pending settlement of its account and allowance of commissions. The trustee commenced an accounting proceeding in the Surrogate's Court seeking approval of its account and payment of commissions and fees. The beneficiary objected and commenced a separate proceeding in the Supreme Court alleging that the trustee had breached its fiduciary duty and engaged in negligence and conversion. The matters were ultimately consolidated and the Supreme Court

granted the trustee's motion for summary judgment on the settlement of its account and payment of commissions and fees.

On appeal, the court considered whether the trustee had acted prudently with regard to the sale of the stock. The court noted that, prior to the sale in question, there had been a diversification plan set forth which limited sales to "odd lots" of appreciated securities, presumably in an effort to minimize the capital gains tax impact on the trust. The court also noted that the beneficiary had not been consulted prior to the sale and learned about the sale when his accountant received a year-end tax statement from the trustee. Furthermore, despite the trustee's duty to communicate, neither the trust officer nor the portfolio manager consulted with the beneficiary prior to the sale. Accordingly, the appellate court held that the lower court erred in granting the motion for summary judgement.

(2) Closely Held Business

When else might diversification not be required? A trust which holds an interest in a family business that the family wishes to control is another situation where the duty to diversify can be overridden by other purposes of the trust.[119]

In Matter of Hyde, the New York court affirmed the decision of the trustees to retain a concentrated position in a closely held company with an unusual capital structure.[120] The trusts in question were established by two sisters and the primary asset of the trusts consisted of

interests in family company. The trust instruments gave the trustees full discretion but were silent as to whether the trustees should invest in or retain shares of the company. About 20 years after the trusts were funded, the trustee sought approval of its accounting. The beneficiaries objected and argued that the trustee had breached its fiduciary duty by failing to diversify the trust assets.

The trustee alleged, and several industry experts testified, that there was no market for the stock. Because the company was a closely held corporation with an unusual capital structure, there was a very limited market of potential buyers. Additionally, the trustee had determined that diversification was not warranted given the general economic situation, the expected tax consequences and the needs to the beneficiaries. The stock paid out a significant dividend which was not easily replaced and the capital gains tax cost of diversification outweighed the benefits of sale. Last, the trustee had considered the settlors' intention in keeping the stock in the family.

3. Effect of Retention Clauses

Can a fiduciary rely on a retention clause contained in the governing instrument? The answer is "it depends." Far from being a blanket protection against liability for retaining an investment, the New York courts have stated that "a retention clause almost requires a greater level of diligence and work."[121] Mandatory, and not precatory, language is critical.[122]

In In re Charles G. Dumont, the court held that the corporate trustee erred in relying on a retention clause authorizing the retention of Kodak stock.[123] The retention clause in question provided:

> *"It is my desire and hope that said stock [Kodak] will be held by my said executors and by my trustee to be distributed to the ultimate beneficiaries under this will, and neither my executors nor my said trustee shall dispose of such stock for the purpose of diversification of investment and neither they nor it shall be held liable for any diminution in the value of such stock."*

The governing instrument further provided:

> *"The foregoing shall not prevent my said executors or my said trustee from disposing of all or part of the stock of Kodak in case there shall be some compelling reason other than diversification of investment for doing so . . . . The foregoing provisions shall not prevent my said Executors or my said Trustee from disposing of all or part of the stock of Eastman Kodak Company in case there shall be some compelling reason other than diversification of investment for doing so."*

The corporate trustee, JP Morgan Chase, maintained the investment in Kodak stock from 1958 to 2001 when it embarked on diversification plan. Meanwhile, the beneficiaries objected to the accounting filed by the trustees alleging breach of fiduciary duty following steep declines in the stock's value.

The facts indicated that the trustee never questioned whether the retention clause was fully binding on the trustee such that it prohibited sale, nor did it consider what might constitute a "compelling reason" for sale.

In the court's view, it is incumbent upon a fiduciary who is acting under the directives of a retention clause to develop a "uniform understanding of the testator's words," based on the input of experienced professionals and in-house legal counsel. "It is also critical that the fiduciary's actions reflect an understanding that a retention clause does not exculpate itself from poor judgment and laziness. . ."

Turning to the matter at hand, the court then examined the trustee's processes around the administration of the trust, the interpretation of the trust terms, communication with the beneficiaries and the ultimate decision to retain the stock in light of the specific circumstances. It found that the trustee did not have a uniform process for interpreting trust instruments, did not engage in conversations with the beneficiary to determine her financial needs, and that the various trust officers who managed the account did not have a consistent understanding of the effect of the retention clause.

Ultimately, the court found that the trustee's internal processes to be lacking and that the trustee's failure to communicate with the beneficiaries and to consider their income needs "directly caused [the trustee] to avoid selling the stock despite a compelling reason for sale."

4. Consent of Settlor and/or Beneficiaries as Bar to Cause of Action

The consent of the settlor and the beneficiaries, either expressly or impliedly, may be a far better protection to a trustee who decides to retain a concentrated investment. A number

of cases, including City Bank Farmers Trust Co v. Cannon, discussed above, have held that the consent of the settlor to certain actions serves as a bar to objections from a remainder beneficiary. For example, in Central Hanover Bank Trust Co. v. Russell, the New York court held that the settlor of a trust who retained a testamentary power of appointment over the remainder and who had approved trust investments in the stock of the corporate fiduciary precluded the remainder beneficiaries from objecting to such investments.[124] Likewise, the consent of the beneficiaries will also preclude them from later objecting to actions that they had previously approved. In Matter of Bloomingdale, the court held that the remainder beneficiaries/co-trustees could not object to the retention of concentrated positions in certain stocks during the period of time that they served as co-trustees with a third party, independent trustee.[125] However, since silence does not equate with consent, a triable issue of fact existed as to whether they were estopped from objecting to the retention of the stock during the period of time which preceded their appointments as co-trustees.

D. Difficulties with Discretion

A trustee's exercise of discretion, particularly with regard to distribution decisions, is a frequent source of conflict and potential litigation.

1. Determination of Settlor's Intent

The first step in properly exercising discretion is for a trustee to develop an understanding of the settlor's intent. The trustee must act "in a state of mind contemplated by the settlor."[126] If the settlor's intent is unclear, the courts traditionally have looked to the four corners of the governing instrument. [127] Although both the UTC and the Restatement Third of Property (Wills and Donative Intent) would allow for the consideration of extrinsic evidence to determine the settlor's intent, the New York courts adhere to the traditional approach. As succinctly stated by the New York Court of Appeals, "'the trust instrument is to be construed as written and the settlor's intention determined solely from the unambiguous language of the instrument itself.'"[128]

2. Judicial Review

The courts are generally reluctant to interfere in a trustee's exercise of a discretionary power when that exercise is reasonable and based on a proper interpretation of the terms of the trust.[129] Rather, a discretionary power is subject to judicial control only to prevent misinterpretation or an abuse of discretion by the trustee.[130]

On the other hand, a court will not permit abuse of discretion by the trustee. What constitutes an abuse of discretion? While there is no hard and fast rule, it depends upon the

purposes and terms of the trust, the standards imposed and the extent of the discretion conferred upon the trustee.[131]

3. Understanding Common Discretionary Standards

With regard to distribution authority, it is critical that the trustee have a clear understanding of the trust's dispositive terms, and whether, or the extent to which, they confer discretionary authority to the trustee.

a) Mandatory Distributions

Trusts with mandatory distribution requirements, such as a trust that calls for the distribution of all net income or a fixed percentage of the trust assets, may be the most straightforward for the trustee to administer from a dispositive standpoint. Trusts which would employ mandatory distribution standards include marital deduction (QTIP) trusts and charitable lead or remainder trusts. It is less common to see mandatory distribution requirements in sprinkle or dynasty trust because such trusts are generally designed with maximum flexibility in mind.

b) Trusts with Ascertainable Standards

Many trusts authorize distributions for "health, education, maintenance and support." These ascertainable standards are often used by settlors to ensure that the beneficiaries' needs are met but in practice, may not give the trustee (or the beneficiaries) a clear enough picture of

the settlor's intent. These four seemingly magic words are derived from the Internal Revenue Code sections 2041 and 2514 and have become so commonplace that they are often referred to as a "HEMS" standard. This language is generally interpreted as allowing the trustee to distribute such funds as are needed for a beneficiary's reasonable expenses.

Traditionally, depending on the precise language used in the governing instrument, trusts with ascertainable standards could be construed as either "discretionary" trusts or "support" trusts. The Restatement (Second) of Trusts describes a "discretionary" trust as one in which "the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply."[132] Neither the beneficiary nor a creditor of the beneficiary may compel the trustee to make a payment from the trust to or on the beneficiary's behalf. Conversely, the Restatement (Second) of Trusts describes a "support" trust as one in which the trustee shall pay or apply only so much of the income [or principal] as is necessary for the education or support of a beneficiary."[133]

A pure "support" trust, where the trustee is directed to distribute so much as is needed for the beneficiary's support in his/her accustomed standard of living, may also limit the trustee's discretion to determine whether a beneficiary's expenses are proper.[134] Today, the

UTC and the Restatement (Third) have eliminated this distinction and treat the latter as discretionary trusts with a standard.

c) Supplemental Language

Sometimes, an ascertainable standard will be supplemented or modified by language referring to a beneficiary's "lifestyle" or "standard of living". While the settlor's intent may be simply to ensure that the beneficiaries will be able to enjoy the same standard of living that they enjoyed during the settlor's lifetime, such language can prove problematic. However, however "there is little uniformity between, or even within, jurisdictions" as to how those standards are interpreted and enforced.[135] In the context of a pot or sprinkle trust with multiple beneficiaries, a so-called "ascertainable standard" may be challenging because beneficiaries may choose to live different lifestyles and lifestyles may change over time.

d) Health and Education

The terms "health" and "education" can pose special difficulties for trustees, particularly those who are managing a trust for multiple beneficiaries. While there is a fair amount of precedent where courts have been called upon to interpret the terms "maintenance and support", the question of how "health" and "education" are to be interpreted is less clear. A fiduciary may find itself at odds with a beneficiary over the settlor's intent.

4. Purely Discretionary Trusts

Last, purely discretionary trusts, where the trustee is authorized – but not required – to make distributions to beneficiaries in the trustee's "sole discretion," can provide the most flexibility, but they also can cause the most friction among multiple beneficiaries. A trustee who is granted "sole" or "absolute" discretion must exercise that power "in good faith and in accordance with the terms and purposes of the trust and in the interests of the beneficiaries."[136]

5. Consideration of Other Resources

One common conflict that trustees encounter in exercising discretionary distribution authority is whether or not the trustee should consider the beneficiaries' other resources. This question frequently arises when the interests of the various beneficiaries are not aligned or where some beneficiaries may take issue with an extravagant lifestyle chosen by other beneficiaries. If the trustee chooses to not consider outside resources, the other current beneficiaries and remaindermen may be disadvantaged, whereas if the trustee does take a beneficiary's own assets into account, the other beneficiaries are benefited.[137]

If the governing instrument directs the trustee to consider a beneficiary's other income and outside resources, or, similarly, expressly prohibits a trustee from doing so, the trustee's

course of action is relatively clear. One the other hand, if the trust instrument is silent, the trustee is placed between a rock and hard place.

There are three different schools of thought as to whether the trustee should consider a beneficiary's income and outside resources when the trust instrument is silent: (i) the trustee is must not consider other resources, (ii) the trustee must consider other resources, and (iii) the trustee may consider other resources in the trustee's discretion.[138] However, there is inconsistency across the country and even within the same jurisdictions as to whether a trustee should or should not consider a beneficiary's other resources in exercising discretionary distribution authority.[139]

6. Unequal Distributions

Provisions authorizing unequal distributions may also prove challenging. Although authorized under the governing instrument, the beneficiaries themselves may take issue with potentially receiving less than another beneficiary who has different financial needs. Although the duty of a trustee to treat beneficiaries impartially does not necessarily mean that beneficiaries should be treated "equally", that can become a sore point in managing the trust. A trustee should be very clear in communicating to the beneficiaries what the distribution standards are and some of the factors that the trustee considers in making those discretionary distribution decisions.

Even when the purpose for which distributions are to be made is clearly expressed and understood by all beneficiaries, differences in ages amongst a large class can result in unequal distributions simply because of rising costs. For example, managing an education trust designed for the collective benefit of the settlor's grandchildren can be particularly tricky. Although the settlor's intent may have been simple – for example, provide for all grandchildren's education costs – in all likelihood, the trustee will be faced with challenging differences such as: how to manage distributions in the face of increasing costs, scholarship opportunities, choice between higher and lower priced schools, and beneficiaries who either choose not to pursue higher education or are a "perpetual student."

7. Process and Procedures

A fiduciary who adopts a clear process and consistent procedures with regard to the exercise of discretion may be protected from fiduciary liability.

In In Matter of JP Morgan Chase Bank (Mark C.H.), the court faulted the corporate trustee for failing to exercise even a reasonable degree of diligence with respect to needs of the beneficiary, a disabled individual.[140] That the beneficiary was significantly disabled and that the settlor had created the trust for the purpose of enhancing his quality of life was abundantly clear. The governing instrument granted the trustees absolute discretion to distribute income and/or principal to the primary beneficiary and his descendants and further specified that the

trustees could pay any income not applied for the primary beneficiary's direct benefit "to any facility he may be residing in and/or to any organization where he may be a client or a participant in any program(s)."[141] The court concluded that that provision reflected both the importance of the primary beneficiary's quality of life to the settlor and the minimum amount of knowledge that the settlor expected the trustee to have.

Communication and knowledge about the beneficiary's circumstances was critical in the prudent exercise of the trustee's discretionary distribution powers. However, the trustee had no process in place to determine what the beneficiary's needs were met. Rather, the trustee was completely inactive in that regard. The court stated that "[i]t is not sufficient for the trustees to simply safeguard the [trust's] assets; instead, the trustees have a duty to [the primary beneficiary] to inquire into his condition and to apply trust income to improving it."[142] Noting that the trustee had failed to keep informed about the beneficiary's needs and had left him to languish in untenable circumstances despite the fact that the trust had sufficient assets to support him, the court ordered a full accounting.

Practical Pointers: Corporate fiduciaries have robust processes around the exercise of discretionary distribution powers. Prior to exercising discretion, a fiduciary might:

- Review the terms of the governing instrument and the standards for which discretion can be exercised. Do not rely on memory or on a trust summary – go back to the source;

- Consider the size of the trust, the yield, other planned or recurring distributions and prior invasions of trust principal;
- Request a budget and other financial information from the beneficiary; and
- If the distribution is for a particular purpose, obtain documentation about the planned expense.

E. <u>Failures to Communicate</u>

As the cases selected above indicate, many fiduciary litigation cases involve some degree of a failure to communicate. As noted above, a trustee has a duty to provide trust beneficiaries with information about a trust that is sufficient for them to protect their interests. At the same time, the trustee also has a duty of confidentiality to keep financial and other personal information about the beneficiaries private. From a fiduciary risk perspective, the provision of information to beneficiaries tends to benefit the fiduciary.[143]

Multiple beneficiaries with concurrent interests are all entitled to information and the provision of this information may cause conflict between the trustee and the beneficiaries or amongst the beneficiaries themselves. Oftentimes, the settlor or older generation beneficiaries will wish to limit the information provided to younger generation beneficiaries but the governing instrument does not relieve the trustee from the duty of disclosure.[144] It is also very common for one beneficiary to appoint himself or herself as the "family spokesperson" who acts as a gatekeeper to the flow of information to and from the beneficiaries.

1. Selective Provision of Information

McNeil v. McNeil is a critical case in understanding a trustee's duty to provide information to *all* of the beneficiaries of a sprinkle trust.[145] While the case was decided in Delaware, it nevertheless is informative for trustees in other jurisdictions. There, the trustees were found to have breached their fiduciary duties by failing to advise the settlor's children that they were actually *current* beneficiaries and not just *remainder* beneficiaries as they had mistakenly been led to believe. Furthermore, the trustees were also in breach for having failed to disclose vital information about the trust to one of the current beneficiaries, even when a specific request for information was made. Last, the facts indicated that [one of the trustees] acted as a conduit for information.

2. Failure to Stay Informed About a Beneficiary's Needs

Many of the cases cited above all involve a breakdown of communication between the trustee and the beneficiary. In Dumont, the trustee was faulted for failing to inquire about the current beneficiary's needs for liquidity or income from the trust.[146] In Matter of JP Morgan Chase Bank (Mark C.H.), the corporate trustee failed to develop an understanding of the beneficiary's living situation and needs.[147]

As noted above, a trust is a fiduciary *relationship*. Communication is a vital element to any healthy intra-personal relationship and that is true with regard to fiduciary relationships as well.

3. Silent Trusts?

Can the settlor relieve the trustees from the duty to provide information to beneficiaries under New York law? The answer at this point is "no". In In Matter of JP Morgan Chase Bank (Mark C.H.), the Surrogate's Court held that a provision in a trust instrument which purported to absolve the trustees from the duty to account (other than a final account) violated public policy and could not be enforced.[148]

4. Communication in Action

What does this all mean in practice? Put very simply, unless the governing instrument provides to the contrary, the beneficiaries are entitled to know about the existence of the trust, to examine the trust property and the accounts and statements related to the trust.[149] While the trustee may find itself under pressure to comply with the desires of the settlor or certain beneficiaries to limit the flow of information, a failure to provide basic information to all beneficiaries who are entitled to such information may lead to a breach. "Even in the absence of a request for information, a trustee must communicate essential facts such as the existence

of the basic terms of the trust. That a person is a current beneficiary of a trust is indeed an essential fact."[150]

Practical Pointers: In order to ensure that the duty to provide information is met, a trustee should:

- Carefully review the governing instrument to determine which beneficiaries have a present right to information about the trust;
- Schedule regular in-person and telephone meetings with the beneficiaries;
- Ensure that all current beneficiaries receive account statements at least annually;
- Maintain current contact information for all beneficiaries and review and update at least annually;
- Maintain a family tree with date of births for all beneficiaries and review and updated annually to ensure that any beneficiary who is no longer a minor receives the information they are entitled to; and
- Document all communications.

F. Effect of Exoneration Clauses

Exoneration clauses are designed to insulate fiduciaries from liability stemming from the failure to exercise reasonable care, diligence or prudence and are not looked upon favorably in New York. The rationale for this view was summarized by the court in Estate of Stralem as follows:

> *"The increasing practice of testamentary draftsmen and corporate fiduciaries in vesting in testamentary fiduciaries almost unlimited powers with a minimum of obligations, is a serious potential menace not only to the rights of a surviving spouse but of the children and other dependents of the testator and of all persons interested in estates. This tendency must be curbed. The primary duties of ordinary care, diligence and*

> *prudence (King v. Talbot, 40 N.Y. 76) and of absolute impartiality among the several beneficiaries (Matter of Stutzer, 156 Misc. 684, 282 N.Y.S. 311) are of the very essence of a trust, and any impairment of these or similar obligations of a fiduciary are contrary to public policy."*[151]

Under New York law, any attempt to exonerate a fiduciary under a testamentary instrument is void as against public policy.[152] EPTL § 11-1.7(a)(1) generally prohibits a testator from exculpating a fiduciary under a Will or codicil from liability for failing to exercise "reasonable care, diligence and prudence."[153]

For many years, there was uncertainty as to whether this general prohibition against exoneration clauses included in testamentary instruments also extended to similar provisions contained in inter-vivos instruments. Because there was no statutory provision addressing the enforcability of exoneration clauses in inter-vivos trusts, the courts in New York reached "divergent views."[154] In Matter of Shore, the court held that the bank on exoneration clauses applied to lifetime trusts.[155] A contrary decision was reached in Matter of HSBC (Knox).[156] Recently, the statute was amended so as to also provide that exoneration clauses contained in lifetime trusts executed are also void as against public policy.

IV. CONCLUSION

What steps can a fiduciary take to protect himself/herself from liability? As noted above, the first step is to develop a deep understanding of the very particular duties imposed upon fiduciaries and how those duties relate to the particular trust or estate at hand.

A few lessons from a corporate fiduciary may be helpful:

1. Understand What You are Getting Into: Corporate fiduciaries often go through an extensive review of the potential situation before accepting an appointment as trustee. This review typically includes:

a. Know Your Customer review of all interested parties

b. Review of governing instrument

c. Review of prior administrative history

d. Review of all trust assets

i. Particular attention is paid to special assets such as oil and gas interests, closely held companies, low-basis investments and concentrated positions.

ii. Concentrations (usually defined as positions exceeding 10%) are considered very carefully. If the trust holds a concentrated position, the fiduciary should develop and implement a plan of diversification that meets with the goals and purposes of the trust and the overall needs of the beneficiaries.

iii. To the extent possible, a corporate fiduciary will want to develop an understanding about the settlor and/or beneficiaries' intention around any specialty assets before the fiduciary appointment is accepted.

2. Develop and Implement Consistent Processes: Assume that everything you have done will be questioned by people and/or courts who will not take your word for anything.

a. Your process needs to be (and appear to be) reasonable, and it needs to be documented.

b. Corporate trustees usually have a certain amount of "automatic" process built into the way they conduct their fiduciary business including committees, business records, etc.

c. Non-professional fiduciaries need to be able to show:

   i. Why did you handle things a certain way?

   ii. How often did you re-visit major issues of trust administration and investing?

   iii. Did you engage professionals when appropriate?

   iv. Did you check in with beneficiaries in a way that most beneficiaries would consider reasonable? (There will always be some beneficiaries who are simply unreasonable by usual standards.)

d. If concerns were raised, how did you deal with them?

e. Even if you are not getting formal releases or accounting settlements along the way, being able to show that you stayed in touch with beneficiaries

about how the trust was being administered and responded respectfully when they raised concerns can be helpful if you end up in an adversarial situation.

3. Understand the Governing Instrument and Clarify Inconsistencies*:* A trustee who fails to fully understand the terms of the governing instrument and to clarify any inconsistencies or ambiguous terms may be faulted for failing to address these issues.

a. Examine all provisions relating to the relative interests of the beneficiaries, the distribution standards and the rights of the various beneficiaries to receive information about the trust.

b. Written trust summaries can be very helpful as a reference point, but the trustee should always review the governing instrument itself when questions arise.

4. Maintain balance among beneficiaries: To the consternation of many beneficiaries, the term "balance" does not mean "equality." There are several things that a trustee might do to ensure that the interests of one beneficiary or class of beneficiaries do not unduly take precedence over the others:

a. Keep a running tally of distributions made to the various beneficiaries. Not only would such a ledger enable a trustee to maintain a sense of whether the beneficiaries are being treated roughly equally (if that is consistent with the

settlor's intent), it may also help a trustee to identify a quiet beneficiary who asks for little and whose interests may be easily overlooked.

b. If the trust instrument calls for equalizing distributions prior to the distribution of principal at the termination of the trust, determine whether periodic "catch-up" distributions are appropriate during the term.

5. Practice Consistent Communication: Proactively communicate with all of the beneficiaries.

a. Schedule regular meetings

b. Ensure that statements and other critical information is sent to all beneficiaries who are then entitled to such information.

c. Don't let the squeaky wheel get the grease or the self-appointed family spokesperson speak for all other beneficiaries. Do not communicate with adult beneficiaries through their parents and, last don't assume that silence means assent.

6. Document all trust administration activity: Maintaining a written record of all trust administration activity is critical.

a. Retain copies of all trust statements, tax returns and other critical information.

b. Keep a record of both decisions to grant a beneficiary's request as well as decisions to deny a request. Any underlying information that the trustee considered should be kept as well.

c. Document investment decisions affecting the trust including investment strategy or asset allocation decisions, the selection of individual investment solutions and any communication with the portfolio manager.

d. Last, maintain copies of all relevant communications with trust beneficiaries.

7. Consider Interim Accountings: While periodic accountings are not required by law in New York, a trustee might wish to render periodic informal accounts to the trust beneficiaries as a way of limiting future liability.

8. Know When to Step Aside and/or to Call Outside Counsel: Relationships change over time. At some point, the interests of the beneficiaries may best be served by the trustee's resignation. If contentious issues arise, the trustee should speak with their outside counsel to determine what steps should be taken to protect the trustee.

[1] Elisa Shevlin Rizzo is a Senior Vice President, Senior Legal Counsel and Senior Fiduciary Officer at The Northern Trust Company ("Northern Trust"). The views expressed are solely those of the author as of the date noted and not Northern Trust or any of its affiliates and are subject to change without notice based on market or other conditions. Portions of this outline were adapted from other material by the author. Elisa would like to gratefully acknowledge her colleagues, Susan D. Snyder and Erica Lord for generously sharing their own written work on these subjects and John Bennett and Jackie Garrod for their comments on this outline.

[2] David C. Blickenstaff, Susan D. Snyder and Erica E. Lord, *Managing Fiduciary Risk in Representing Trustees and Executors*, ACTEC HEART OF AMERICA FELLOWS INSTITUTE (Feb. 28, 2019).

[3] RESTATEMENT (THIRD) OF TRUSTS § 2 (emphasis added).

[4] Meinhard v. Salmon, 249 N.Y. 458, 463–64, 164 N.E. 545, 546 (1928).

[5] Matter of Wallens, 9 N.Y.3d 117, 877 N.E.2d 960, 847 N.Y.S.2d 147 (2007) *citing* Birnbaum v. Birnbaum, 73 N.Y.2d 461, 541 N.Y.S.2d 746 (1989) *quoting* Meinhard v. Salmon, *supra* n.4.

[6] Matter of Wallens, supra n. 5.

[7] RESTATEMENT (THIRD) OF TRUSTS § 78.

[8] Karen E. Boxx, *Of Punctilios and Paybacks: The Duty of Loyalty Under the Uniform Trust Code,* 67 Missouri L. Rev. (2002) *citing* 2A Austin Wakeman Scott & William Franklin Fratcher, THE LAW OF TRUSTS §§ 170-170.25, at 311-437 (4th ed. 1987); *see* RESTATEMENT (THIRD) OF TRUSTS § 78, cmt. c.

[9] RESTATEMENT (THIRD) OF TRUSTS § 78(3).

[10] Charles Bryan Baron, *Self Dealing Trustees and the Exoneration Clause: Can Trustees Ever Profit from Transactions Involving Trust Property?* ST. JOHNS L. REV. Vol. 72: No. 1, Article 2 (1998) available at: https://scholarship.law.stjohns.edu/lawreview/vol72/iss1/2 *quoting* In re Ryan's Will, 291 N.Y. 376, 52 N.E.2d 909 (1943).

[11] RESTATEMENT (THIRD) OF TRUSTS § 77.

[12] King v. Talbot, 40 N.Y. 76, 85–86, *quoted in* Matter of Hahn, 62 N.Y. 821, 466 N.E.2d 144 (1984), Matter of Bank of N.Y., 35 N.Y.2d 512, 518–519, 364 N.Y.S.2d 164, 323 N.E.2d 700 (1974), and Matter of Clark, 257 N.Y. 132, 136, 177 N.E. 397. *See also* Blickenstaff, Snyder and Lord, *supra* n.2 *citing* RESTATEMENT (THIRD) OF TRUSTS § 90, cmt. d.

[13] In Matter of Witherill, 37 A.D.3d 879 (3rd Dept. 2007), the court surcharged the executor of the decedent's estate who claimed to be a "skilled financial advisor" for failing to exercise the same level of diligence as would be expected of a prudent investor with special skills. *See also* RESTATEMENT (THIRD) OF TRUSTS§ 90, cmt. d.

[14] EPTL § 11-2.3(c) provides in pertinent part as follows:

Delegation of an investment or management function requires a trustee to exercise care, skill and caution in:

(A) selecting a delegee suitable to the exercise of the delegated function, taking into account the nature and value of the trust assets subject to such delegation and the expertise of the delegee;

(B) establishing the scope and terms of the delegation consistent with the purposes of the governing instrument;

(C) periodically reviewing the delegee's exercise of the delegated function and compliance with the scope and terms of the delegation; and

(D) controlling the overall cost by reason of the delegation.

[15] Matter of Goldstick, 177 A.D.2d 225, 238-239 (1st Dept. 1998) *citing* Purdy v. Lynch, 145 N.Y.462.

[16] RESTATEMENT (THIRD) TRUSTS § 79.

[17] See generally, LORING AND ROUNDS: A TRUSTEE'S HANDBOOK § 6.2.5; *see also* 3 Scott & Ascher § 17.15 and RESTATEMENT (THIRD) TRUSTS § 79 .

[18] Ira Mark Bloom and William P. LaPiana, Final Report on the EPTL-SCPA Leg. Advisory Comm. 6th Report (Jan. 27, 2016) available at www.nysba.org/FinalReport2016/ *citing* Milea v. Hugunin, 24 Misc.3d 1211(A) (Surr. Ct. 2009), In re Peabody, 198 Misc. 505, 513 (Surr. Ct. 1950) *aff'd. 277* A.D. 905 and In re Watson, 213 N.Y. 177, 183 (1914).

[19] John B. Langbein, *Questioning the Duty of Loyalty,* 114 YALE LAW JOURNAL, 929, 939 (2005) (hereinafter "Langbein, *Questioning*").

[20] For an overview of the expansion of the duty to provide information to beneficiaries, *see* Kevin D. Millard, *The Trustee's Duty to Inform and Report Under the Uniform Trust Code*¸40 REAL PROP., PROBATE AND TRUST JOURNAL, (Summer 2005) at 373. *See also* Langbein, *Questioning, supra* n. 19 at 949.

[21] Langbein, *Questioning,* supra n.19 at 949-950 comparing the RESTATEMENT (SECOND) OF TRUSTS § 173, cmt. d and UTC § 813(a). RESTATEMENT SECOND §173, cmt d provides "[o]rdinarily the trustee is not under a duty to the beneficiary to furnish information to him in the absence of a request for such information."

[22] Under UTC § 813(a), a trustee must "keep the qualified beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests." *See also* RESTATEMENT (THIRD) OF TRUSTS § 82.

[23] McNeil v. McNeil, 798 A.2d 503, 510 (Del. 2002)(exclusion of one beneficiary from information regarding the terms and operating results of sprinkle trust for the benefit of the settlor's wife, his descendants and their spouses was a breach of the trustees' fiduciary duties to *all* beneficiaries of the trust).

[24] N.Y. Surrogates Court Procedure Act ("SCPA") § 2309(4).

[25] Margaret Valentine Turano, Practice Commentaries SCPA § 2309 *citing* Matter of Kaskawitz, 25 Misc.3d 1228(A), 906 N.Y.S.2d 771 (Surr. Ct. West. Co. 2009).

[26] SCPA § 2102.

[27] RESTATEMENT (THIRD) OF TRUSTS § 78, cmt. I, cited in Blickenstaff, Snyder and Lord, *supra* n. 2.

[28] W. Brantley Phillips, Jr. *Chasing Down the Devil: Standards of Prudent Investment Under the Restatement (Third) of Trusts*, 54 WASH. & LEE L. REV. 335, 336 (1997).

[29] For a comprehensive overview of the development of the Prudent Investor Rule, *see* John H. Langbein, *The Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641 (1996) (hereinafter, "Langbein, *Prudent Investor*"). Professor Langbein describes the Uniform Prudent Investor Act as a "tightly interconnected set of reforms . . . driven by profound changes that have occurred" as a result of the development of the theory of efficient markets and modern portfolio theory. *See also* Max M. Schanzenbach and Robert M. Sitkoff, *The Prudent*

Investor Rule and Market Risk: An Empirical Analysis, JOURNAL OF EMPIRICAL LEGAL STUDIES, Vol. 14, Issue 1, 129-168, (March 2017).

[30] Uniform Prudent Investor Act (UPIA) §§ 2(b), 2(e), 3 and 9. The UPIA has been adopted in 43 states, the District of Columbia and the US Virgin Islands. For the full text of the act, go to https://www.uniformlaws.org/viewdocument/final-act-with-comments-70?CommunityKey=58f87d0a-3617-4635-a2af-9a4d02d119c9&tab=librarydocuments (site last visited 3/15/2019).

[31] UPIA § 2(a).

[32] UPIA §§ 2(a) and (b); RESTATEMENT (THIRD) OF TRUSTS § 90.

[33] UPIA § 2(b).

[34] EPTL § 11-2.3(a). The New York Prudent Investor Act applies to any investment made or held in the trust on or after 1/1/1995.

[35] EPTL § 11-2.3(b)(3)(B).

[36] RESTATEMENT (THIRD) OF TRUSTS § 90(c).

[37] Matter of Janes (Janes II), 223 A.D.2d 20, 27 (4th Dept. 1996).

[38] Matter of Donner, 82 N.Y.2d 574, 585 (1993). *See also* Matter of JP Morgan Chase Bank N.A. (Strong) 2013 N.Y. Slip Op 51946(U)(Surr Ct, Monroe Co. Nov. 26, 2013); Matter of Janes, 90 N.Y.2d 41, 659 N.Y.S.2d 165, 681 N.E.2d 332 (1997); Matter of Wellington Trusts, 165 A.D.3d 809, 813 (2nd Dept. 2018).

[39] Phillips, *supra* n. 28 at 358, comparing RESTATEMENT (SECOND) OF TRUSTS § 227, cmt. y and RESTATEMENT (THIRD) OF TRUSTS § 227, cmt. c.

[40] RESTATEMENT (THIRD) OF TRUSTS § 90, general comment (c); *see also* RESTATEMENT (THIRD) § 79, comment (b).

[41] RESTATEMENT (THIRD) OF TRUSTS § 90, general comment (c).

[42] A full discussion of the UPIA is beyond the scope of this outline. For more information, *see* Susan Porter, *Unanticipated Consequences and Fallout from Tax Planning Strategies: Emerging Issues under the Twin UPIAs:*

Uniform Prudent Investor Act: Restatement Third of Trusts and Uniform Principal and Income Act 1997, ABA JOINT FALL CLE MEETING (2008).

[43] EPTL § 11-2.3(b)(5).

[44] UPIA §§ 104(a).

[45] EPTL § 11-2.3(b)(5).

[46] EPTL § 11-2.3(b)(5)(C).

[47] EPTL 11-2.3(b)(5)(C)(i)-(v), (viii).

[48] EPTL § 11-2.3(b)(5)(C)(vi) and (vii).

[49] EPTL § 11-2.4(e)(2)(B).

[50] ETPL § 11-2.4(e)(B)(III).

[51] EPTL § 11-2.4(b)(1),(2),(3).

[52]Matter of Estate of Ives, (Surr. Ct. Broome Co. 2002).

[53]Id.

[54] Boxx, *supra* n. 8 at 280.

[55] UTC § 802.

[56] 90A C.J.S. Trusts § 335 *citing* In re Carter's Estate, 6 N.J. 426, 78 A.2d 904 (1951) and City Bank Farmers Trust Co. v. Cannon, 264 A.D. 429, 35 N.Y.S. 2d 870 (2nd Dept. 1942), *decision amended on other grounds*, 265 A.D. 863, 38 N.Y.S.2d 245 (2nd Dept. 1942) *and judgement aff'd*. 291 N.Y. 125, 51 N.E. 2d 674, 157 A.L.R. 1424 (1943).

[57] UTC § 802(b). A transaction that is affected by a conflict of interest is voidable by the beneficiary.

[58] Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein*, 47 WM. & MARY L. REV. 541 (2005).

[59] Boxx, *supra* n. 8 at 282.

[60] Leslie, *supra* n. 58 at 546.

[61] Boxx, *supra* n. 8 at 282 *citing* Scott and Fratcher, §170.10 .

[62] RESTATEMENT (SECOND) OF TRUSTS § 170, cmt. f provides: "A trustee can properly purchase trust property for himself with the approval of the court. The court will permit a trustee to purchase trust property only if in its opinion such purchase is for the best interest of the beneficiary. Ordinarily the court will not permit a trustee to purchase trust property if there are other available purchasers willing to pay the same price that the trustee is willing to pay."

[63] RESTATEMENT (SECOND) OF TRUSTS § 170; RESTATEMENT (THIRD) OF TRUSTS § 78.

[64] In re Kilmer's Will, 187 Misc. 121, 61 N.Y.S. 51 (Surr. Ct. 1946).

[65] RESTATEMENT (THIRD) OF TRUSTS § 78, cmt. e(2).

[66] RESTATEMENT (SECOND) OF TRUSTS § 170, cmt. n.

[67] City Bank Farmers Trust Co. v. Cannon, *supra* n.56.

[68] Id. *citing* Meinhard v. Salmon, *supra* n.4.

[69] Id.

[70] Matter of Wallens, *supra* n.5.

[71] RESTATEMENT (THIRD) OF TRUSTS § 78, cmt. c.; Scott on Trusts § 170. *See also* John H. Langbein, *Questioning the Trust Law Duty of Loyalty*, THE YALE LAW JOURNAL, Vol. 114:929, 2005 at 931 *citing* George Gleason Bogert & George Taylor Bogert, THE LAW OF TRUSTS AND TRUSTEES §543 at 217 (rev. 2d ed. 1993); 2A Austin Wakeman Scott & William Franklin Fratcher, THE LAW OF TRUSTS §170 at 311 (4th ed. 1987).

[72] Matter of Rothko, 43 N.Y.2d 305, 401 N.Y.S.2d 449, 372 N.E.2d 291 (1977).

[73] Matter of Rothko, 84 Misc. 2d 830, 379 N.Y.S.2d 923 (Surr. Ct. NY Co. 1975). Under the second contract, up to 35 paintings could be sold per year from each of two groups, pre-1947 and post-1947 for 12 years at a price no less than the estate appraisal and the gallery would receive a 50% commission for each painting sold to a non-dealer or a 40% commission for paintings sold to or through other dealers.

[74] Id. *citing* Dutton v. Willner, 52 N.Y. 312, 318; Munson v. Syracuse G. & C. R. R. Co., 103 N.Y. 58, 74; Meinhard v. Salmon, *supra* n. 4; and Wendt v. Fischer, 243 N.Y. 439, 444.

[75] EPTL § 11-1.6(a), (b) and (c).

[76] 90A C.J.S. Trusts § 737.

[77] In re Coe's Will, 80 Misc.2d 374363 N.Y.S.2d 265 (Surr. Ct. Nassau Co. 1975).

[78] Langbein, *Questioning*, *supra* n. 19.

[79] Id.

[80] Matter of Heller, 6 N.Y. 3d 649, 816 N.Y.S.2d 403, 849 N.E.2d 262 (2006).

[81] Prior to 2001, Bertha Heller had received income distributions averaging about $190,000 per year. After the trustees made the unitrust election, her annual income dropped to about $70,000 per year.

[82] Matter of Wallens, *supra* n.5.

[83] Matter of Wallens, supra n.5 *citing* Matter of Bruches, 67 A.D.2d 456, 415 N.Y.S.2d 664 (2nd Dept.1979) and In re Abert's Estate, 118 N.Y.S.2d 864 (Sur. Ct., N.Y. County 1950).

[84] RESTATEMENT (THIRD) OF TRUSTS § 38(2).

[85] Matter of Duke, 220 A.D.2d 241, 632 N.Y.S.2d 532 (1st Dept. 1995).

[86] Id.

[87] 2010 N.Y. Misc. LEXIS 3228, 243 N.Y.L.J. 61 (March 26, 2010).

[88] Estate of Robert C. Atkins, 2010 N.Y. Misc. LEXIS 3228, 243 NYLJ 61 (March 26, 2010).

[89] 90A C.J.S. Trusts § 335 *citing* In re Carter's Estate, 6 N.J. 426, 78 A.2d 904 (1951) and City Bank Farmers Trust Co. v. Cannon, *supra* n.56

[90] RESTATEMENT (THIRD) OF TRUSTS § 78, cmt. c.

[91] Birnbaum v. Birnbaum 17 A.D.2d 409, 416 (N.Y. App. Div. 1986) citing SCOTT ON TRUSTS 170 (3rd ed. 1967).

[92] RESTATEMENT (SECOND) OF TRUSTS §§ 205, 206. *See* Matter of Witherill, *supra* n. 13; Barry L. Zins, *Trustee Liability for Breach of the Duty of Loyalty: Good Faith Inquiry and Appreciation Damages,* 49 FORDHAM L. REV. (1981).

[93] 142 A.D.3d 1000 (2nd Dept. 2016).

[94] Id. *citing* Matter of Carbone, 101 A.D.3d 866, 868 (2012); cf. Matter of Hahn, 62 N.Y.2d 821, 824 (1984) *supra* n.12 "[A] fiduciary owes a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect" Birnbaum v Birnbaum, 73 N.Y.2d 461, 466 (1989); *see* Matter of Wallens, *supra* n.5; Matter of Schultz, 104 A.D.3d 1146, 1148 (2013).

[95] Id. citing Matter of Lovell, 23 A.D.3d 386, 387 (2005). See also Matter of Donner, 82 N.Y.2d 574 (1993), Matter of Marsh, 106 A.D.3d 1009 (2013) and Matter of Pati, 151 A.D.2d 1006 (1989).

[96] EPTL § 10-10.7.

[97] Matter of Bloomingdale, 48 A.D.3d 559 (2nd Dept. 2008) *citing* Matter of Niles*,* 113 N.Y. 547 (1889) and Matter of McCormick*,* 304 A.D.2d 759 (2003).

[98] Id.

[99] Matter of Goldstick, *supra* n. 15 *citing* Wilmerding v. McKesson, 103 N.Y.329, Matter of Halstead, 44 Misc. 176 *aff'd sub nom.* Matter of Halstead, 110 App. Div. 909 *aff'd* 184 NY 563.

[100] Matter of Goldstick, *supra* n.15.

[101] Id. *citing* Matter of Howard, 110 A.D. 61, *aff'd* 185 N.Y. 539.

[102] EPTL § 11-2.3(b); Matter of James, 90 N.Y. 2d2 41, 681 N.E.2d 332, 659 N.Y.S.2d 165 (1987) *rearg. den.*, 90 N.Y. 2d 885, 661 N.Y.S.2d 827 (1987); Matter of Wellington Trusts, *supra* n.38.

[103] EPTL § 11-2.3(b). Matter of Wellington Trusts, *supra*, n. 38.

[104] UPIA § 1(b).

[105] Id.

[106] EPTL § 11-2.3(b)(3)(C).

[107] RESTATEMENT (THIRD) OF TRUSTS § 90 provides that a trustee has an affirmative duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so. UPIA § 3 sets forth a similar rule which generally requires diversification unless the trustee "reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

[108] UPIA § 4.

[109] Matter of Janes, *supra* n. 38. Janes was the first in a line of relatively recent cases where the courts have examined whether a trustee was negligent for failing to diversify investments. For a good summary on the lessons derived from these cases, *see* C. Raymond Radigan, *Rulings on Trustee's Duty to Diversify: What Have We Learned*, NYLJ (Sept. 12, 2011).

[110] Under the Will, 50% of the decedent's estate was to pass to a marital trust for the benefit of Cynthia, 25% of the estate was to be distributed to a charitable trust for the benefit of selected charities and the balance of the estate was to fund a second trust for Cynthia which called for income distributions to her during her lifetime with the remainder passing to charity.

[111] In the trustee's view, elements of hazard would include deficiencies in several investment quality factors including: (i) the capital structure of the company, (ii) the competency of its management, (iii) dividend history, (iv) expected future direction of the company's business, and (v) the opinion of investment bankers and analysts. Janes, *supra* n. 38 at 49.

[112] Id. at 49 citing EPTL § 11-2.2(a)(1).

[113] Id. at 50.

[114] Id. at 54.

[115] EPTL §11-2.3(a)(2)(C).

[116] Janes, *supra* n.38 at 50.

[117] UPIA § 3, comments.

[118] Margesson v. Bank of New York, 738 N.Y.S.2d 411 (3rd Dept. 2002).

[119] UPIA, § 3, comments.

[120] Matter of Hyde, 845 N.Y.S2d 833 (3rd Dept. 2007), *app. den* 881 N.E.2d 1197 (2008), *sub. app.,* 876 N.Y.S.2d 196 (3rd Dept 2009), *aff'd in part, modified in part*, 2010 NY LEXIS 1341 (June 29, 2010).

[121] In re Charles G. Dumont, 791 N.Y.S.2d 868 (2004) *rev'd on other grounds,* 809 N.Y.S.2d 360 (4th Dept. 2006) *app. den.* 813 N.Y.S.2d 689 (4th Dept. 2006) *app. den.* 855 N.E.2d (2006), *rearg. den.* 860 N.E.2d 993 (2006).

[122] RESTATEMENT (THIRD) OF TRUSTS § 228, cmt. e, f.

[123] Dumont, *supra* n. 122.

[124] Central Hanover Bank Trust Co. v. Russell, 290 N.Y. 593.

[125] Matter of Bloomingdale, 853 N.Y.S.2d 92 (App. Div. 2008).

[126] Bogert, TRUSTS AND TRUSTEES § 228 *citing* RESTATMENT (SECOND) OF TRUSTS § 187 and RESTATEMENT (THIRD) OF TRUSTS § 50(2).

[127] Pamela Lucina and John T. Walsh, *That's Not What Mom or Dad Wanted*, TRUSTS AND ESTATES MAGAZINE, (Feb.0 2016) *citing* Bank of America v. Judeine, 26 N.E.3d 555, Kristoff v. Center Bank, 985 N.E.2d 20, Eckles v. Davis, 14 S.W.3d 687, Matter of Cohorn's Estate, 622 S.W.2d 486, Kelly v. Estate of Johnson, 788 N.E.2d 933, Dennis v. Kline, 120 So.3d 11 (Fla. Dist. Ct. App. 2013), Clairmont v. Larson, 831 N.W. 388. *See also* In re Estate of Stahle, NYLJ Jan. 23, 2001, col. 32.

[128] Matter of Chase Manhattan Bank, 6 N.Y.3d 456 (Ct of Appeals 2006) quoting Mercury Bay Boating Club v San Diego Yacht Club, 76 N.Y. 2d 256 (1990). *See also* Matter of Gilbert, 39 N.Y.2d 663, 666 (1976).

[129] RESTATEMENT (THIRD) OF TRUSTS § 50(1), cmt. b. *See* Matter of Roberts, 61 N.Y.2d 782, 473 N.Y.S.2d 163, 461 N.E. 2d 300 (1984), Glenn v. Chase Lincoln First Bank, 201 A.D. 2d 908, 607 N.Y.S.2d 802 (1994).

[130] RESTATEMENT (THIRD) OF TRUSTS § 50(1).

[131] Id., cmt. b.

[132] RESTATEMENT (SECOND) OF TRUSTS § 155(1).

[133] Id.

[134] Bogert, TRUSTS AND TRUSTEES §229.

[135] Id. §228.

[136] *See* Estate of Wallens, *supra* n.5 (trustee granted broad discretion must act "reasonably and in good faith in attempting to carry out the terms of the trust").

[137] Bogert, TRUSTS AND TRUSTEES § 228.

[138] Bridget A. Logstrom Koci, *Discretionary Distributions: Trust Decanting and Consideration of a Beneficiary's Other Resources,* ACTEC FIDUCIARY LITIGATION COMMITTEE MEETING (Fall 2014).

[139] Id.

[140] In re JP Morgan Chase Bank, N.A., 38 Misc. 3d 363, 956 N.Y.S.2d 856, 2120 N.Y. Slip Op. 22387 (Surr. Ct., NY Co. 2012).

[141] Id.

[142] Id.

[143] Blickenstaff, Lord and Snyder, supra n. 2 at 3 *citing* Patricia M. Soldano and Lauren Benenati, *Millenials and the Family Office*, TRUSTS & ESTATES at 29 (Aug. 2016).

[144] Certain states, such as Delaware, do allow for "silent" trusts. A full discussion of that topic is outside the scope of this outline, but for more information, *see* Jocelyn Margolin Borowsky, William Lunger and Gregory J. Weinig,

Silence is Golden – The Best Way to Set Up a Quiet Trust, Roadmap to Navigating the Issues and Pre-Mortem Validation, 11TH ANNUAL DELAWARE TRUST CONFERENCE (October 25-26, 2016).

[145] 798 A.2d 503(Del. 2002).

[146] Matter of Dumont, *supra* n.122.

[147] Matter of JP Morgan (Mark C.H.), *supra* n. 141.

[148] Id.

[149] Charles D Fox IV and Thomas W. Abendroth, *Trustee's Duty to Account and Disclose*, AMERICAN BANKER'S ASSOCIATION BRIEFING/WEBINAR (April 5, 2018).

[150] McNeil v. McNeil, 798 A.2d 503 (2002).

[151] Estate of Stralem, 695 N.Y.S.2d 274 (Surr. Ct. Nassau Co. 1999).

[152] Estate of Stralem, *supra* n. 152 *citing* Matter of Allister, 144 Misc.2d 994, 545 N.Y.S.2d 483; Matter of Robbins, 144 Misc.2d 510, 544 N.Y.S.2d 427; Matter of Lang, 60 Misc.2d 232, 302 N.Y.S.2d 954; Matter of Lubin, 143 Misc.2d 121, 539 N.Y.S.2d 695)*;* Matter of Malasky, 290 A.D. 2d 631 (3rd Dept. 2002); Estate of Frances E. Francis, 239 N.Y.L.J. 50 (Surr. Ct. Westchester Co. 2008). For a comprehensive discussion of the history of exoneration clauses under New York law, *see* Cooper, Ilene S. and Harper, Robert M. (2012), *Incomplete Protection: Exoneration Clauses in New York Trusts in Powers of Attorney,* TOURO L. REV. Vol. 28, No. 2, Article 4, available at http://digitalcommons.tourolaw.edu/lawreview/vol28/iss2/4.

[153] EPTL §11-1.7(a)(1).

[154] NYSBA Trusts and Estates Law Section, Memorandum in Support of Proposed Legislation EPTL §11-1.7.

[155] Matter of Shore, 19 Misc.3d 663 (Surr. Ct. 2008)

[156] 98 A.D.3d 300 (4th Dept. 2012).

Using Trusts to Resolve Litigation

Hon. Acea M. Mosey
Erie County Surrogate's Court, Buffalo

Disputes involving trusts present unique challenges, including sensitive family dynamics, high financial stakes, and complex procedural, legal, and tax issues. Trust law has evolved to offer various options for resolving disputes and preserving the purpose of the trust and the grantor's intent. Aside from strictly legal considerations, however, it is important for attorneys to draft flexible trust instruments, trustees to stay current with the needs of beneficiaries, and to act promptly when altered circumstances necessitate a modification to the trust.

I. The Basics

Overarching consideration in planning and drafting: drafting flexible instruments and understanding and staying current with needs of beneficiaries (*Matter of Kroll*, 143 AD3d 716 [2016]).

A. Grantor's Intent

Trusts can be used for a variety of different reasons; therefore, it is of paramount importance to understand the grantor's objective and intent when drafting trust documents.

- Revocable trusts: can be used to manage assets during lifetime, avoid probate at death and protect beneficiaries.

- Irrevocable trusts: can be used to avoid probate, manage and protect assets, reduce taxes, qualify or maintain government benefits and provide for charities.

B. Execution

1. EPTL § 7-1.17 sets forth the required formalities for a lifetime trust:

- It must be in writing, executed and acknowledged by the creator and, unless he or she is the sole trustee, by at least one trustee, in the manner required by the laws of this state for the recording of a conveyance of real property, or

- Be executed in the presence of two witnesses who shall affix their signatures to the trust instrument.

- The acknowledgment may be subject to challenge if not in compliance with the requirements for the recording of a deed.

2. A testamentary trust requires the same formalities of execution as a will pursuant to EPTL § 3-2.1.

3. Electronic signature not permitted for valid trust execution (NY Technology Law § 307).

C. Nomination of a Trustee

1. *Matter of Nuchereno*, Erie Co. Surrogate's Court, February 23, 2019 [Mosey, J.] - petition to appoint trustee of an inter vivos trust denied as decedent had entered into a Property Settlement and Separation Agreement, incorporated but not merged, into a divorce decree which created a trust for the sole infant beneficiary and provided for appointment of trustee at the sole discretion of the Surrogate's Court. The governing trust executed by decedent had a provision regarding the appointment of trustees that conflicted with the PSSA, in that it nominated decedent as the initial trustee, nominated a successor, and then provided that the trustee be whomever the adult beneficiaries "vote to nominate". Decedent's Will was a "pour over" Will that provided all his

assets be paid to the trust. The petition to appoint certain trustees was denied on the basis that the conflicting trust provision could not be used to contravene decedent's obligations pursuant to the PSSA by creating the Living Will to serve as a Will substitute, therefore, the Court appointed the successor trustees. Also, the no contest provision in the trust "cannot be applied to circumvent another party's claim under an agreement entered by the Decedent or grantor during his lifetime" (citing *Matter of Friedman*, 146 Misc 2d 91 [1989]).

2. *Matter of Gadsden*, Kings Co. Surrogate's Court, March 20, 2019 [Lopez Torres, J.] granted motion for summary judgment on petition filed by trust beneficiary pursuant to SCPA 711 (3) and (8) to remove nominated trustee who failed to make any principal distributions, used Trust assets to benefit some beneficiaries, and failed to file an accounting and judicial settlement proceeding despite being ordered to do so by the Court.

D. Exculpatory Clauses

1. Clear and concise forfeiture, i.e., "no contest" clauses that express settlor's intent – incentivize harmony amongst beneficiaries.

2. An amendment to EPTL §11-1.7 has extended the prohibitions against use of exculpatory clauses to inter vivos trusts.

   a. EPTL § 11-1.7(a), amended effective August 24, 2018, now states:

      > "The attempted grant to an executor, testamentary trustee, or inter vivos trustee, or his or her successor, of any of the following enumerated powers or immunities is contrary to public policy:

(1) The exoneration of such fiduciary from liability for failure to exercise reasonable care, diligence and prudence.

(2) The power to make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation or otherwise."

b. EPTL § 11-1.7(c) states that:

> "Any person interested in an estate or trust may contest the validity of any purported grant of any power or immunity within the purview of this section without diminishing or affecting adversely his or her interest in the estate or trust any provision in any will or trust to the contrary notwithstanding."

E. Situs

- Proceedings are frequently commenced to transfer the situs of a trust to another jurisdiction. In allowing the situs of a trust to be transferred out of New York, the courts have considered the intent of the decedent, and particularly the presence or absence of any provisions in the trust directing that only the laws of New York should govern the administration of the trust or a clause prohibiting the transfer of the situs of the trust.

- Where no such provisions exist, and the Court finds that the administration of the trust will be facilitated by the transfer and promote the interests of the

beneficiary, a request to allow the situs of a trust to be transferred to another state may be granted.

- There must be some nexus between the trust and the designated jurisdiction. In addition to the settlor's intent other factors generally considered by courts in determining the trust situs are the location of the trust corpus, the residence or domicile of the trustee, and to a lesser degree the residence of the beneficiaries.

Matter of Hettrick, 61 Misc 3d 1220(A) [2018]: Although the Court has the power to change the situs of a trust, removal is not automatic. Here, two trustees resided in New York; however, the beneficiary and trust protector requested removal to Virginia to "facilitate" the administration of the trust. Removal was denied, the Court pointing to advances in technology (such as e-mail, fax, video conferencing, on-line banking services [and the like]) which allow trustees, beneficiaries and the courts to "communicate almost instantly". Court e-filing also permits instantaneous access to the courts.

Matter of Rockefeller, 2 Misc 3d 554 [2003]: The Court approved the resignation of New York testamentary trustee and replacement with non-New York testamentary trustee on basis of eliminating trust's exposure to New York fiduciary income tax but, refused to grant change of situs to the location of the new trustee.

F. Trust Protectors or Advisors

New York does not currently have a statue governing the use of trust protectors. Generally, the role of a trust protector is to oversee the trustee's actions in administering a trust to ensure those actions comport with the terms of the trust and intent of the grantor.

1. What is a trust protector?

    - A trustee is required to administer a trust in accordance with the terms of the trust.

    - The role of a trust protector, however, is to oversee the trustee's actions in administering a trust to ensure that those actions comply with the law as well as the grantor's intent and purpose of the trust in question.

    - The powers given to a trust protector vary widely, however, generally a trust protector oversees many important decisions that a trustee makes.

2. Why consider a trust protector?

    - Alternative to going to court if a dispute arises

    - Remove/replace trustees

    - Arbitrate disputes between trustee and beneficiaries, or between beneficiaries

3. Proposed legislation permitting directed trusts in NYS, EPTL §11-2.2(a)

II. Reformation of a Trust, When Needed

A. Testamentary Trust – *Matter of Knapp*, 41 Misc 3d 1202(A) [2013] – co-trustees petition to reform testamentary trust to (1) allow trustees limited power to invade

trust principal, (2) reduce the age at which the current beneficiaries receive distributions of their shares of the trust and (3) dispense with Will's express requirement that one of the beneficiaries make certain visits to his grandmother, or face reductions in the value of his portion of the trust, (4) create a mechanism for the appointment of successor trustees without court approval, and (5) establishing that the trustees are held to the prudent investor standard (EPTL §11-2.3). Petition was denied in its entirety, although the trustees and beneficiaries had agreed to the relief in the petition. The Court held that when testator's intentions are clearly expressed in a will the petition must be denied, and the trustees are statutorily bound by EPTL §11-2.3.

B. Inter Vivos Trust - *Matter of Sukenik*, 162 AD 3d 564 [2018] – Appellate Division allowed a petition to reform an inter vivos trust and IRA beneficiary designation form even though the documents were clear and unambiguous on their face, and despite Surrogate's warning that "to reform instruments…based only upon the presumption that one who executes testamentary instruments intends to minimize taxes would expand the reformation doctrine beyond recognition and would open the flood gates to reformation proceedings aimed at curing any and all kinds of inefficient tax planning".

C. Recent Tax Changes and Implications

1. For New Yorkers, federal estate tax reform doesn't technically change anything about New York's estate tax, but it does mean that the difference between the federal exemption and the New York exemption has now increased significantly. New York's current exemption amount is $5.74 million, which would have made it equal to the previous federal exemption had that not been revised. Now, the federal exemption amount is almost double the New York exemption amount.

2. The discrepancy between the federal and New York exemptions underscores the need to check with an attorney as to how your current estate plan may be impacted by tax reform. If your current Will, for example, carves out a credit shelter trust for a surviving spouse with the deceased spouse's federal exemption (as opposed to his state exemption), there could be a significant – and unanticipated – state estate tax bill due at the death of the first spouse.

3. In addition, the absence of a New York gift tax, combined with an increase in the federal exemption, provides an opportunity for wealthy New Yorkers to give more away during life to reduce state estate taxes at death.

    - New Yorkers who have an estate close to the New York exemption amount may wish to consider a gifting program designed to continuously keep the value of their estate below the exemption amount. This is because New Yorkers are subject to a "cliff" whereby if their estate exceeds the New York exemption amount by 5%, they can no longer take advantage of the New York exemption at all. Their entire estate is subject to New York estate tax from dollar one.

4. Married New York residents whose estates will likely be valued more than the New York estate tax exclusion amount should review how their estate planning documents fund trusts that will not qualify for the marital deduction, such as "bypass," "credit shelter" or "disclaimer" trusts.

    - If their estates are likely to be valued below the federal estate tax exclusion amount, couples can take full advantage of New York's increased estate tax exclusion amount by funding these trusts with an amount equal to the New York exclusion amount. If these trusts are instead funded with the full federal exclusion amount at the first spouse's death, New York estate tax will be imposed on the portion of

the federal exclusion amount that exceeds the New York exclusion amount.

5. Non-grantor trusts are trusts which are independent taxpayers and which pay their own tax (versus a grantor trust where you are taxed on trust income).

6. Non-grantor trusts may help minimize benefits from the new 20% income tax deduction available to pass-through businesses entities.

7. Life Insurance will no longer be needed to pay estate tax but will be useful in new trust planning.

8. The doubling of the exemptions from $5 to $10 million inflation is a temporary benefit – the law may change after 2025 and the exemption may change back to $5 million.

    - Drafters should use as much of the new exemption as they can, which will require making transfers to trusts that constitute completed gifts for transfer tax purposes. This means that the plan will limit the control or strings your client has on the trusts receiving assets to avoid estate inclusion. This will affect the way the trusts are used.

    - Drafters will need to have trusts set-up, so trustee can gain access to trust assets.

    - Charitable trusts reduce taxable estate.

D. Why You May Still Need a Trust

1. GST/QTIP

Matter of Seiden, New York County, October 9, 2018 [Mella, J.] – proceeding pursuant to New York Tax Law 998. The Court was asked to decide the effect of a federal estate tax repeal for 2010 on the NY estate tax attributable to QTIP trusts for surviving spouses of persons who died in 2010, in a proceeding to vacate and set aside a notice of estate tax deficiency. Decedent died in Nov. 2014 predeceased by her husband in 2010. She was a beneficiary of a trust under husband's will that was eligible for estate tax treatment as QTIP--the trust qualified for a marital deduction in the estate of the first spouse to die. A repeal of the federal estate tax for 2010 did not require husband's estate to file a federal estate tax return but was required to file a NY estate tax return. The case here concerned the tax treatment of the trust in wife's estate, as surviving spouse--value of the trust property was excluded on the federal estate and NY estate tax returns. The tax department assessed additional tax for over $462,000 attributable to the QTIP trust. The Court found IRC §2044 inapplicable, the QTIP property was not included in wife's federal gross estate nor in the NY gross estate. Thus, the petition was granted, and the notice of tax deficiency vacated.

- Tax Department is not filing an appeal

- Defect may have been cured with passage of April 2019 NYS Budget – no QTIP allowed if not taken in first estate

2. Supplemental Needs Trust

- If a trust for a beneficiary who has a disability does not meet the criteria for a supplemental needs trust under EPTL§7-1.12 due to ambiguous language or language that clearly provides for support of the beneficiary,

the trustee should apply to a court to reform the trust into a supplemental needs trust under EPTL §7-1.12.

- Courts frequently face the question of whether to reform a trust created before the legislature's 1993 enactment of this section to meet the requirements of this section and obtain its benefits.

- In *Matter of Newman*, 18 Misc 3d 1118(A) [2008], for example, the decedent died in 1988, leaving a 60-year-old daughter who functioned at a third-grade level. He left his residuary estate in trust and directed the trustee to use the income for daughter's benefit. The trustees could also invade the principal for the "more adequate support and maintenance" of the daughter and could "defray" the daughter's health expenses. The executor wanted to reform the trust to make it a Supplemental Needs Trust, and the Court granted the petition, relying on the testator's words "more adequate support" and "defray" to conclude that he meant to supplement, not supplant, government benefits. He did not want her to be "relegated to living solely on available government benefits ...." The Court cited cases, relying on *Matter of DeRosa*, NYLJ, April 29, 2006, at 30, col. 2, and *Matter of Kamp*, 7 Misc 3d 615 [2005], which allowed reformation, and rejecting the narrow holding in *Matter of Rubin*, 4 Misc 3d 634 [2004], which prohibited it.

3. Pet Trust

   - EPTL §7-8.1 allows a grantor to create a trust for the care and maintenance of a beloved pet, which is a legally enforceable document, like any other trust. A trustee is designated therein, or if none, the Court will appoint a trustee (EPTL §7-8.1(a)). The principal and income of the

pet trust must be used for the benefit of the designated animal, unless expressly stated differently. By operation of law, the pet trust terminates when the animal dies, upon termination, the trustee shall transfer the unexpended trust property as directed in the trust instrument or, if there are no such directions in the trust instrument, the property shall pass to the estate of the grantor (EPTL §7-8.1(c)).

- A Court may reduce the amount of property transferred into the trust "if it determines that amount substantially exceeds the amount required for the intended use", and the amount of the reduction passes as unexpended trust property (EPTL §7-8.1(d)). Although a pet may be protected for its entire lifespan, this does not necessarily protect said pet from a bitter relative because, like any other trust, a pet trust may be contested. A party may bring an accounting proceeding against the trustee, may petition to remove a trustee, or even move to invalidate the pet trust for a grantor's lack of capacity. *Eg*: The Leona Helmsley Will which cut out her grandchildren and instead provided the bulk of her assets to her dog, Trouble. She left Trouble $12 million dollars in trust so that the dog may maintain its extravagant lifestyle which included thousands of dollars in routine dog grooming, gourmet dog food and around the clock security guards. The Court reduced the pet trust from $12 million to $2 million, finding that Helmsley's trust was overfunded for the carrying out of decedent's wishes. The Court did not adjust the trust principal to interfere with Helmsley's desire to care for her pet. Rather, the trust principal was reduced because the assets funding the trust were greater than what was required to carry out her intentions.

- Tax Treatment – Unlike other testamentary trusts where the designated beneficiary is responsible on paying tax for any income received by the trust, an animal is not a "person" pursuant to the IRC which is responsible for paying taxes. However, to ensure that taxes are

collected, the IRC provides that in jurisdictions where pet trusts are valid, assets that are distributed to a pet trust are included as part of the decedent's gross taxable estate and no deductions (charitable or otherwise) are permitted.

III. Decanting

EPTL § 10-6.6

Common reasons for decanting include income tax savings, administration and trustee succession efficiency, and to extend the trust term.

1. Power of Appointment
   - Decanting can be used to provide the trustees the power to grant beneficiaries a general power of appointment. Exercise of this power can result in income tax savings by causing part or all the trust to be taxed in a beneficiary's estate, sometimes without triggering estate tax because of increased federal and state tax exemption (currently $5,450,000). Under current estate tax laws, inclusion of trust property in a beneficiary's estate results in a step up in the income tax basis of trust assets to fair market value at the beneficiary's death, generating lower income taxes on the sale of trust assets.

2. Consolidate multiple trusts
   - Combining multiple trusts may lower administrative costs, resulting in a more efficient and economical trust for the benefit of the beneficiaries.

3. Separate trusts
   - Splitting one trust for multiple beneficiaries into different trusts for each beneficiary or family group allows different needs to be addressed.

- *Matter of Hoppenstein*, 162 AD3d 512 [June 14 2018], *lv to appeal denied* 32 NY 3d 967 [Oct 18 2018]. Contested proceeding for settlement of the trustees' account of an irrevocable trust by settlor, objectants sought partial summary judgment to void the trustees' distribution of a $10 million insurance policy on settlor's life from a 2004 trust to a new trust settlor created in 2012. The Court approved the exercise of a decanting power granted under the trust instrument as opposed to under the statute. Noting that EPTL §10-6.2(k) specifically provides that the statute shall not constrict any right of appointment that arises under the governing instrument or common law, Surrogate Rita Mella held that statutory compliance with procedure for decanting under §10-6.6 was "immaterial".

4. Add or modify spendthrift provisions

5. Avoid or Reduce State Income Taxes on Trust Assets

- A trust can be decanted to take advantage of the current estate tax exemption and achieve a full step up in income tax basis of the trust assets upon an individual's death, thereby reducing estate and income tax liability.

- If a New York resident trust no longer has a trustee domiciled in New York, has no real or personal property located in New York and has no New York source income, then capital gains and accumulated income will not be subject to New York income tax. [N.Y. Tax Law § 603(b)] Therefore, if a New York based trust includes assets located in another state, the trustee should consider decanting those assets to an appointed trust in the other tax jurisdiction. By doing so, the decanted assets might avoid New York capital gains tax and accumulated income tax.

IV. Miscellaneous Proceedings and Alternatives

A. Cy Pres – EPTL § 8-1.1 – *Matter of Lee*, Erie County Surrogate's Court, December 16, 2016 [Howe, J.]

B. Use of Informal Accountings to Reduce Trustee Liability

In New York, there is no requirement that trustees file recurring trust accountings. A recent decision out of the Appellate Division holds that informal accountings sever liability, as long as full disclosure has been given by the fiduciary.

- *Matter of Spacek*, 155 AD3d 747 [2017]: the decedent's will provided that her estate was to be split among six (6) beneficiaries. The executor sent an agreement releasing her from acts done as executor, accompanied by the estate's tax returns and other financial documents, to the beneficiaries, which they signed. After the executor petitioned to judicially settle the account, one of the beneficiaries filed objections. The Appellate Division affirmed the Surrogate's decision to deny the motion to set aside the release. The Court held that use of:

> "an informal accounting is as effectual for all purposes as a settlement pursuant to a judicial decree...[I]f a fiduciary gives full disclosure in his [or her] accounting to which the beneficiaries are parties…they should have to object at that time or be barred from doing so after the settlement of the account." [internal citations omitted].

C. Termination of an Uneconomical Trust – EPTL § 7-1.19

- Under EPTL § 7-1.19, a trustee can seek termination of a testamentary or inter vivos trust if its continued administration is uneconomical. A

Court may grant termination of a trust if it is satisfied that: (1) it is economically impracticable to continue administering the trust; (2) the trust does not expressly prohibit administration; (3) termination would not defeat the purpose of the trust; and (4) termination serves the beneficiaries' best interests.

- *Matter of Sausner,* Erie County Surrogate's Court, August 6, 2014 [Howe, J.) see also *Matter of Kistner,* NYLJ, January 23, 2006, at p. 35, col. 1: The Court directed termination of the trust where the trust could pay little or no income to the income beneficiary and the remainder person did not object to the termination of the trust.

- Courts are constrained to respect the intent of the grantor, therefore the Court may deny an application to terminate a trust even when all beneficiaries consent to its termination: *Matter of Dauman,* 12 Misc 3d 1173A [2006]: The Court denied the application to terminate the trust, although such early termination was not expressly prohibited by the terms of the decedent's will. The Court based its conclusion on the following: (1) the petitioners had not sufficiently demonstrated that the continued expense of administering the trust was uneconomical; (2) the proposed early termination would defeat the trust purposes; and (3) the petitioners had not shown any benefit which would inure to the remainder persons by early termination. See also *Matter of Zara*, 2014 NY Slip Op 30854(U). The Court denied a request to terminate a trust as uneconomical even when all parties consented, holding that "intent should be respected by the Court, even where all the interested parties are willing to ignore it."

D. ADR/Mediation

Dispute resolution through mediation or other alternative dispute resolution is particularly helpful in resolving disputes arising out of trusts and estates.

- Facilitates working through some of the emotional issues and complex family dynamics inherent in trust and estate disputes.

- Consider drafting provisions requiring mediation or other dispute resolutions in trust documents.

<u>APPENDIX</u>

to

"Using Trusts to Avoid Litigation"

Presented by:
Honorable Acea M. Mosey
Erie County Surrogate's Court

Matter of Nuchereno, Erie County Surrogate's Court, File No. 2018-1408
Order dated February 23, 2019 [Mosey, J.]

Matter of Gadsden, Kings County Surrogate's Court File No. 2016-604
Decision dated March 20, 2019 [Lopez-Torres, J.] **(used with author's permission)**

Matter of Seiden, New York County Surrogate's Court File No. 2014-4802
Decision and Order dated October 9, 2018 [Mella, J.] **(used with author's permission)**

Matter of Lee, Erie County Surrogate's Court File No. 69-5100
Decree dated December 16, 2016 [Howe, J.]

Matter of Sausner, Erie County Surrogate's Court File No. 2011-3587
Memorandum and Order dated August 6, 2014 [Howe, J.]

STATE OF NEW YORK
SURROGATE'S COURT : COUNTY OF ERIE

FILED
FEB 23 2019
SURROGATE'S COURT
ERIE COUNTY, N.Y.

In the Matter of the trust held for the benefit of ███████████ under the Trust Agreement for the Raymond R. Nuchereno Revocable Living Trust dated January 27, 2017

ORDER

File No. 2018-1408

A petition having been filed by Maria Valeri [hereafter, Valeri], verified March 22, 2018, seeking the appointment by this Court of a trustee of the within *inter vivos* trust, and verified objections having been filed to the petition by Maureen Schmitt [hereafter, Schmitt], and this Court having appointed Sharon L. Wick, Esq., as guardian ad litem [hereafter, the GAL] for the beneficiary of the Article XII trust set up under this trust, ███████████, a minor who is the son and sole distributee of Raymond A. Nuchereno [hereafter, Nuchereno], the deceased grantor of this trust and Valeri's former husband, and the matter having duly come on to be heard before the undersigned, and this Court having read and filed all the papers listed at the foot of this Order, and upon all the prior papers and proceedings heretofore had herein, and due deliberation having been had, and this Court having determined as follows:

(a) Nuchereno, who died on June 17, 2017, had been married to Valeri, but they entered into a Property Settlement and Separation Agreement [hereafter, the Agreement] on May 3, 2012, which was incorporated into a June 12, 2012 judgment

of divorce but not merged therein;

(b) The Agreement provided, *inter alia,* that (i) ████ "shall receive, upon the death of [Nuchereno], his intestate share of [Nuchereno's] estate", (ii) "[Nuchereno] warrants, together with and on behalf of his representatives, next of kin, executors, administrators, and assigns, that <u>the value of [Nuchereno's] estate which shall be available for ████ in Trust, will be no less than three million dollars</u>" (emphasis added), and (iii) the trustee for ████ "shall be appointed at the sole discretion of the Surrogate in the County in which [decedent's] estate is probated", and that the trustee, in any event, shall <u>not</u> be Robert Nuchereno;

(c) The within trust, executed by Nuchereno on January 24, 2017, provides that he is the initial trustee, followed (i) by Schmitt, or (ii) by Timothy Joldos, Jr., or (iii) whomever the adult beneficiaries "vote to nominate";

(d) Nuchereno's January 24, 2017 Will, which has been admitted to probate by this Court, provides that all the assets in his estate be paid into the within trust;

(e) The GAL correctly points out that the successor trustee provisions of the within trust, designating Schmitt and/or others as trustee upon Nuchereno's death, are at complete variance with the Agreement entered into between Nuchereno and Valeri, <u>and that</u>, to "allow the designation of a Trustee in the Living Will to stand in contravention of the Settlement Agreement would mean that the Decedent can

circumvent his obligations under the Settlement Agreement by creating the Living Trust to serve as a 'Will substitute' ";

(f) The GAL also correctly points out that the "no contest provision" in the trust here "cannot be applied to circumvent another party's claim under an agreement entered into by the Decedent or grantor during his lifetime [*Matter of Friedman*, 146 Misc 2d 91 (1989)]";

and based upon the foregoing determinations, I hereby conclude as follows:

(1) Only this Court may, pursuant to the 2012 Agreement between Nuchereno and Valeri, appoint the trustee of the within trust now that Nuchereno has died;

(2) The "no contest" provision of the trust has no application to this petition and the relief sought herein;

(3) Neither Valeri nor Schmitt have any right to be appointed as successor trustee of this trust;

(4) The validity of the trusts under Articles VIII, X and XI, alluded to in petitioner's papers, are not presently before this Court for adjudication and are a matter to be brought hereafter either under the estate [file #2017-2802] or in this *inter vivos* matter;

and, accordingly, it is hereby

ORDERED that Chanel T. McCarthy, Esq., 424 Main Street, Suite 1820, Buffalo, New York 14202, and Bridget Williams, 4511 Hyde Park Blvd., Niagara Falls, New York 14305, shall be, and they hereby are, appointed as co-trustees of the Article XII trust hereunder, with the issue of a trustee under the Article X trust, of which [redacted] is also a beneficiary, deferred; and it is further

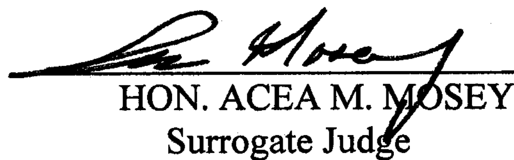
ORDERED that all assets pertaining to this Article XII trust shall be turned over to the co-trustees forthwith, together with an accounting thereof by whomever has been in possession of such assets since Nuchereno's death; and it is further

ORDERED that the GAL shall submit her fee application to the undersigned, with a copy thereof sent to the co-trustees appointed hereunder, on or before March 15, 2019, and the co-trustees shall have seven (7) days thereafter to file and serve any responsive papers, after which this Court will decide the fee application on the papers; and it is further

ORDERED that counsel for Valeri shall submit his application for reasonable attorney fees to be paid from this trust on account of having to bring this proceeding to compel compliance with the Agreement, and the same shall be filed on or before March 15, 2019, and served (on or before that same date) on the GAL and upon the

co-trustees, and the GAL and the co-trustees shall have until March 22, 2019 to file and serve any responsive papers after which that application shall be decided by me on the papers.

DATED: Buffalo, New York
February 23, 2019



HON. ACEA M. MOSEY
Surrogate Judge

Papers Considered

1. Verified petition, filed March 26, 2018, with exhibits;

2. Verified objections, filed September 11, 2018, with exhibits;

3. October 26, 2018, reply affirmation of Catherine B. Eberl, Esq., attorney for petitioner Maria Valeri;

4. November 9, 2018, surreply affirmation of William C. Moran, Esq., attorney for objectant Maureen Schmitt;

5. November 8, 2018, affidavit of Maureen Schmitt;

6. Report and Recommendation of Sharon L. Wick, Esq., guardian ad litem for ████ ██████, dated November 28, 2018;

7. December 4, 2018, supplemental affirmation of William C. Moran, Esq.;

8. December 14, 2018, supplemental reply affirmation of Catherine B. Eberl, Esq.;

9. December 14, 2018, supplemental Report and Recommendation of GAL Wick;

10. December 21, 2018, second supplemental reply affirmation of William C. Moran, Esq.

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF KINGS

--x

In the Matter of the Petition of CARRIE GADSDEN
To Remove Robert Gadsden as Trustee of the Estate of

EFFIE GADSDEN, Deceased.

DECISION
File No. 2016-604/F/G

--x

LÓPEZ TORRES, S.

The following papers were considered in this summary judgment motion:

PAPERS	NUMBERED
Amended Notice of Motion for Summary Judgment by Petitioner, Affidavit in Support with Exhibits.........	1,2
Affidavit in Opposition by Respondent	3

In this contested miscellaneous proceeding, Carrie Gadsden (the petitioner) moves for summary judgment granting her petition to remove Robert Gadsden (the respondent) as trustee of the Effie Gadsden Living Trust (the Trust), and to appoint herself as successor trustee of said trust.

Background

Effie Gadsden (the decedent) died at the age of 96 on June 15, 2015, survived by six adult children, including the petitioner and the respondent herein. In 2012, the decedent, as grantor, created the Trust for her benefit and, upon her death, for her children (the beneficiaries). The decedent named herself as trustee until her death and named two of her children, Mary Gadsden and the respondent, as alternate successor trustees. Mary Gadsden post-deceased on August 7, 2015, and the respondent became the successor trustee. The sole asset of the Trust is a parcel of real property located at 684 St. Marks Ave., Brooklyn 11216 (the property), which had belonged to decedent before she transferred her ownership interest to the Trust in 2012. None of the beneficiaries live at the property, a residential building generating rental income. Pursuant to the Trust, upon the decedent's death, the principal of the Trust shall be distributed in equal shares to all the decedent's children. To date, the respondent has not distributed the Trust property to the

decedent's children. The petitioner commenced a proceeding to compel the respondent to account, granted by order of the court dated July 6, 2016[1] (2016 order), wherein the respondent was directed to account within sixty days of service of the order with Notice of Entry, and to cause a citation to be issued to all interested parties "with due diligence, without undue delay." Although an accounting was eventually submitted, it was not filed within the ordered time frame, and no citation has issued. The petitioner commenced a proceeding on July 12, 2018, to compel the distribution of the Trust property, granted by decision and order dated December 19, 2017[2] (2017 order), wherein the respondent was directed to distribute the principal and retained income of the Trust to the decedent's children within thirty days. It is undisputed that the respondent has not complied with either the 2016 order or the 2017 order.

On December 28, 2017, the petitioner commenced the instant proceeding, seeking an order removing the respondent as Trustee. She contends that the respondent is unfit to serve based on his failure to comply with court orders, failure to distribute estate assets in a timely manner, failure to pay real estate taxes since at least 2012, and "wasting and improperly applying the assets of the Effie Gadsden Living Trust for his own personal use." She further contends that the respondent converted stocks which are estate assets into his own name, committed perjury in his pleadings, ignored requests for information, failed to distribute assets for over two years, treated the estate as his own personal property, and withdrew sums of cash from the Trust bank account ranging from $500 to $3,800 without explanation. Petitioner asserts that the market value of the property is $1,420,000 and must be sold in order to distribute the net proceeds equally to all the beneficiaries, as directed by the Trust.

Verified objections to the instant petition were interposed by the respondent, wherein he contends that four of the beneficiaries have purportedly expressed a desire to keep the property "in the family," that he has offered the petitioner cash payments of $5,000 or more in partial distribution, which she has rejected, and that he is ready to proceed with the transfer of title to each beneficiary as directed by the 2017 order.

The petitioner moves for summary judgment to dismiss the objections and for an order

---

[1] Issued by the Honorable Diana Johnson

[2] Issued by the Honorable John Ingram

removing the respondent as Trustee pursuant to SCPA 711 (3), (8) and SCPA 719 (10)[3]. She contends that the respondent should be removed because he has not complied with the explicit provision of the Trust to distribute the Trust property to the children, despite the lapse of three yeas since the decedent's death. Furthermore, the petitioner asserts that the respondent is in violation of the 2016 and 2017 orders, which directed him to file a judicial accounting and cause citations to issue, and to distribute the Trust principal and retained income within 30 days. She asserts that, upon his alleged willful and repeated disobedience of the court's orders and apparent unwillingness to effectuate the express provisions of the Trust, the respondent is unfit to carry out the duties of a trustee pursuant to SCPA 711 (3) and removal is warranted.

In opposition, the respondent avers that the rental income he collected from the Trust property have been used to pay the living expenses of four out of six of the trust beneficiaries, namely, his brothers and a nephew, the sole distributee of a post-deceased beneficiary. The respondent further avers that the Trust provides that "no accounting is required." The court notes, however, that the respondent did not interpose any objection to the prior petition to compel an accounting, and made no motion to reargue after the 2016 order directing him to account was issued. The respondent further avers that he is filing a motion to vacate the 2017 order based on "law office failure;" however, the records of this court indicate that no such motion has been filed. The respondent contends the instant motion should be denied as he "has undisputedly administered the assets of the estate fully and efficiently."

On a motion for summary judgment, the movant, the petitioner herein, has the burden of establishing a *prima facie* showing of entitlement to judgment as a matter of law, tendering sufficient evidence in admissible form to demonstrate the absence of any material issue of fact. *Zuckerman v City of New York*, 49 NY2d 557 (1980). Once met, the burden shifts to the party opposing the motion, the respondent herein, to demonstrate the existence of material issues of fact that preclude summary judgment determination. *Phillips v. Kantor & Co.*, 31 NY2d 307 (1972). Where there is any doubt as to the existence of material issues of fact, "or where the issue

---

[3] The applicability of SCPA 719, which provides that the court may make a decree revoking letters issued to a fiduciary without process, to the instant proceeding is unclear where, here, the relief sought was on notice by petition and jurisdiction has been obtained.

is 'arguable,' 'issue-finding, rather than issue-determination, is the key to the procedure.'" *Sillman v Twentieth Century-Fox Film Corp.*, 3 NY2d 395 (1957).

SCPA 711 sets forth specific grounds which may form the basis for a court to revoke letters, including where a fiduciary has "wilfully refused or without good cause neglected to obey any lawful direction of the court contained in any decree or order or any provision of law relating to the discharge of his duty" (SCPA 711 [3]) or where a fiduciary "does not possess the qualifications required of a fiduciary by reason of substance abuse, dishonesty, improvidence, want of understanding, or who is otherwise unfit for the execution of office" (SCPA 711 [8]). The removal of a fiduciary is a matter within the discretion of the court. *Stolz v New York Cent. R.R. Co.*, 7 NY2d 269 (1959). It is deemed a serious remedy to be used sparingly and "only upon a clear showing of serious misconduct that endangers the safety of the estate," *Matter of Duke*, 87 NY2d 465 at 473 (quotations omitted) (1996). *See also Matter of Delaney*, 2018 NY Slip Op 32755(U) (Sur Ct, Nassau County) (fiduciary's failure to comply with a so-ordered stipulation demonstrated an "unequiovocal showing of serious misconduct that endangered the estate"); *Estate of Bishop*, 2018 NYLJ LEXIS 3859 (Sur Ct, Bronx County) (fiduciary's failure to sell the estate property by refusing to select appraisers and brokers warranted revocation of letters); *Falum v Birnbaum*, 191 AD2d 227 (1st Dept 1993) (lower court's revocation of executor's letters for failure to provide a her correct address as ordered by the Surrogate was upheld).

Upon the papers presented, the petitioner has satisfied her burden of demonstrating entitlement to judgment as a matter of law, and the respondent has failed to raise the existence of any material issues of triable fact to preclude summary judgment. The clear and unambiguous language of the Trust requires that upon the grantor's death, the Trustee must distribute the Trust principal and retained income to all the beneficiaries. The Trust expressly provides

> Upon the death of the Grantor, the principal of this trust then remaining shall be paid and distributed to the children of the Grantor, Robert Gadsden, Mary Gadsden, Carrie Beatrice Gadsden, Russell Edward Gadsden, David Ralph Gadsden, and Willie Rivers in equal shares per stirpes

It is uncontroverted that the respondent has not distributed the principal of the Trust and by his own admission, the respondent has been using Trust assets to benefit some of the beneficiaries, specifically "the rents collected from the building pay their living expenses (i.e., rent, food,

telephone bill, and utilities)," while other beneficiaries, including the petitioner, have received no distribution since the decedent's death. Notwithstanding the issuance of the 2016 order, which directed the respondent to account within sixty days and "cause a citation to be issued and complete service to be made, with due diligence, without undue delay, on all persons interested in the proceeding," the respondent failed to timely file said petition and to date, no citation has been issued nor service completed in the proceeding. Notwithstanding the court's issuance of the 2017 order which directed the respondent "to distribute the principal and retained income of the Trust to the decedent's children within thirty days of receiving notice of this order," it is undisputed that no such distribution has been made. While the respondent claims in his opposition that "[he is] ready to proceed with the transfer of title to each beneficiary based on the [2017] Order," he nonetheless remains in clear violation of said order.

The respondent's continuing failure to distribute the Trust principal, despite the express language of the Trust and despite the order of this Court, demonstrates a want of understanding of his fiduciary responsibilities to carry forth the mandate of the Trust for the benefit of all the beneficiaries, not just those he chooses to benefit (SCPA 711 [3]), as well as a willful refusal or neglect to obey, without good cause, the lawful direction of the court (SCPA 711 [8]). These failures rise to the level of serious misconduct that endangers the estate, thereby warranting removal as fiduciary.

Accordingly, the petitioner's motion for summary judgment is granted to the extent that the objections are dismissed, Robert Gadsden is removed as Trustee of the Effie Gadsden Living Trust, and Carrie Gadsden is appointed as successor Trustee, upon her duly qualifying.

Settle decree.

Dated: March 20, 2019
Brooklyn, New York

HON. MARGARITA LÓPEZ TORRES
SURROGATE

SCANNED New York County Surrogate's Court Date: October 9, 2018

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

---x

Application of Sara Jane Hogan, as Executor, Seeking to Vacate and set aside a Determination of the New York State Department of Taxation and Finance Declaring an Estate Tax Deficiency in the Estate of

EVELYN SEIDEN,

Deceased.

---x

DECISION and ORDER
File No.: 2014-4802/B

M E L L A, S. :

This is a proceeding pursuant to New York Tax Law § 998 to vacate and set aside a Notice of Estate Tax Deficiency. The court is asked here to determine the effect of the federal estate tax repeal for the year 2010 on the New York estate tax attributable to "QTIP" trusts for surviving spouses of individuals who died in that year.

Decedent Evelyn Seiden (decedent, or wife) died in November 2014, predeceased in 2010 by her husband, Jules Seiden (husband). Decedent was the beneficiary of a trust under her husband's will that was eligible for estate tax treatment as Qualified Terminable Interest Property, known as a "QTIP" trust. In general, a QTIP trust qualifies for the marital deduction in the estate of the first spouse to die, despite the surviving spouse's lack of control over the remainder as would otherwise be required (*compare* IRC § 2056 [b] [5], *with* IRC § 2056 [b] [7] [B]).[1] To so qualify under the federal law the first estate must make a specific election on its

---

[1] As aptly explained by the 9th Circuit federal appeals court,

> "The QTIP is an exception to an exception to an exception. In general, a tax is levied on the transfer of estates. § 2001. However, the marital deduction is an exception to this rule, and any interest in property which passes to a surviving spouse is not considered part of the decedent's gross estate. § 2056(a). Life estates and other terminable interests are an exception to the marital deduction. § 2056(b)(1). Finally, the QTIP regime is an exception to the terminable interest exception to the marital deduction. A QTIP is a terminable interest in property which has certain limiting characteristics: (1) the surviving spouse receives all of the income from the property for life, distributed at least annually (a "qualifying

federal estate tax return (IRC § 2056 [b] [7] [B] [i] [III]). A concomitant federal tax code provision, IRC § 2044, requires that trust property for which a marital deduction "was allowed" in this manner be included in the estate of the surviving spouse.

Due to the repeal of the federal estate tax for the year 2010, the estate of the husband in this case was not required to file, and did not file, a federal estate tax return.[2] The husband's executor was required to file, and did file, a New York estate tax return. On the New York return the executor elected QTIP treatment in the manner authorized by the New York State Department of Taxation of Finance (Tax Department) in its Technical Services Bureau Memorandum TSB -M-10(1)(M), Estate Tax, March 16, 2010 (TSB Memorandum). In accordance with those instructions, she filed a "pro forma" federal return with the New York return, indicating the election by listing the QTIP property in a space on the federal form

---

> income interest"); (2) no person can appoint any part of the property to any person other than the surviving spouse; and (3) the decedent's estate elects to treat the interest as a QTIP. § 2056(b)(7)(B). If an interest is a QTIP, the regime establishes a legal fiction: for the purposes of estate taxes, the entire property is treated as if it passed to the surviving spouse (and, consequently, nothing to the remainder [beneficiaries])—even though the surviving spouse actually possesses only the income interest. § 2056(b)(7)(A). Therefore, the marital deduction of § 2056(a) applies to the entire QTIP property and the property is not included in the gross estate of the decedent.
>
> "The underlying premise of the QTIP regime is that the surviving spouse is deemed to receive and then give the entire QTIP property, rather than just the income interest. The purpose of the QTIP regime is to treat the two spouses as a single economic unit with respect to the QTIP property while still allowing the first-to-die spouse to control the eventual disposition of the property."

(*Estate of Morgens v C.I.R.*, 678 F3d 769, 771 [9th Cir 2012].)

[2] The federal estate tax for 2010 was repealed by Section 501 of the Economic Growth and Tax Relief Reconciliation Act of 2001. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 gave executors the option to apply the estate tax to the estates of decedents who died in 2010 in return for certain income tax benefits, but the husband's executor here did not exercise that option.

designated for that purpose.[3] The husband's estate took a marital deduction for the trust property in calculating the New York estate tax, and the Tax Department issued a closing letter accepting the return in 2012.

The case here concerns the tax treatment of the trust in the estate of the wife, as the surviving spouse. Her executor excluded the value of the trust property on the federal estate tax return on the basis that no federal marital deduction had been claimed or "allowed" in the husband's estate, as is required to trigger inclusion in the second estate under IRC § 2044. The Internal Revenue Service issued a closing letter accepting the return as filed. The estate also excluded the trust property on decedent's New York estate tax return, taking the position that New York law defines its gross estate by reference to the federal gross estate, which clearly excludes the property. The Tax Department disagreed and assessed additional tax in the amount of $462,546.18,[4] all attributable to the QTIP trust. Decedent's estate seeks here to vacate the alleged deficiency. There are no disputed factual issues, and the parties have agreed that the court decide the matter on the papers submitted.

The Estate's Position

The estate argues that IRC § 2044 has no application to the wife's estate because, as stated above, no federal marital deduction was allowed in the estate of her pre-deceased husband. Since the trust property is not includible in her federal gross estate, it follows, the estate maintains, that the property is not includible in her New York gross estate, which is defined solely by reference to the federal definition. As provided in New York Tax Law (TL) § 954 (a):

[3] Specifically, the trust property for which the election was made and which is referred to herein as the "QTIP" property was 78.4 percent of a trust designated as "Family Trust" under the husband's will.

[4] Including interest, the deficiency amounts to $529,342.86. Decedent's estate has paid the deficiency to stop the running of interest.

> "The New York gross estate of a deceased resident means his or her federal gross estate as defined in the internal revenue code (whether or not a federal estate tax return is required to be filed) . . . ."[5]

The Tax Department Position

The Tax Department contends that TL § 951 as it existed in 2010 requires a different result. That statute provided, "[A]ny reference to the Internal Revenue Code means the United States Internal Revenue Code of 1986, with all amendments enacted on or before July 22, 1998 . . . ." Thus, the Tax Department argues, the reference in TL § 954 (a) to the internal revenue code means the internal revenue code as it existed on July 22, 1998, when a federal marital deduction was "allowed," making IRC § 2044 operative under New York's tax regime to require inclusion of the trust property in the second estate.

Discussion

The Tax Department analysis is incorrect. First, the relevant tax law is that which existed in 2014, when decedent died, and not in 2010, because it is the tax on the wife's estate that concerns us here. In 2014, TL § 951 (a) was rewritten to change references to the federal tax law from that in effect on July 22, 1998, to the law as in effect on January 1, 2014. The statute as amended was made applicable to estates of persons, like decedent, who died after April 1, 2014 (L 2014, ch 59, pt X, §§ 1, 11). Under the federal tax law in effect on January 1, 2014, no marital deduction was "allowed" for decedents dying in 2010.[6]

Second, even under the law as it existed prior to 2014, no federal marital deduction was "allowed" in the husband's estate. To be "allowed" as QTIP property, it is necessary that the

[5] The statute includes modifications to the federal definition concerning out-of-state property, limited powers of appointment, and taxable gifts, not relevant here.
[6] As noted above, executors had the option of electing certain income tax benefits in lieu of the benefits of estate tax repeal, but no such election was made here.

executor make a particular election on the federal estate tax return. IRC § 2056 (b) (7) clearly states:

> "(i) . . . The term 'qualified terminable interest property' means property—
>
> . . .
>
> "(III) to which an election under this paragraph applies.
>
> . . .
>
> "(v) Election
> An election under this paragraph with respect to any property shall be made by the executor on the [federal estate tax return] . . . ."

See Estate of Morgens v C.I.R. (133 TC 402, 410-411 [2009], *affd* 678 F3d 769 [9th Cir 2012]) where the Tax Court stated:

> "Three requirements must be met for terminable interest property to qualify as QTIP: (1) The property passes from the decedent, (2) the surviving spouse has a qualifying income interest for life in the property, and (3) *the executor of the estate of the first spouse to die makes an affirmative election to designate the property as QTIP*. Sec.2056(b)(7)(B)" (*emphasis added*).[7]

The husband's executor did not make the required election in this case. Therefore, IRC §2044 does not apply, the QTIP property is not included in the wife's federal gross estate, and the property is not included in the New York gross estate as defined in TL § 954 (a).

The Tax Department also maintains that the TSB Memorandum referred to above is controlling and dispositive of the issue. The memorandum specifically states that if (as here) an election was made on a New York return to qualify trust property for QTIP treatment, "the value of the QTIP property for which the election was made must be included in the estate of the surviving spouse." This memorandum, however, is merely a statement of the Tax Department's

---

[7] *Accord Terrell v Sullivan*, 2015 WL 2473178, *3 (Super Ct Conn, Jud Dist of New Britain, Tax and Administrative Appeals Session, Apr 29, 2015, No. CV136020308) ("Since January 1, 1982, federal law has *allowed* a marital deduction [*if an appropriate election is filed*] for certain trusts even though the surviving spouse only has life use in the trust assets" [*emphasis added*]).

position and has no legal effect. The role of memoranda such as this is explained in TL §171 [Rule Twenty-third]:

> "Technical memoranda issued by the department shall advise and inform taxpayers and others of existing interpretations of laws and regulations by the department or changes to the statutory or case law of interest to the public."

The memoranda "do not have legal force or effect, do not set precedent and are not binding" (20 NYCRR 2375.6 [c]). *See Matter of AIL Systems, Inc.*, NY St Tax Appeals Trib DTA No. 819303, May 4, 2006, *available at* https://www.dta.ny.gov/pdf/archive/Decisions 819303.dec.pdf:

> "Technical Service Bureau Memoranda are merely informational statements issued by the Division [of Taxation] to disseminate current policies and guidelines and are advisory in nature, have no legal force or effect, are not binding and do not rise to the level of promulgated rule or regulation."

The memorandum cites IRC § 2044 and Tax Law § 954, but, as discussed above, neither of these sections supports the policy it announces. The Tax Department cannot use a TSB memorandum to override statutory provisions.

The Tax Department argues further that the "duty of consistency" doctrine prevents the wife's estate from taking one position on its tax return when the husband's estate had taken another. This doctrine is a form of estoppel, intended to prevent a taxpayer from benefiting from its error or omission on a tax return, only to take a contrary position on a subsequent return after the statute of limitations has expired on the first. The flaw in this argument is twofold: the husband's estate did not make an error or omission, and the wife's estate has not taken a contrary position. Both estates followed the law in effect at the time of their decedents' respective deaths. In a related argument the Tax Department attempts to show that it "relied" to its detriment on the husband's estate return by allowing the statute of limitations to run on the claim for a marital

deduction. But that claim was entirely lawful, and the Tax Department cites no authority for how it might properly have denied that deduction.

The Tax Department also argues that the New York State legislature always intended that marital deduction property be taxed in the estate of the second spouse to die. The estate correctly responds that it is entitled to rely on the plain language of the statute, without resort to speculation about what the legislature intended. As the Court of Appeals stated in *Branford House, Inc. v Michetti* (81 NY2d 681, 686 [1993]),

> "Generally, a court may not assume the existence of legislative error and change the plain language of a statute to make it conform to an alleged intent."

It is true that a court may "correct" a legislative error in certain cases, but only "if it is established unquestionably that (1) the true legislative intent is contrary to the statutory language, and (2) the mistake is due to inadvertence or clerical error" (*id.*). The Tax Department has established neither of these elements. In fact, the legislature has amended the Tax Law in other ways to take account of the federal changes (including § 951, as discussed above, and § 955 [c]), but, in the eight years since the repeal of federal tax for the year 2010, has not acted to change the effect of the repeal on QTIP property in the circumstances of this case. The court also notes "the general rule" that "tax statutes are to be strictly construed with any doubt resolved in favor of the taxpayer" (*Compass Adjusters & Investigators v Commissioner of Taxation & Fin. of State of N.Y.*, 197 AD2d 38, 42 [3d Dept 1994]; *see also Matter of Gallatin*, 188 Misc 54, 55 [Sur Ct, Orange County 1946], *affd* 273 AD 870 [2d Dept 1948], *affd* 298 NY 812 [1949] ["In construing tax statutes it has been held that the literal meaning of the words is important, for such statutes are not to be extended by implication"]).[8]

[8] This rule of construction applies to statutes that impose tax, such as that under consideration here, and is to be distinguished from laws relating to the collection of tax, not an

Lastly, the Tax Department posits that a decision vacating the deficiency in this case will "open the floodgates" to tax avoidance. As the estate points out, however, the legislature could still amend the Tax Law to apply to future estates. Moreover, it is not guaranteed that all or even part of any QTIP trust would be subject to New York estate tax at the death of the surviving spouse under present law. The trust property might decrease in value; it might be distributed and spent down; or the surviving spouse might change domicile to another state.

For the foregoing reasons, the petition is granted and the Notice of Deficiency is hereby vacated. This decision constitutes the order of the court.

Clerk to notify.

Dated: October 9, 2018

SURROGATE

---

issue in this case (*Matter of Roosevelt Raceway, Inc. v Bedell*, 24 Misc 2d 374 [Sup Ct, Nassau County 1960], *affd* 12 AD2d 787 [2nd Dept 1961]).

At a Surrogate's Court held in and for the County of Erie, at the County Hall, in the City of Buffalo, New York, in said County, on the 24 day of Dec, 2016.

FILED

DEC 16 2016

SURROGATE'S OFFICE
ERIE COUNTY, N.Y.

PRESENT: HON. Barbara Howe,
Surrogate Judge

STATE OF NEW YORK
SURROGATE'S COURT : ERIE COUNTY

In the Matter of the Application of HSBC Bank USA, N.A. as Surviving Trustee of the Trust Created under Article THIRD of the Last Will and Testament of

- of -

LILLIAN C. LEE,

Deceased.

DECREE

File No. 69-5100/C

HSBC Bank USA, N.A. (referred to herein as "Petitioner") as Trustee of the Trust created ("Trust") under Article THIRD of the Last Will and Testament of Lillian C. Lee ("Will"), having presented to this Court a verified petition ("Petition") praying for a decree (A) determining that Lillian C. Lee ("Decedent") had a general charitable intent to benefit a Catholic organization which provides health care services to patients in the Brooklyn, New York area and a general charitable intent to benefit a Catholic organization which provides services to destitute, abandoned, and neglected and dependent children in the Brooklyn, New York area; (B) determining the closing of St. Mary's Hospital and the judicial dissolution of the Catholic Child Care Society of the Diocese of Brooklyn have made the disposition of the Trust pursuant to the second paragraph of Article THIRD (a)(1) of the Will impossible; (C) determining that the substitution of the New York Methodist

Hospital and Calvary Hospital, Inc. for St. Mary's Hospital and the substitution of St. John's Residence for Boys, Inc. for the Catholic Child Care Society of the Diocese of Brooklyn will most effectively accomplish Decedent's general charitable intent with respect to the Trust; (D) ordering the substitution of the New York Methodist Hospital and Calvary Hospital, Inc. for St. Mary's Hospital and the substitution of St. John's Residence for Boys, Inc. for the Catholic Child Care Society of the Diocese of Brooklyn, as beneficiaries of the Trust; (E) ordering that the New York Methodist Hospital and Calvary Hospital, Inc. take St. Mary's Hospital's share of the remaining balance of Part A of the Trust ("Part A Balance") in equal shares and that Calvary Hospital, Inc. use its one-fourth (1/4) share of the Part A Balance for hospital purposes at its facilities in Brooklyn, New York; and (F) granting such other and further relief as the Court deems just and proper; and

Upon a citation having been issued to the interested parties to this proceeding as determined by this Court; and

Upon satisfactory proof of service of process upon all interested parties required to be served; and

Upon the appearance of Petitioner by Phillips Lytle LLP (Erica N. Carducci, Esq.); and

Upon the filing of a Notice of Appearance by Melissa H. Thore, Assistant Attorney General of the State of New York, indicating that the Attorney General has no objections to the relief requested in the Petition;

Upon the failure of any other interested parties to appear;

This Court having received no objections to the relief requested in the Petition; and

This Court being satisfied that all of the allegations of the Petition are true;

IT IS ORDERED AND DECREED that it is hereby determined that, in creating the Trust, the Decedent had a general charitable intent to benefit a Catholic organization which provides health care services to patients in the Brooklyn, New York area and a general charitable intent to benefit a Catholic organization which provides services to destitute, abandoned, and neglected and dependent children in the Brooklyn, New York area.

IT IS FURTHER ORDERED AND DECREED that it is hereby determined that the closing of St. Mary's Hospital and the judicial dissolution of the Catholic Child Care Society of the Diocese of Brooklyn have made the disposition of the Trust pursuant to the second paragraph of Article THIRD (a)(1) of the Will impossible.

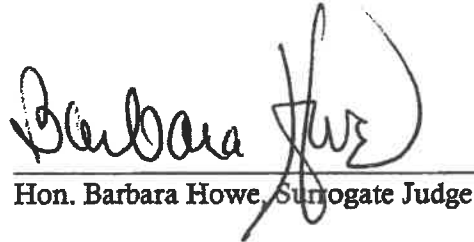
IT IS FURTHER ORDERED AND DECREED that it is hereby determined that the substitution of the New York Methodist Hospital and Calvary Hospital, Inc. for St. Mary's Hospital and the substitution of St. John's Residence for Boys, Inc. for the Catholic Child Care Society of the Diocese of Brooklyn will most effectively accomplish Decedent's general charitable intent with respect to the Trust.

IT IS FURTHER ORDERED AND DECREED that New York Methodist Hospital and Calvary Hospital, Inc. be substituted for St. Mary's Hospital as beneficiaries of the Trust.

IT IS FURTHER ORDERED AND DECREED that St. John's Residence for Boys, Inc. be substituted for the Catholic Child Care Society of the Diocese of Brooklyn, as a beneficiary of the Trust.

IT IS FURTHER ORDERED AND DECREED that the New York Methodist Hospital and Calvary Hospital, Inc. take St. Mary's Hospital's share of the Part A Balance in equal shares and that Calvary Hospital, Inc. use its one-fourth (1/4) share of the Part A Balance for hospital purposes at its facilities in Brooklyn, New York.

Dated: December 16, 2016



Hon. Barbara Howe, Surrogate Judge

E-C4/Doc #01-2991172.1

STATE OF NEW YORK
SURROGATE'S COURT : COUNTY OF ERIE

FILED
AUG - 6 2014
SURROGATE'S OFFICE
ERIE COUNTY, N.Y.

In the Matter of the Estate of

FRANK D. SAUSNER
Deceased.

File No. 2011-3587/B

DENIS A. KITCHEN, JR., ESQ.
Attorney for Katharina Weinzler,[1] Executrix of the Estate

JOSEPH W. KEEFE, ESQ.
Attorney for Frank E. Sausner & Mark Sausner

MEMORANDUM AND ORDER

BARBARA HOWE, J.

Frank Sausner died on August 14, 2011 at the age of 78, survived by his three children, Frank E. Sausner [hereafter, Frank], Mark Sausner [hereafter, Mark], and Katharina Weinzler [hereafter, Katharina]. Decedent's Will, dated June 20, 2006, was admitted to probate on September 29, 2011, and his daughter Katharina was appointed fiduciary of the estate.

On December 4, 2013, Katharina filed a petition for judicial settlement of her final account, to which Frank and Mark have filed objections. They argue that the estate had a one-half interest in real property located at 9025 Tonawanda

[1] Katharina Weinzler was formerly known as Katharina Kaiser.

Creek Road, Clarence, New York, which was sold after decedent's death. They say that one-half of the sale proceeds should have been included in the accounting, but was not. Katharina has replied to the objections with both procedural and substantive opposition.

Also pending before me is a petition by Frank and Mark to terminate a testamentary trust set up for their benefit. They argue that the trust is "uneconomical"; and they also argue that the terms of the trust "are not in our best interests." Katharina filed an answer to the termination petition, opposing that relief. In support of her answer, she filed affidavits by Mordaunt and by Joanne Lazik [hereafter, Lazik]. Lazik was employed by Mordaunt and was a witness to decedent's Will.

(A)

THE ACCOUNTING PROCEEDING

(i)

In her reply papers, Katharina first seeks dismissal of the objections to the extent interposed by Mark:

> "Mark C. Sausner has already signed and acknowledged a Release dated June 21, 2013 stating that I as Executrix have fully and satisfactorily accounted to him and consenting to my release and discharge from all liability."

Mark's June 21, 2013 document fully releases Katharina with respect to her handling of this estate. Mark has never sought to set aside his release (*see, e.g., Matter of Frutiger*, 29 NY2d 143 [1971] and *Matter of Hunter*, 4 NY3d 260, 276, fn 6 [2005]), so that release precludes the filing by him now of any objection to the accounting (*Matter of Cheng Ching Wang*, 114 AD3d 939 [2014]). Thus, Mark's objections are hereby dismissed.

(ii)

Frank, then, remains as sole objectant to Katharina's accounting. Frank's only dispute with the accounting is his claim that one-half of the proceeds from the sale of real property in Clarence, New York following decedent's death should be included in the estate. He contends that a deed transferring that property in June, 2006 from decedent to himself and Katharina made the grantees tenants in common and not joint tenants with right of survivorship. As such, so Frank says, when decedent died, his estate became the owner of his one-half interest in the property.

Katharina filed her reply to the objections, together with an affidavit from Timothy Mordaunt, Esq. [hereafter Mordaunt], who was decedent's attorney and who prepared both decedent's Will and the deed in question. Mordaunt asserts that the deed language used by him was normal language used to convey out the fee interest in the property to Katharina but to reserve to decedent a life estate only, something that was reiterated and made explicit in a subsequent clause in the deed.

As the Court in *Matter of New Cr. Bluebelt, Phase 4*, 79 AD3d 888, 891 [2010], observed:

> "Real Property Law §240 (3) provides that deeds 'must be construed according to the intent of the parties, so far as such intent can be gathered from the whole instrument, and is consistent with the rules of law.' Where a deed is ambiguous, courts look beyond the written instrument to the surrounding circumstances (*see Wilson v. Ford*, 209 NY 186, 196 [1913]; *De Paulis Holding Corp. v Vitale*, 66 AD3d 816 [2009]; *Andersen v. Mazza,* 258 AD2d 726 [1999])" (emphasis added).

When the language in a deed is "clear and unambiguous," the meaning of its terms "cannot be changed by unexpressed intentions of the parties" (*Gross v. Cizauskas*, 53 AD2d 969, 970 [1976], *citing Geneva v. Henson*, 195 NY 447 [1909]). However, when the deed language is "doubtful or susceptible of varying interpretations" (*id.*), the Court may determine the parties' intent by considering the surrounding circumstances, the situation of the parties at the time of the conveyance, and the general subject matter of the transaction (*see Rome v. Vescio*, 58 AD2d 990, 991 [1977], rev'd on other grounds 45 NY2d 980 [1978]; *see also, Matter of Friedman*, 2009 NY Misc Lexis 4335 [2009]; *Stevens v. Smith*, 12 Misc 3d 1179A [2006]; and *Matzell v. Distaola*, 105 AD2d 500 [1984]).

Moreover, "construction of a deed is generally a question of law for the court" (*O'Brien v. Bocchino*, 13 AD3d 1055, 1056 [2004]), as is the issue of whether a deed's language is susceptible of more than one interpretation (*Chisholm*

v. De Rose, 41 AD3d 1158, 1159 [2007]). When a Court does construe a document, such as a deed, "'[f]orm should not prevail over substance' (*William C. Atwater & Co. v. Panama R. Co.*, 246 NY 519, 524 [1927])" (*Matter of Stravinsky*, 4 AD3d 75, 81 [2003]). And, as has been aptly observed, "'[t]here is no surer way to misread any document than to read it literally' (*Guiseppi v. Walling*, 144 F2d 608, 624 [1944] [HAND, J., concurring], *affd* 324 US 244 [1945])" (*id.*, at 82).

Here, the deed language in question is as follows:

> " This Indenture
>
> Made the 20th day of June Two Thousand and Six (2006) Between Frank Dean Sausner, individually and as Surviving Spouse of Frieda Sausner, Deceased (5/28/00) residing at 9025 Tonawanda Creek Rd., Clarence Ctr., N.Y. 14032, party of the first part, and Frank Dean Sausner, residing at 9025 Tonawanda Creek Rd., Clarence Ctr., N.Y. 14032, and Katharina R. Kaiser residing at 2068 Whitehaven Road, Grand Island, New York 14072; parties of the second part;
>
> Witnesseth that the said party of the first part, in consideration of One and No More Dollars, ($1.00 and No More) lawful money of the United States, paid by the parties of the second part, do(es) hereby grant and release unto the said parties of the second part, themselves and their heirs and assigns forever [the real property thereafter described]."

However, following the legal description of the property, the deed provides:

> "RESERVING in and to the parties of the first part a life estate in the subject premises; provided however, that in the event that the parties of the first part shall for a continuous period of ninety days fail to occupy the

premises as a place of residence, the life estate reserved herein shall thereupon terminate" (emphasis added).

Although the deed appears at first to convey title to decedent and Katharina as tenants in common, a reading of "the whole instrument" (*Matter of New Cr. Bluebelt, Phase 4, supra*, at 891) clearly demonstrates that that was not decedent's intent. Decedent clearly and unambiguously reserved to himself a life estate in the property. This reservation would have been completely unnecessary if he had not conveyed -- or intended to convey[2] -- the entire fee ownership of the property to Katharina. *See, e.g., Matter of Vadney*, 83 NY2d 885, 887 [1994].

Thus, it is clear as a matter of law, and I so construe this deed, that decedent intended to reserve a life estate for himself at the same time as he conveyed out his entire fee interest in the property to Katharina.

Accordingly, Frank's objection to the account must be, and it hereby is dismissed, and the account is approved.

(B)

PETITION TO TERMINATE THE TESTAMENTARY TRUST

Frank and Mark seek an Order from this Court terminating the testamentary trust created under decedent's Will. They claim that the trust is

---

[2] I need not, and do not, express any opinion as to whether the language of the deed used by Mordaunt in the "granting" clause is usual or ordinary language employed when a grantor seeks to convey himself or herself a life estate. Likewise, I do not consider Mordaunt's affidavit in construing the deed itself.

uneconomical and that the terms of the trust are not in their best interests.

Decedent's residuary estate was left in his Will to his sons, Frank and Mark, in equal shares. Article FOURTH of the Will, however, provided (1) that a separate trust be set up for each son, and (2) that the trustee (decedent's daughter, Katharina):

> "shall distribute to my sons . . . the sum of One Hundred ($100.00) Dollars, each, per month from the principal or net income of the Trust" (emphasis added).

According to their attorney, the value of each trust currently "is in excess of $50,000.00".

In *Matter of Keriotis*, 22 Misc 3d 1121A [2009], the Court pointed out that:

> "A New York testamentary trust is an irrevocable expression of the testator's intent, which is to be respected by the Court. *Matter of Wentworth*, 230 NY 176 (1920); *Matter of Abel*, NYLJ, Aug. 22, 2000, at 29, col 5 (Sur Ct, Bronx County). 'Its duration may not be foreshortened by judicial fiat or by act of the interested parties.' *In re Duignan's Will*, 85 NYS2d 846 (Sur Ct, Westchester County 1948). While EPTL 7-1.9 permits termination of a trust upon consent of all interested persons, the statute is limited to terminations during the lifetime of the settlor of the trust. Therefore, except in limited circumstances (see EPTL 7-1.19), a testamentary trust is indestructible. *In re Duignan's Will, supra.*
>
> In recognition of the difficulty of terminating a testamentary trust, the legislature enacted EPTL 7-1.19. L. 2004, ch. 359. EPTL 7-1.19 provides that the court

> may terminate a testamentary trust if it finds that: (1) the continuation of the trust is economically impracticable, (2) the express terms of the disposing instrument do not prohibit its early termination, and (3) such termination would not defeat the specified purpose of the trust and would be in the best interests of the beneficiaries" (emphasis added).

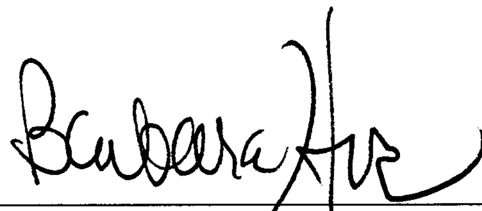
Here, the obvious purpose of the trust was to provide regular, albeit minimal, income to Frank and Mark. In essence, the trust was created as a spendthrift trust. Katharina, as trustee, opposes early termination of the trust, and she specifically "[d]enies that the trust is uneconomical."

Significantly, Frank and Mark have not offered anything to show the trust is economically impractical or "uneconomical." Their simple assertion that the trust is "uneconomical" is conclusory only, and it is unsupported in any way.

There being no basis before this Court to grant the relief sought in the termination petition, that petition must be, and it hereby is, denied, and the petition is dismissed.

This decision shall constitute the Order of this Court and no other or further order shall be required.

DATED: BUFFALO, NEW YORK
August 6, 2014



HON. BARBARA HOWE
Surrogate Judge

Using Trusts to Avoid Litigation

Presented by:
Hon. Acea M. Mosey
Erie County Surrogate's Court

USING TRUSTS TO AVOID LITIGATION

Disputes involving trusts present unique challenges, including sensitive family dynamics, high financial stakes, and complex procedural, legal, and tax issues. Trust law has evolved to offer various options for resolving disputes and preserving the purpose of the trust and the grantor's intent. Aside from strictly legal considerations, however, it is important for attorneys to draft flexible trust instruments, trustees to stay current with the needs of beneficiaries, and to act promptly when altered circumstances necessitate a modification to the trust.

I. Basics

II. Reformation of a Trust, When Needed

III. Decanting

IV. Miscellaneous Proceedings and Alternatives

The Basics: Grantor's Intent and Execution

Grantor's Intent

- Trusts can be used for a variety of different reasons; therefore, it is important to understand the grantor's objective and intent when drafting trust documents.
- Revocable trusts:
  - can be used to manage assets during lifetime;
  - avoid probate at death; and
  - protect beneficiaries.
- Irrevocable trusts:
  - can be used to avoid probate;
  - manage and protect assets;
  - reduce taxes, qualify or maintain government benefits; and
  - provide for charities.

Execution

- EPTL § 7-1.17 sets forth the required formalities for a lifetime trust:
- It must be in writing, executed and acknowledged by the creator and, unless he or she is the sole trustee, by at least one trustee, in the manner required by the laws of this state for the recording of a conveyance of real property,

OR

- Be executed in the presence of two witnesses who shall affix their signatures to the trust instrument.
- The acknowledgment may be subject to challenge if not in compliance with the requirements for the recording of a deed.

The Basics: Nomination of a Trustee

Matter of Nuchereno, Erie Co. Surrogate's Court, February 23, 2019 [Mosey, J.]

- Petition to appoint trustee of an *inter vivos* trust denied as decedent had entered into a Property Settlement and Separation Agreement, incorporated but not merged, into a divorce decree, which created a trust for the sole infant beneficiary and provided for appointment of trustee at the sole discretion of the Surrogate's Court.
- The governing trust executed by decedent had a provision regarding the appointment of trustees that conflicted with the PSSA, in that it nominated decedent as the initial trustee, nominated a successor, and then provided that the trustee be whomever the adult beneficiaries "vote to nominate".
- Decedent's Will was a "pour over" Will that provided all his assets be paid to the trust. The petition to appoint certain trustees was denied on the basis that the conflicting trust provision could not be used to contravene decedent's obligations pursuant to the PSSA by creating the Living Will to serve as a Will substitute, therefore, the Court appointed the successor trustees. Also, the no contest provision in the trust "cannot be applied to circumvent another party's claim under an agreement entered by the Decedent or grantor during his lifetime" (citing *Matter of Friedman*, 146 Misc 2d 91 [1989]).

The Basics: Exculpatory Clauses

Clear and concise forfeiture, i.e., "no contest" clauses that express settlor's intent – **incentivize harmony among beneficiaries.**

EPTL § 11-1.7(a), amended effective August 24, 2018, now states:

"The attempted grant to an executor, testamentary trustee, or *inter vivos* trustee, or his or her successor, of any of the following enumerated powers or immunities is contrary to public policy:

(1) The exoneration of such fiduciary from liability for failure to exercise reasonable care, diligence and prudence.

(2) The power to make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation or otherwise."

EPTL § 11-1.7(c) states that:

"Any person interested in an estate or trust may contest the validity of any purported grant of any power or immunity within the purview of this section without diminishing or affecting adversely his or her interest in the estate or trust any provision in any will or trust to the contrary notwithstanding."

An amendment to EPTL §11-1.7 has extended the prohibitions against use of exculpatory clauses to *inter vivos* trusts.

The Basics: Situs

Factors to Consider

- The intent of the decedent, and particularly the presence or absence of any provisions in the trust directing that only the laws of N.Y. should govern the administration of the trust or a clause prohibiting the transfer of the situs of the trust;
- There must be some nexus between the trust and the designated jurisdiction;
- Settlor's intent;
- The location of the trust corpus;
- The residence or domicile of the trustee; and
- Residence of the beneficiaries (to a lesser degree).

Matter of Hettrick, 61 Misc 3d 1220(A) [2018]

- Although the Court has the power to change the situs of a trust, removal is not automatic.
- Here, two trustees resided in New York; however, the beneficiary and trust protector requested removal to Virginia to "facilitate" the administration of the trust.
- Removal was denied, the Court pointing to advances in technology (such as e-mail, fax, video conferencing, on-line banking services [and the like]) which allow trustees, beneficiaries and the courts to "communicate almost instantly."
- Court e-filing also permits instantaneous access to the courts.

The Basics: Trust Protectors/Advisors

What is a trust protector?

- A trustee is required to administer a trust in accordance with the terms of the trust.
- The role of a trust protector is to oversee the trustee's actions in administering a trust to ensure:
  - that those actions comply with the law;
  - comply with grantor's intent; and
  - purpose of the trust in question.
- The powers given to a trust protector vary widely, however, generally a trust protector oversees many important decisions that a trustee makes.

Why consider a trust protector?

- Alternative to going to court if a dispute arises
- Remove/replace trustees
- Arbitrate disputes between trustee and beneficiaries, or between beneficiaries

New York does not have a statue governing the use of trust protectors.

Reformation of a Trust, When Needed

- Testamentary Trust
- Inter Vivos Trust
- Recent Tax Changes and Implications

Testamentary Trust

Matter of Knapp, 41 Misc 3d 1202(A) [2013]

Co-trustees petition to reform testamentary trust to:

(1) allow trustees limited power to invade trust principal;

(2) reduce the age at which the current beneficiaries receive distributions of their shares of the trust;

(3) dispense with Will's express requirement that one of the beneficiaries make certain visits to his grandmother, or face reductions in the value of his portion of the trust;

(4) create a mechanism for the appointment of successor trustees without court approval; and

(5) establishing that the trustees are held to the prudent investor standard (EPTL §11-2.3).

Petition was denied in its entirety, although the trustees and beneficiaries had agreed to the relief in the petition. The Court held that when testator's intentions are clearly expressed in a will the petition must be denied, and the trustees are statutorily bound by EPTL §11-2.3.

Inter Vivos Trust

Matter of Sukenik, 162 AD 3d 564 [2018]

Appellate Division allowed a petition to reform an *inter vivos* trust and IRA beneficiary designation form even though the documents were clear and unambiguous on their face, and despite Surrogate's warning that "to reform instruments…based only upon the presumption that one who executes testamentary instruments intends to minimize taxes would expand the reformation doctrine beyond recognition and would open the flood gates to reformation proceedings aimed at curing any and all kinds of inefficient tax planning."

Recent Tax Changes and Implications

- For New Yorkers, federal estate tax reform means that the difference between the federal exemption and the New York exemption has now increased significantly.
- New York's current exemption amount is **$5.74 million**, which would have made it equal to the previous federal exemption had that not been revised.
- Now, the federal exemption amount is almost double the New York exemption amount.

- The discrepancy between the federal and New York exemptions underscores the need to determine if a current estate plan may be impacted by tax reform.
- If a Will, for example, carves out a credit shelter trust for a surviving spouse with the deceased spouse's federal exemption (as opposed to his state exemption), there could be a significant – and unanticipated – state estate tax bill due at the death of the first spouse.

PRIOR LAW

DATE OF DEATH	FEDERAL EXCLUSION	NEW YORK EXCLUSION	SPREAD
April 1, 2017 to December 31, 2017	$5,490,000 per individual/ $10,980,00 per married couple	$5,250,000 per individual Not portable	$240,000 per individual Plus $5,490,000 portability
January 1, 2018 to December 31, 2018	$5,600,000 Individual/ $11,200,000 per married couple	$5, 250,000 per individual Not portable	$350,000 per individual Plus
January 1, 2019 and beyond	SAME	SAME	$0

2017 TAX REFORM ACT

DATE OF DEATH	FEDERAL EXCLUSION	NEW YORK EXCLUSION	SPREAD
April 1, 2017 to December 31, 2017	Approx. $11,180,000 per individual $22,360,000 per married couple	$5,250,000 per individual Not portable	Approx. $5,930,000 per individual Plus $11,180,00 portability
January 1, 2018 to December 31, 2018	Approx. $11,180,000* per individual $22,360,000 per married couple	$5,600,000* per individual Not portable	$5,580,000* per individual Plus $22,360,000 potability
January 1, 2019 and beyond	$5,600,000* per individual $12,200,000 per married couple	$5,600,000* per individual Not Portable	$0 Plus $5,600,000 portability

** Based on 2018 inflation-adjusted amounts, but could be higher*

What is Portability?

- At a first glance, a provision of the Tax Relief and Job Creation Act of 2010 (the "Tax Relief Act") might seem to have eliminated any necessity of CST planning by creating a default provision in the law that accomplishes what estate planners have done for years through careful planning and drafting. The law in 2010 created a way to ensure that the estate tax exclusion amount for the first-to-die spouse is preserved and carried over to the surviving spouse and then, eventually, to the ultimate beneficiaries. This is the so-called "portability."

Should Portability be Solely Relied on for Smaller Estates?

Full reliance on portability is not recommended. Rather, credit shelter trusts should continue to be used in estate planning. Why?

- No protection of growth and no indexing for inflation of the portability amount.
- Only federal exclusion amount is portable.
- The GST exemption is not portable.
- Portability is not automatic and requires an affirmative action.
- Portability does not add up in case of multiple predeceased spouses.
- Trusts offer advantages and planning outside of transfer tax savings.

A Closer Look at Credit Shelter Trusts

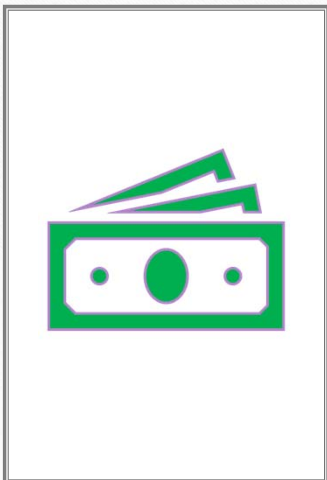
- Credit Shelter Trust is one of the most common trusts that is utilized in estate planning, and is typically (but not always)a testamentary trust as opposed to a trust created during life.
- This type of trust is also commonly referred to as a so-called "By-Pass Trust". Structuring and incorporating a credit shelter trust ("CST") into an estate plan starts with understanding two basic premises of transfer taxation:
- 1. Estate taxes are not imposed on assets of any amount passing to a surviving spouse (when surviving spouse is US citizen), and
- 2. The exemption amount (or a dollar-for-dollar corresponding tax credit amount) is an amount that is available at death to each spouse to shelter from estate taxes irrespective of who is the immediate or ultimate recipient of the "sheltered" assets

Why Credit Shelter Trusts are Still Necessary

- Trusts offer advantages and planning outside of transfer tax savings. Although portability may theoretically offer the same federal estate tax savings, planning with trusts opens doors to many valuable additional benefits such as asset protection, for example.
- No one is completely protected against potential creditor risk, especially anyone with substantial personal wealth.
- With portability, the inherited assets are fully reachable to all of the surviving spouse's present and future creditors, as well as creditors in bankruptcy and, if the surviving spouse then divorces, to the ex-spouse.
- Assets in CST can be protected from bankruptcy and divorce. Trusts can also provide professional money management and intelligent distribution of the trust fund.
- Finally, a CST offers certainty and the ultimate protection of the disposition of the assets at the termination of the trust (most often, on the death of the surviving spouse).

Why Credit Shelter Trusts are Still Necessary

- If relied upon portability, the deceased spousal unused exemption amount is subject to the disposition by the surviving spouse. This is most often a concern where spouses have children from prior marriages or other family members who they would like to separately provide for.
- The surviving spouse could easily benefit the beneficiaries of her choice – for example, her children from the first marriage, - to the detriment of the decedent's children if there is no trust created on the death of the first-to-die.



Annual Exclusion Gift Tax

- In 2017, the annual exclusion gifting amount was $14,000 (or $28,000 if spouses elect to split gifts).
- For calendar years 2018 and 2019, the annual exclusion amount was increased to $15,000 per recipient for present interest gifts.
- The annual exclusion of $15,000 permits spouses who consent to split their gifts to transfer a total of $30,000 per recipient per year without gift tax.

GST/QTIP

Matter of Seiden, **New York County, October 9, 2018 [Mella, J.]** – proceeding pursuant to New York Tax Law 998.

- The Court was asked to decide the effect of a federal estate tax repeal for 2010 on the NY estate tax attributable to QTIP trusts for surviving spouses of persons who died in 2010, in a proceeding to vacate and set aside a notice of estate tax deficiency.
- Decedent died in Nov. 2014 predeceased by her husband in 2010. She was a beneficiary of a trust under husband's will that was eligible for estate tax treatment as QTIP--the trust qualified for a marital deduction in the estate of the first spouse to die.
- A repeal of the federal estate tax for 2010 did not require husband's estate to file a federal estate tax return, but was required to file a NY estate tax return. The case here concerned the tax treatment of the trust in wife's estate, as surviving spouse--value of the trust property was excluded on the federal estate and NY estate tax returns. The tax department assessed additional tax for over $462,000 attributable to the QTIP trust.
- The Court found IRC §2044 inapplicable, the QTIP property was not included in wife's federal gross estate nor in the NY gross estate. Thus, the petition was granted, and the notice of tax deficiency vacated.
- Tax Department is not filing an appeal
- Defect may have been cured with passage of April 2019 NYS Budget – no QTIP allowed if not taken in first estate

Planning with QTIPS

Disadvantages Advantages

Disadvantages

- Lack of control by the surviving spouse and inability to plan with the QTIP funds.
- Conflicts Between Surviving Spouse and Remainder Beneficiaries.

Advantages

- Certainty with respect to the final disposition of assets.
- The availability of GSTT planning.
- Assets are not included in the probate estate of the surviving spouse.
- Flexibility of the post-death elections.

SUPPLEMENTAL NEEDS TRUST

If a trust for a beneficiary who has a disability does not meet the criteria for a supplemental needs trust under EPTL§7-1.12, due to ambiguous language or language that clearly provides for support of the beneficiary, the trustee should apply to a court to reform the trust into a supplemental needs trust under EPTL §7-1.12.

Supplemental Needs Trust

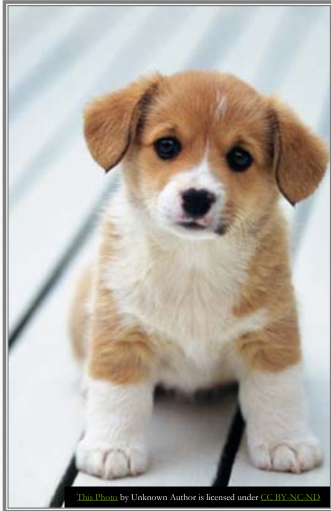
- In ***Matter of Newman*, 18 Misc 3d 1118(A) [2008],** the decedent died in 1988, leaving a 60-year-old daughter who functioned at a third-grade level.
  - He left his residuary estate in trust and directed the trustee to use the income for daughter's benefit. The trustees could also invade the principal for the "more adequate support and maintenance" of the daughter and could "defray" the daughter's health expenses.
  - The executor wanted to reform the trust to make it a Supplemental Needs Trust, and the Court granted the petition, relying on the testator's words "more adequate support" and "defray" to conclude that he meant to supplement, not supplant, government benefits. He did not want her to be "relegated to living solely on available government benefits ...." The Court cited cases, relying on *Matter of DeRosa*, NYLJ, April 29, 2006, at 30, col. 2, and *Matter of Kamp*, 7 Misc 3d 615 [2005], which allowed reformation, and rejecting the narrow holding in *Matter of Rubin*, 4 Misc 3d 634 [2004], which prohibited it.

Irrevocable Medicaid Income Only Trust

- A Trust must be Irrevocable in order to preserve assets for Medicaid purposes.
- The Grantor CANNOT be the Trustee.
- The Grantor can retain right to income from the trust.
- The Grantor must not have any access to principal from the trust otherwise it will be considered available for Medicaid purposes.
- Any principal or income that can be distributed to the Grantor or Grantor's spouse will be considered available for Medicaid purposes
- H.E.M.S. standard is not acceptable for Medicaid.

Irrevocable Medicaid Income Only Trust

- Removes the asset from the Grantor's name for Medicaid purposes.
- Grantor will avoid a Medicaid penalty period after five years.
- All income is reported on the Grantor's individual tax return.
- Retain real estate tax exemptions with the equivalent of a life estate.
- Preserve step-up in basis upon Grantor's death.
- The Grantor can reserve limited power of appointment to make limited changes to beneficiaries by Will.
- Avoid the spend-down of assets.
- Save assets for heirs and beneficiaries
- **If the Trust provides income to the Grantor, it can effect Medicaid benefits down the road.**
- **If the Trust is not properly drafted, there may be a need for a separate tax return and there will be higher tax rates.**
- **Note: There will be a penalty tax of any gifts made within the 5 year period of applying for Medicaid.**



PET TRUSTS

Pitfalls in Pet Planning

Pet Trusts

- EPTL 7-8.1(a) provides that any individual may intervene for the benefit of the pet, and the court, *sua sponte*, may appoint someone to enforce the terms of the trust. This same section also creates an exception to the rule-against perpetuities problem in estate planning, which would have forced the pet trust to terminate 21 years after the death of a life in being, . Under the EPTL, the trust shall terminate only when all animal beneficiaries of the trust are no longer alive. The trust names a trustee to manage the funds of the trust, a caretaker who has physical custody of the pet, and an enforcer.

Karl Lagerfeld died on Feb. 19, 2019, and prior to his passing, he told French magazine, "Le Figaro," that Choupette is an heiress. The creative director had an estimated net worth of anywhere between $195 million and $300 million, and the feline could inherit at least a portion.

Filling in the Gaps: Power of Attorney & Inter-vivos Pet Trusts

- Attorneys who address only the pet issue on a limited basis through wills have permitted a huge gap in coverage for their client's pets. Having only a testamentary pet trust, or a trust which is contained in a will, leaves a gaping hole in pet planning for it can take months, if not years, to probate or administer an estate, receive letters testamentary and letters of trusteeship, and during this period of pendency, the pet will be without coverage as to its physical care and money to cover its care. Without a representative of an estate to take possession of the pet, the pet's care will be in limbo.

A Power of Attorney, and the Drafting of an Inter-vivos Pet Trust.

- A provision in a power of attorney that the agent should arrange for pet care and custody is the first step in ensuring that the pet is cared for when a client is alive, but unable to care for his pet, or communicate to whom the pet should be given.
- The attorney's job would purely be to transfer the pet to the caretaker of her choosing, or, if there is an inter vivos trust, custodian set forth in an inter vivos trust. The concept began as a "honorary trust" because in old trusts there were no means to enforce the terms of the trust for the benefit of a pet, a "beneficiary" that obviously did not have access to the courts to enforce its rights against the trustees. The trustee was part of an honor system where she was trusted to carry out the terms of the trust for the benefit of the pet, but could not be legally forced to do so.
- There are now provisions that may be placed in pet trusts for enforcers or those who have the ability to bring the custodian or trustee to court to force him to carry out the terms of the trust for the benefit of the pets.

DECANTING

The act of distributing assets from an old trust to a new trust with different terms.

Just as one can decant wine by pouring it from its original bottle into a new bottle, leaving the unwanted sediment in the original bottle.

DECANTING: Power of Appointment EPTL 10-6.6

This Photo by Unknown Author is licensed under CC BY-NC

- Decanting can be used to provide the trustees the power to grant beneficiaries a general power of appointment.
- Exercise of this power can result in income tax savings by causing part or all the trust to be taxed in a beneficiary's estate, sometimes without triggering estate tax because of increased federal and state tax exemption (currently $5,450,000).
- Under current estate tax laws, inclusion of trust property in a beneficiary's estate results in a step up in the income tax basis of trust assets to fair market value at the beneficiary's death, generating lower income taxes on the sale of trust assets.

DECANTING

Consolidate Multiple Trusts

- May lower administrative costs
- Resulting in more efficient and economical trust for benefit of beneficiaries

Separate Trusts

- Splitting 1trust for multiple beneficiaries into different trusts for each beneficiary or family group allows different needs to be addressed.

Add or Modify Spendthrift Provisions

DECANTING

Avoid or Reduce State Income Taxes on Trust Assets

- A trust can be decanted to take advantage of the current estate tax exemption

AND

- Achieve a full step up in income tax basis of the trust assets upon an individual's death, thereby reducing estate and income tax liability.

DECANTING

Avoid or Reduce State Income Taxes on Trust Assets

- If a N.Y. resident trust no longer has a trustee domiciled in N.Y., has no real or personal property located in N.Y. and has no N.Y. source income, then capital gains and accumulated income will not be subject to N.Y. income tax. [N.Y. Tax Law § 603(b)]
- If N.Y. based trust includes assets located in another state, the trustee should consider decanting those assets to an appointed trust in the other tax jurisdiction.
- By doing so, the decanted assets might avoid N.Y. capital gains tax and accumulated income tax.

Miscellaneous Proceedings and Alternatives

- Cy Pres – EPTL § 8-1.1 – *Matter of Lee*, Erie County Surrogate's Court, December 16, 2016 [Howe, J.]
- Use of Informal Accountings to Reduce Trustee Liability
- Termination of an Uneconomical Trust – EPTL § 7-1.19
- ADR/Mediation

In New York: Use of Informal Accountings to Reduce Trustee Liability

There is no requirement that trustees file recurring trust accountings. A recent Appellate Division decision holds that informal accountings sever liability, as long as full disclosure has been given by the fiduciary.

Matter of Spacek, 155 AD3d 747 [2017]: the decedent's will provided that her estate was to be split among six (6) beneficiaries. The executor sent an agreement releasing her from acts done as executor, accompanied by the estate's tax returns and other financial documents, to the beneficiaries, which they signed. After the executor petitioned to judicially settle the account, one of the beneficiaries filed objections. The Appellate Division affirmed the Surrogate's decision to deny the motion to set aside the release. The Court held that use of:

"an informal accounting is as effectual for all purposes as a settlement pursuant to a judicial decree...[I]f a fiduciary gives full disclosure in his [or her] accounting to which the beneficiaries are parties…they should have to object at that time or be barred from doing so after the settlement of the account." [internal citations omitted].

Termination of an Uneconomical Trust

EPTL § 7-1.19

Matter of Sausner, Erie County Surrogate's Court, August 6, 2014 [Howe, J.) see also *Matter of Kistner,* NYLJ, January 23, 2006, at p. 35, col. 1:

The Court directed termination of the trust where the trust could pay little or no income to the income beneficiary and the remainder person did not object to the termination of the trust.

A Court may grant termination of a testamentary or inter vivos trust if it is satisfied that:

(1) it is economically impracticable to continue administering the trust;
(2) the trust does not expressly prohibit administration;
(3) termination would not defeat the purpose of the trust; and
(4) termination serves the beneficiaries' best interests.

ADR/Mediation

Dispute resolution through mediation or ADR is helpful in resolving disputes arising out of trusts and estates.

- Facilitates working through some emotional issues & complex family dynamics inherent in trust & estate disputes.
- Consider drafting provisions requiring mediation or other dispute resolutions in trust documents.

This Photo by Unknown Author is licensed under CC BY-NC-ND

THANK YOU!

Questions?

Florida Trust Considerations for the New York Practitioner

Amy B. Beller, Esq.
Beller Smith, Boca Raton, FL

Michael S. Schwartz, Esq.
Curtis, Mallet-Prevost, Colt & Mosle LLP, NYC

TABLE OF CONTENTS

Page #

Introduction 1

I. Who Can Serve As Trustee? 1

II. Trustee Compensation – Fixed Fee versus "Reasonable Compensation" 1

1. "Reasonable Compensation" 2

2. Lodestar Method 3

III. In Terrorem Clauses 4

1. What Is An In Terrorem Clause? 4

2. Enforceable Alternatives 4

IV. Rule Against Perpetuities 6

1. New York's Rule 6

V. Modification and Decanting 8

1. Modification 8

2. Decanting 12

VI. Annual Accountings 14

1. New York 14

2. Florida 14

VII. Limitation Notice Procedures 16

1. General Statute of Limitations for Breach of Trust 16

2. Florida's "Limitation Notice" 17

3. Trust Disclosure Document 17

4. When Limitation Notice Applies to Trust Disclosure Document 17

5. Demystifying the Limitation Notice Concept 18

VIII. Incorporation By Reference 19

IX. Fee Shifting in Trust Cases 21

X. Homestead in Trusts 22

1. Overview 22
2. What is Not Homestead 23
3. Alienation of Homestead and Transfers to Irrevocable Trusts 24
4. Homestead in Revocable Trusts 25
5. Waiver 26

Conclusion 26

Introduction

With no state income or estate tax, and with warmer temperatures during the cold winter months, Florida has always been an attractive place for many New Yorkers. So it is quite common for a New York practitioner to encounter an existing Florida trust or a client who wants to establish a trust in Florida.

This presentation will flag ten unique features of Florida trust law that differ from New York law - from annual accounting requirements to the impact of homestead laws on trusts, and beyond. The seminar will then suggest drafting tips and ways of anticipating and dealing with any associated issues.

I. Who Can Serve As Trustee?

While Florida law imposes numerous restrictions on who may act as personal representative of an estate (i.e., the executor of the estate), such as requiring the personal representative to be either a Florida resident1 or, regardless of residence, a spouse, sibling, parent, child, or other close relative of the decedent,[2] the restrictions on who may act as trustee of a Florida trust are much less stringent.

Under Florida law, anyone capable of taking legal title or beneficial interest in property may serve as trustee.[3] Those individuals and corporations capable of taking legal title or beneficial interest by virtue of "gift, grant, bequest, descent or operation by law, may take the same subject to a trust and they will become trustees."[4]

Florida law also permits trust companies incorporated in Florida, state banking and savings institutions, and national banking associations and federal savings and loan associations to act as trustee.[5]

II. Trustee Compensation – Fixed Fee versus "Reasonable Compensation"

In New York, trustees are entitled to a fixed fee, as outlined in New York's SCPA §§ 2308 and 2309. If a trust instrument fails to include a provision

[1]Fla. Stat. § 733.302.
[2]Fla. Stat. § 733.304.
[3]Hitchcolk v. Mortgage Sec. Corp., 95 Fla. 147, 177 (1928), citing JAIRUS WARE PERRY, A TREATISE ON THE LAW OF TRUSTS AND TRUSTEES § 39 (3d ed. 1882).
[4]*Id.*
[5]Fla. Stat. § 660.41.

directing the commissions to which the trustee is entitled, these statutory provisions act as default rules.[6]

In Florida, trustees, including co-trustees,[7] are entitled to commissions for administering trusts, and if the terms of the trust do not specify the trustee's compensation, the trustee is entitled to "compensation that is reasonable under the circumstances."[8]

As stated in Florida Statute § 736.0708, if the terms of the trust do in fact specify the trustee's compensation, the trustee is entitled to be compensated as specified, but courts may allow more or less compensation if:

a) The trustee's duties differ substantially from those contemplated at the creation of the trust; or
b) The trust's specified compensation would be "unreasonably low or high."[9]

Finally, the trustee is allowed reasonable compensation for other services rendered, if any, in addition to the reasonable compensation received as trustee.[10]

As discussed below, courts consider a variety of factors to determine the reasonableness of a trustee's compensation, rejecting use of the lodestar method.

1. "Reasonable Compensation"

What constitutes "reasonable" compensation? In *West Coast Hospital Ass'n v. Florida National Bank of Jacksonville*, 100 So. 2d 807 (Fla. 1958), the Florida Supreme Court established the following factors to consider when assessing reasonableness:[11]

- The amount of capital and income received and disbursed by the trustee
- The wages or salary customarily granted to agents or servants for performing similar work in the community
- How successful the trustee is in administering the trust
- Whether the trustee used unusual skill or experience in administering the trust
- Fidelity or disloyalty of the trustee
- The level of risk and responsibility assumed by the trustee
- Time spent administering the trust

[6] *See* Ilene Sherwyn Cooper & Erin Moody, *Reasonable Compensation for the Individual Fiduciary*, NYSBA JOURNAL, http://www.nysba.org/CustomTemplates/Content.aspx?id=64008.
[7] Fla. Stat. § 736.0103 (23).
[8] Fla. Stat. § 736.0708.
[9] *Id.*
[10] *Id.*
[11] *See* West Coast Hospital Asso. v. Florida Nat'l Bank, 100 So. 2d 807, 811 (Fla. 1958).

- Community's customary treatment of allowances to trustees by settlors or courts and of charges incurred by trust companies and banks
- Nature of the work done during the trust's administration (level of skill or judgment required)
- Estimates provided by the trustee of the value of his/her/its services
- Payments made by the beneficiary to the trustee and intended to go toward the trustee's compensation

2. Lodestar Method

Federal courts have applied the lodestar method—under which attorney fee calculations are determined by the number of hours required to perform the services multiplied by a reasonable hourly rate—to determine trustee fees in bankruptcy cases.[12] Although Florida courts have employed the lodestar method to calculate attorneys' fees, personal representatives' fees, and guardians' fees, use of this method to determine a trustee's fee remains controversial.[13] Specifically, in *Robert Rauschenberg Foundation v. Grutman*,[14] the District Court of Appeal, Second District rejected the lodestar method in determining the trustee's fee.[15]

In *Rauschenberg*, the trustees sought $51-55 million in fees based on the *West Coast* factors. The sole residuary beneficiary, the Robert Rauschenberg Foundation, Inc., argued that the trustees were entitled to a "reasonable fee" and requested that the Court use the lodestar method to arrive at such a fee, arguing that the trustees were only entitled to $375,000 under this method. The trial court rejected the lodestar method, employed the *West Coast* factors, and arrived at $24,600,000 as a reasonable trustee fee, and the District Court of Appeal affirmed.[16]

In light of the court's reasoning in *Rauschenberg*, Florida practitioners should continue to use the *West Coast* factors as a guide in determining reasonable compensation for trustees.

[12]In re McKinney, 374 B.R. 726 (N.D. Cal. 2007).
[13]JON SCUDERI, ADMINISTRATION OF TRUSTS IN FLORIDA § 13.2 (8th 2014).
[14]Robert Rauschenberg Found. v. Grutman, 198 So. 3d 685 (Fla. 2d DCA 2016) rev. den. 2016 WL 3185202.
[15]*Id.*, at 688.
[16]*Id.*

III. In Terrorem Clauses

1. What Is An In Terrorem Clause?

An in terrorem clause, also known as a no-contest clause or a penalty clause for contest, is a provision which purports to penalize an interested person for contesting a will or other proceedings relating to an estate. While these clauses are enforceable in New York, unless contested based on probable cause,[17] they are unenforceable in Florida.[18] Similar clauses in trusts are also unenforceable in Florida.[19]

Here is Florida's "penalty clause for contest" provision:

(1) A provision in a trust instrument purporting to penalize any interested person for contesting the trust instrument or instituting other proceedings relating to a trust estate or trust assets is unenforceable.

(2) This section applies to trusts created on or after October 1, 1993. For purposes of this subsection, a revocable trust shall be treated as created when the right of revocation terminates.[20]

2. Enforceable Alternatives

A. Sign Instrument Prior to Moving to Florida

If a settlor, prior to moving to Florida, executes a trust instrument containing a valid in terrorem clause under the governing law of the trust, a beneficiary's attempt to contest the trust in Florida may trigger application of the in terrorem clause, enforceable in the governing state. The New York Surrogate's Court's decision in *In re Shamash v. Stark*[21] well illustrates this jurisdictional interchange.

The petitioner in *In re Shamash v. Stark* previously challenged a Will and a revocable trust (containing an in terrorem clause) in a Florida court, which dismissed for lack of jurisdiction.[22] The petitioner then filed an accounting and removal proceeding in New York, the governing jurisdiction of the trust. The court granted the respondents' motion to dismiss, which claimed that the

[17]NY EPTL § 3-3.5.
[18]Fla. Stat. § 732.517.
[19]Fla. Stat. § 736.1108.
[20]*Id.*
[21]In re Shamash v. Stark, 2009 NYLJ LEXIS 3716.
[22]*Id.*, at 2.

petitioner had no standing, as "whatever interest the petitioner may have had in the trust was revoked pursuant" to the contest in Florida.[23]

The trust's governing law, therefore, critically affects the enforceability of an in terrorem clause.

B. Conditional Bequests

While provisions in trusts which force a beneficiary to forfeit her right to contest the instrument in order to receive the devise are against Florida public policy, a clause which allows an alternative devise to a statutory minimum benefit may be upheld by a Florida court.[24]

In *Dinkins v. Dinkins*, the 5th District Court of Appeals affirmed a trial court's order holding that a provision in a widow's late husband's trust was not an invalid penalty clause and that a separate trust created for her could be used to satisfy her elective share.[25] The widow challenged the enforceability of the "Conditional Specific Bequest of Cash" provision in her late husband's living trust agreement, copied below, arguing that it was an unlawful penalty clause, as it would penalize her for taking her elective share by inducing her to forfeit the $5 million cash bequest:

> If my spouse, JEANETTE M. DINKINS, survives me, and if she or her legal representative makes a valid disclaimer of all of her interest in the QTIP Trust created under Article VII of this Trust Agreement, and also makes a valid waiver of her right . . . to elect the elective share in my estate, then the Trustee shall distribute five million dollars ($5,000,000.00) to JEANETTE M. DINKINS, outright and free of trust. . . . My objective is to provide five million dollars ($5,000,000.00) of assets to JEANETTE M. DINKINS, in addition to . . . any . . . property to which JEANETTE M. DINKINS is entitled as a result of my death, except for the Elective Share.

The trial court and the District Court of Appeal rejected the widow's argument, reasoning that the clause at issue provided her with an optional alternative to a statutory minimum benefit, unlike a no contest clause, which forces the beneficiary to choose between the right to contest an instrument and the right to take anything under it.[26]

[23] *Id.*, at 5.
[24] Dinkins v. Dinkins, 120 So. 3d 601 (Fla. Ct. App. 2013).
[25] *Id.*, at 602.
[26] *Id.*, at 603.

IV. Rule Against Perpetuities

1. New York's Rule

New York's rule against perpetuities is codified in NY EPTL § 9-1.1, as follows:

(a)

(1) The absolute power of alienation is suspended when there are no persons in being by whom an absolute fee or estate in possession can be conveyed or transferred.

(2) Every present or future estate shall be void in its creation which shall suspend the absolute power of alienation by any limitation or condition for a longer period than lives in being at the creation of the estate and a term of not more than twenty-one years. Lives in being shall include a child conceived before the creation of the estate but born thereafter. In no case shall the lives measuring the permissible period be so designated or so numerous as to make proof of their end unreasonably difficult.

(b) No estate in property shall be valid unless it must vest, if at all, not later than twenty-one years after one or more lives in being at the creation of the estate and any period of gestation involved. In no case shall lives measuring the permissible period of vesting be so designated or so numerous as to make proof of their end unreasonably difficult.

2. Florida's Rule

Florida's rule against perpetuities is codified in Fla. Stat. § 689.225, as follows in relevant part:

(2) Statement of the rule.

(a) A nonvested property interest in real or personal property is invalid unless:

1. When the interest is created, it is certain to vest or terminate no later than 21 years after the death of an individual then alive; or

2. The interest either vests or terminates within 90 years after its creation.

(b) A general power of appointment not presently exercisable because of a condition precedent is invalid unless:

1. When the power is created, the condition precedent is certain to be satisfied or become impossible to satisfy no later than 21 years after the death of an individual then alive; or

2. The condition precedent either is satisfied or becomes impossible to satisfy within 90 years after its creation.

(c) A nongeneral power of appointment or a general testamentary power of appointment is invalid unless:

1. When the power is created, it is certain to be irrevocably exercised or otherwise to terminate no later than 21 years after the death of an individual then alive; or

2. The power is irrevocably exercised or otherwise terminates within 90 years after its creation.

(d) In determining whether a nonvested property interest or a power of appointment is valid under subparagraph (a)1., subparagraph (b)1., or subparagraph (c)1., the possibility that a child will be born to an individual after the individual's death is disregarded.

(e) If, in measuring a period from the creation of a trust or other property arrangement, language in a governing instrument (i) seeks to disallow the vesting or termination of any interest or trust beyond, (ii) seeks to postpone the vesting or termination of any interest or trust until, or (iii) seeks to operate in effect in any similar fashion upon, the later of:

1. The expiration of a period of time not exceeding 21 years after the death of a specified life or the survivor of specified lives, or upon the death of a specified life or the death of the survivor of specified lives in being at the creation of the trust or other property arrangement, or

2. The expiration of a period of time that exceeds or might exceed 21 years after the death of the survivor of lives in being at the creation of the trust or other property arrangement, that language is inoperative to the extent it produces a period of time that exceeds 21 years after the death of the survivor of the specified lives.

(f) As to any trust created after December 31, 2000, this section shall apply to a nonvested property interest or power of appointment contained in a trust by substituting 360 years in place of "90 years" in each place such term appears in this section unless

the terms of the trust require that all beneficial interests in the trust vest or terminate within a lesser period.

V. Modification and Decanting

1. Modification

A. Trust Instrument Modification

One way to modify a trust non-judicially is to do so in accordance with the trust instrument. This approach can be facilitated during the drafting phase by inserting provisions which enable future modification and can expressly permit the trustee or others to modify the trust in certain circumstances.

If, however, the trust instrument is already in existence, the instrument may have provisions already built in which may still allow modification. Such provisions include the following, one or more of which may accomplish the intended change:

- Power of substitution
- Power to terminate the trust
- Trustee succession, removal, appointment
- Trustee power to delay distribution
- Change trust administration situs
- Change governing law
- Turn grantor trust powers on or off
- Trust division
- Power of amendment
- Disclaimer
- Powers of appointment
- Merge similar trusts

B. Statutory Modification – Judicial and Non-Judicial

i. Judicial Modification

Certain methods of statutory modification require judicial consent, as examined below:

- Trust Reformation[27]
    - An amendment of an unambiguous trust document to correct a mistake in order to reflect the grantor's actual intent.

[27]Fla. Stat. § 736.0415.

- Two types: (1) reformation to correct a scrivener's error; (2) reformation to correct a mistake of law or fact.
- Requires institution of a judicial action or proceeding with the court presiding over the trust.
- Trusts created with the "old" Rule Against Perpetuities period (lives in being plus 21 years or 90 years) cannot be modified without court intervention, except by decanting.[28]

- Modification of Charitable Trusts[29]
  - Allows a court to modify or terminate a trust if a particular charitable purpose becomes unlawful, impracticable, impossible to achieve, or wasteful.
- Modification Not Inconsistent with Settlor's Purpose[30]
  - A trust may be modified if the trust purpose has been fulfilled, becomes illegal, impossible, wasteful, or where, due to circumstances not anticipated by the settlor, compliance would defeat the material purpose of the trust.
  - In addition to showing an unanticipated change of circumstances, proponents of the modification must also establish that compliance with the existing terms of the trust would defeat or substantially impair the accomplishment of a material purpose of the trust as a result of the change in circumstances.
- Modification in Best Interests of Beneficiaries[31]
  - A court may modify an irrevocable trust if compliance with the existing terms of the trust is not in the best interests of the beneficiaries.
  - The phrase "best interests," due to its broadness, allows modification of almost any trust under this provision, provided that the trust itself meets the requirement of the statute.
  - Not available for (1) irrevocable trusts created prior to January 1, 2001 or (2) irrevocable trusts created after December 31, 2000 that either have the "old" Rule Against Perpetuities period (lives in being plus 21 years or 90 years), or expressly prohibit judicial modification.
- Modification to Achieve Settlor's Tax Objectives[32]

[28]Fla. Stat. § 736.0412.
[29]Fla. Stat. § 736.0413.
[30]Fla. Stat. § 736.04113.
[31]Fla. Stat. § 736.04115.
[32]Fla. Stat. § 736.0416.

- A court may modify the terms of a trust in a manner that is not contrary to the settlor's probable intent in order to achieve the settlor's tax objectives. The modification may have retroactive effect.

- Modification or Termination of Uneconomic Trusts[33]
  - A court may modify or terminate a trust or remove a trustee and appoint a new trustee if the court determines that the value of the trust property is insufficient to justify the cost of administration.
  - If a trust is terminated under this section, the trustee shall distribute the trust property "in a manner consistent with the purposes of the trust."
  - Terminating the trust does not necessarily mean all assets are being paid to the current beneficiaries. Instead, the assets may be paid out among the current and remainder beneficiaries based on the actuarial value of their interests or some other agreement.

ii. Non-Judicial Modification

- Settlement Agreements[34]
  - "Interested persons" (those whose interest would be affected by a settlement agreement) may enter into a binding non-judicial settlement agreement with respect to any matter involving a trust.
  - Can be used to modify or terminate a trust as long as a court could approve such modification or termination pursuant to one of the foregoing judicial modification options under the Florida Trust Code.
- Consent Agreements[35]
  - A trust may be modified at any time after the settlor's death upon the unanimous agreement of the trustee and all qualified beneficiaries.
  - Not available for irrevocable trusts created prior to January 1, 2001 or irrevocable trusts created after December 31, 2000 that have the "old" Rule Against Perpetuities period (lives in being plus 21 years or 90 years), unless the trust terms expressly authorize non-judicial modification.

[33]Fla. Stat. § 736.0414.
[34]Fla. Stat. § 736.0111.
[35]Fla. Stat. § 736.0412.

- Not available for irrevocable trusts for which a charitable deduction is allowed until the termination of all charitable interests.

- Termination of Uneconomic Trusts[36]
  - After notice to qualified beneficiaries, a trustee may terminate a trust if the value of the trust property is less than $50,000 and the trustee concludes that the value of the trust property is insufficient to justify the cost of administration.
  - If a trust is terminated under this section, the trustee must distribute the trust property in a manner consistent with the purposes of the trust.
- Division of Trusts[37]
  - A trust can be divided without a judicial proceeding.
  - A trust may be divided for many reasons, such as tax planning, simplified administration, litigation avoidance or resolution, economics or state income tax savings.
- Merger of Trusts[38]
  - Typically done to reduce administrative costs such as trustee's fees or income tax filings, or for investment reasons. Can also be a cost effective alternative to judicial proceedings aimed at correcting the trust defect.
  - Merging one trust into another trust is permissible if the result does not impair the rights of any beneficiary, even when the terms of the trust are not identical.

C. Comparison to New York

New York law allows trust revocation and amendment under certain limited circumstances, including the following:

- Upon the written consent of all beneficially interested persons, the creator of a trust may revoke or amend the whole or any part of the trust instrument.[39]
- Termination of an uneconomic trust in New York must be made through an application to the court.[40]
- For charitable trusts, upon petition, courts will enforce the *cy pres* doctrine.[41]

[36]Fla. Stat. § 736.0414(1).
[37]Fla. Stat. § 736.0417.
[38]Fla. Stat. § 736.0417.
[39]NY EPTL § 7-1.9.
[40]NY EPTL § 7-1.19.

- Trustees may amend a trust to allow it to qualify for tax benefits the settlor intended to achieve.[42]

Although New York courts traditionally strictly adhered to the terms of the trust and thereby to the settlor's wishes, overtime, however, in order to address changing circumstances of trusts, New York courts have shifted toward a more liberal approach, increasingly in favor of trust modification and reformation.[43] For example, New York courts have allowed reformation of trusts to correct drafting errors[44] and to create supplemental needs trusts under certain circumstances.[45]

2. Decanting

Trust decanting—the phrase used to describe transfers by a trustee from one trust into a new trust—can serve various purposes, such as to correct a scrivener's error, to clarify ambiguities, to provide the trustee with more discretion, to lengthen the duration of the trust, or to change the trust situs. In Florida, courts recognize common law and state statute, in addition to the trust instrument itself, as authority for trust decanting.

A. Common Law Authority

i. Florida

In *Phipps v. Palm Beach Trust Co.*,[46] the first U.S. case to recognize the trustee's power to decant,[47] the trust at issue allowed a trustee, in the trustee's sole discretion, to transfer any part of the trust assets to the grantor's children and their descendants.

The individual trustee, the grantor's husband, instructed the corporate trustee to transfer the assets into a new trust with updated terms.[48] The corporate trustee then petitioned the court to determine whether the individual trustee had

[41]NY EPTL § 8-1.1(c).
[42]NY EPTL § 11-1.11.
[43]*See* C. Raymond Radigan and Jennifer F. Hillman, *The Evolution of Trust Reformation and Modification Under New York Law*, NEW YORK LAW JOURNAL, July 9, 2012, http://rmfpc.com/wp-content/uploads/2012/07/The-Evolution-of-Trust-Reformation-and-Modification-Under-New-York-Law_CRR_JH_7.2012.pdf.
[44]In re Katz, 2007-364/D/E, N.Y.L.J. 1202719006763, at 1 (Sur. Ct. Richmond Cty. Feb. 2, 2015).
[45]In re Rappaport, 21 Misc.3d 919 (Sup. Ct. Nassau Co. 2008).
[46]Phipps v. Palm Beach Trust Co., 142 Fla. 782 (1940).
[47]ACTEC Comments on Transfers by a Trustee from an Irrevocable Trust to Another Irrevocable Trust (Sometimes called "Decanting") (Notice 2011-101) Released December 21, 2011, https://www.actec.org/resources/comments-on-transfers-by-a-trustee/.
[48]Phipps v. Palm Beach Trust Co., 142 Fla. 782, 784 (1940).

authority to provide such instruction.[49] The Supreme Court of Florida held that a trustee could invade trust property by transferring it to another trust so long as one or more of the beneficiaries of the original trust are also beneficiaries of the new trust.[50]

ii. New York

In *In re Hoppenstein*, which has been subsequently affirmed,[51] a common law right to decant in New York was recognized.[52] This is consistent with paragraph (k) of New York's decanting statute, which provides that the statute "shall not be construed to abridge the right of any trustee to appoint property in further trust that arises under the terms of the governing instrument of a trust or under any other provision of law or under common law, or as directed by any court having jurisdiction over the trust."[53]

As was the case in *In re Hoppenstein*, use of a common law right to decant or a decanting based on the terms of the trust instrument can be a method used to side-step requirements of New York's decanting statute, such as notice requirements to beneficiaries. It is unclear what limitations or restrictions exist with respect to a common law decanting or decanting based on the terms of a trust instrument, as there is limited case law on the topic.[54]

B. State Statute

i. Florida

Codifying *Phipps*, Florida enacted its first decanting statute in 2007.[55] Florida then passed a revised statute in 2018 designed to better conform to other states' decanting statutes and to clarify ambiguities in the 2007 statute. The 2018 statute includes the following major updates:[56]

- Expands trustee's ability to decant trust principal under the terms of the trust
- Provides support for disabled beneficiaries

[49]*Id.*
[50]*Id.*, at 786.
[51]Matter of Hoppenstein, 2017 N.Y. Misc. LEXIS 3851.
[52]In re Estate of Hoppenstein, 2017 NYLJ LEXIS 2902, at 9.
[53]NY EPTL § 10-6.6 (k).
[54]*See* Brad Dillon & Michael S. Schwartz, *Who Needs a Decanting Statute?,* NEW YORK STATE BAR ASSOCIATION TRUSTS AND ESTATES LAW SECTION NEWSLETTER, Fall 2017, at 11.
[55]Fla. Stat. § 736.04117.
[56]House of Representatives, Final Bill Analysis, HB 413, https://www.flsenate.gov/Session/Bill/2018/413/Analyses/h0413z.CJC.PDF.

- Imposes greater notice requirements when a trustee exercises the ability to decant trust principal

ii. New York

New York's decanting statute, EPTL Section 10-6.6, shares much in common with Florida's decanting statute. The 2011 amendments to the statute, much like the 2018 amendments to Florida's decanting statute discussed above, aimed to enhance decanting flexibility. Although there are subtle differences between the two, both statutes provide a powerful tool for practitioners.

VI. Annual Accountings

1. New York

Trustees of a New York trust have a duty to account when the trust instrument requires it, when there is a change or removal of trustee, and when a court issues an order compelling an accounting, but there is no requirement for a periodic accounting unless provided for in the trust instrument.[57] A trust instrument cannot alleviate a trustee's duty to account.[58] Although not required, in practice, many trustees account after a number of years or when there has been a substantive matter in the trust administration which affects beneficiaries' rights.

A beneficiary may seek a court order compelling an accounting, and a court may at any time order an accounting when in the best interests of the trust.[59] In addition to a beneficiary seeking such relief, New York law provides that right to others, including a creditor (presumably of an estate), a successor fiduciary, a co-fiduciary, and even the surety on a fiduciary bond.[60] A person whose interest in a trust is contingent nonetheless may seek to compel an accounting.[61] A trustee may also seek judicial settlement of a voluntary accounting.[62]

2. Florida

Trustees of a Florida trust have a duty to keep the qualified beneficiaries of a trust reasonably informed of the trust and its administration.63 More specifically, the Florida Trust Code imposes a duty upon the trustees of an

[57]SCPA 2205 and Comments thereto.
[58]EPTL 11-1.7; Matter of Malasky, 290 A.D.2d 631, 736 N.Y.S.2d 152 (3d Dep't 2002).
[59]SCPA 2205
[60]Id.
[61]Matter of Castellucci, N.Y.L.J. July 18, 2014, at 37, col 2.
[62]SCPA 2208.
[63]Fla. Stat. § 736.0813.

irrevocable trust to provide an accounting of the trust to all qualified beneficiaries "at least annually" and on termination of the trust or change of the trustee.64 The annual accounting requirement for irrevocable trusts often comes as a surprise to trustees who are represented by out-of-state counsel. The requirement applies not just to trusts which were irrevocable from inception, but also to revocable trusts which have become irrevocable by their terms (usually upon the death of the settlor), as well as testamentary trusts such as marital and credit shelter trusts. This duty to account cannot be avoided by drafting, as it is a mandatory provision for which the Florida statute governs notwithstanding any contrary language in the trust instrument.[65]

The contents of a required accounting are also specified in the Florida Trust Code, and include:

- A statement identifying the trust, the trustee, and the time period covered by the accounting;
- Information showing all cash and property transactions and all significant transactions affecting administration, including compensation paid to trustees and trustees' agents;
- Gains and losses during the accounting period;
- To the extent feasible, identification and value of trust assets on hand, showing both carrying value (acquisition value) and estimated current value;
- Identification of noncontingent liabilities with estimated current amounts;
- To the extent feasible, identification of significant transactions that do not affect the amount for which the trustee is accountable, including name changes in investments, adjustments to carrying value, change of custodial institutions, and stock splits;
- A statement reflecting allocation of receipts, disbursements, accruals, or allowances between income and principal when the allocation affects any beneficiary of the trust;
- In a final accounting, a plan of distribution.[66]

A failure to provide an annual accounting for an irrevocable trust is itself a breach of duty under Florida law.[67] Thus, when trustees of an irrevocable trust have failed to render an annual accounting as required by the Florida Trust Code, a complaint by a beneficiary seeking to compel an accounting will frequently include a claim for damages and attorneys' fees, denial or disgorgement of

[64]Fla. Stat. § 736.0813(1)(d).
[65]Fla. Stat. § 736.0105(2)(s).
[66]Fla. Stat. § 736.08135.
[67]Fla. Stat. § 736.1001(1): "A violation by a trustee of a duty the trustee owes a beneficiary is a breach of trust."

trustees' compensation, and sometimes even removal of trustees, under the available remedies for breach of fiduciary duty.[68]

A qualified beneficiary is defined in the Florida Trust Code as a living beneficiary who, on the date of the beneficiary's qualification, is a distributee or permissible distributee, would be a distributee or a permissible distributee if the current distributee's interest terminated on that date, or would be a distributee or permissible distributee if the trust terminated on that date.[69] In other words, both the current beneficiary and the next-in-line beneficiaries are considered qualified beneficiaries and are entitled to an annual accounting. A charitable organization expressly designated to receive distributions has the rights of a qualified beneficiary if the above requirements are met.[70]

A qualified beneficiary of an irrevocable trust may waive the accounting requirement and may withdraw a previous waiver.[71] Both the waiver and the withdrawal must be in writing.[72]

Finally, Florida's annual accounting requirement does not apply to revocable trusts, which are part of the typical pour-over-will and revocable trust Florida estate plan. A trustee of a revocable trust only owes duties to the settlor as long as the trust is revocable.[73]

VII. Limitation Notice Procedures

1. General Statute of Limitations for Breach of Trust

Although not expressly stated in Florida statutes, it is likely that the general statute of limitations in Florida for acts constituting breach of trust by a trustee is four years, based on the catchall "all other matters" in the statute.[74] The Florida Trust Code sets forth the outside limitations periods for breach of trust matters as the latter of:

- Ten years after the date the trust terminates, the trustee resigns, or the fiduciary relationship ends if the beneficiary had actual knowledge of the trust and its beneficiary status;
- Twenty years after the date of the act or omission of the trustee that is complained of if the beneficiary had actual knowledge of the existence of the trust and its beneficiary status;

[68]Fla. Stat. § 736.1001 (remedies for breach), § 736.1004 (attorneys' fees in breach cases).
[69]Fla. Stat. § 736.0103(16).
[70]Fla. Stat. § 736.0110.
[71]Fla. Stat. § 736.0813(2).
[72]*Id.*
[73]Fla. Stat. § 736.0813(4) and 736.0603(1).
[74]Fla. Stat. 95.11(3)(p).

- Forty years after the date the trust terminates, the trustee resigns, or the fiduciary relationship ends.[75]

When a beneficiary shows by clear and convincing evidence that the trustee actively concealed facts supporting the breach claim, any existing statute of repose shall be extended by thirty years.[76]

2. Florida's "Limitation Notice"

The Florida Trust Code provides a means to shorten the statute of limitations for breach of trust from four years to six months. Florida Statute Section 1008(2) provides:

> Unless sooner barred by adjudication, consent, or limitations, a beneficiary is barred from bringing an action against a trustee for breach of trust with respect to a matter that was adequately disclosed in a trust disclosure document unless a proceeding to assert the claim is commenced within 6 months after receipt from the trustee of the trust disclosure document or a limitation notice that applies to that disclosure document, whichever is received later.

A limitation notice is defined as "a written statement of the trustee that an action by a beneficiary against the trustee for breach of trust based on any matter adequately disclosed in a trust disclosure document may be barred unless the action is commenced within 6 months after receipt of the trust disclosure document or receipt of a limitation notice that applies to that trust disclosure document, whichever is later."[77]

3. Trust Disclosure Document

A trust disclosure document is defined as "a trust accounting or any other written report of the trustee. A trust disclosure document adequately discloses a matter if the document provides sufficient information so that a beneficiary knows of a claim or reasonably should have inquired into the existence of a claim with respect to a matter."[78]

4. When Limitation Notice Applies to Trust Disclosure Document

A limitation notice applies to a trust disclosure document when:

- it is contained in the trust disclosure document;

[75]Fla. Stat. § 736.1008.
[76]*Id.*
[77]Fla. Stat. § 736.1008(4)(c).
[78]Fla. Stat. § 736.1008(5).

- it is part of a different trust disclosure document received within one year;
- it accompanies the trust disclosure document or another trust disclosure document received within one year;
- it is delivered separately within 10 days after delivery of the trust disclosure document or of another trust disclosure document received within one year;
- it is received more than 10 days after delivery of the trust disclosure document but only if the limitation notice references that trust disclosure document.[79]

In addition, a limitation notice is not considered to have been "delivered separately" if the notice is accompanied by another written communication, other than a written communication that refers only to the limitation notice.[80]

5. Demystifying the Limitation Notice Concept

If you're confused by the above, you are not alone. Florida lawyers struggle with the applicable limitation notice provisions. To make it simple, the best practice is that whenever you serve beneficiaries with any accounting or information relating to trust administration matters, even if it is just a letter advising of a change in investments, in custodial institutions or investment advisers, a distribution, or payment of compensation to a trustee, attorneys or accountants, you should include at the same time a separate document called "Limitation Notice" which includes the suggested statutory notice language set forth above. A sample Limitation Notice is included at the end of these materials. Again, best practices would have the Limitation Notice sent by means which can be proven to have been delivered to the beneficiary, although that is not required. If you provide a limitation notice along with a trust disclosure document, the beneficiary will have six months to bring a breach of fiduciary duty claim based upon any matters which are "adequately disclosed" in the trust disclosure document.

Some financial institutions are now including limitation notice language in their account statements. This is particularly helpful when beneficiaries are receiving monthly, quarterly or annual account statements. In this case, the beneficiary will again be limited to six months to bring any action based on the information disclosed in the account statement.

The question of what is adequately disclosed may present a wrinkle. In one recent case, a beneficiary successfully argued in court that the trustee's accounting did not adequately disclose matters concerning his expenditures when

[79] *Id.*
[80] *Id.*

the accounting listed payments to stores like Home Depot but did not specify what the payments were for. When it turned out the purchases were for improvements which the trustee undertook on a home which was being distributed to the trustee individually, the court refused to impose the six month limitation on the beneficiary's claim of breach.[81] Thus, if you want to be sure to have the six month limitation apply, detailed disclosure is recommended.

VIII. Incorporation By Reference

Florida Statute § 732.512, a provision in the Florida Probate Code, expressly provides for incorporation by reference of a trust into a testator's will:

> (1) A writing in existence when a will is executed may be incorporated by reference if the language of the will manifests the intent and describes the writing sufficiently to permit its identification.
>
> (2) A will may dispense of property be reference to acts and events which have significance apart from their effect upon the dispositions made by the will, whether they occur before or after the execution of the will or before or after the testator's death. The execution or revocation of a will or trust by another person is such an event.[82]

Incorporation by reference is typically used in Florida estate plans, where a will references and incorporates by reference the provisions of a revocable trust executed immediately prior to execution of the will. However, where the will incorporates the terms of the trust into a will only if the trust is no longer in existence at the time of the testator's death, there may not be an effective incorporation by reference because the writing.[83] A trust referenced in a will which does not exist cannot be incorporated by reference.[84]

Because a trust must be in existence when the will is executed in order to be incorporated by reference, when a will and trust are to be executed at the same execution ceremony, the trust must be executed first. Of course, if the trust is a previously existing trust at the time the will is executed, there is no issue as to the "writing in existence" requirement.[85]

Application of the incorporation by reference doctrine has its issues. In *Pasquale v. Loving*,[86] the decedent, Mary, executed her will in 2005, and died in 2009 at the age of 98. The Pasquale brothers filed a complaint challenging "all

[81]In re Pearl Donohue Cross Trust, 24 Fla. L. Weekly Supp. 808a (Fla. 15th Jud. Cir. Jan. 4, 2016) (copy appended hereto).
[82]Fla. Stat. § 732.512
[83]Bravo v. Sauter, 727 So. 2d 1103 (Fla. 4th DCA 1999)(second wife's election of her statutory elective share did not extinguish her interest in the trust income).
[84]Swan v. Florida Nat'l Bank, 445 So. 2d 622 (Fla. 3d DCA 1984).
[85]
[86]82 So. 3d 1205 (Fla. 4th DCA 2012).

trust documents and amendments thereto and the probate administration." The Pasquales' complaint was dismissed by the trial court because, although their trust contest was valid, the trial court held that the complaint was not a will contest, and the Pasquales were required to file a timely challenge to validity of the will because the will incorporated the trust by reference. The Fourth District Court of Appeal reversed, finding that the complaint did sufficiently allege the elements of a will contest, but importantly reaffirmed the notion that "the Pasquales could not challenge the validity of the trust without also contesting the will. The trust was incorporated by reference into the 2005 will. … Because the trust was incorporated into the will, the Pasquales could not properly challenge the validity of the trust while adequate remedies were available in probate."[87]

The *Pasquale* case caused a stir in the Florida trusts and estates community. Because the time to contest a will is relatively short (three months from service of a notice of administration)[88], *Pasquale* creates a trap for the unwary if the will incorporates a trust by reference which trust is the subject of a challenge. This is only true, however, if there are probate assets; where the trust has been fully funded and there are no assets subject to probate, a will contest would not be necessary. One should be mindful of relying on an assumption that there are no probate assets, because often probate assets are discovered well after a probate proceeding has been commenced.

To address the potential trap identified in the *Pasquale* case, the Real Property, Probate and Trust Law Section of the Florida Bar is working on a draft statutory fix to require a warning to be included in the Notice of Administration warning that one may be required to file a will contest in order to pursue a challenge to a trust.

Related to but distinct from incorporation by reference is the Separate Writing for Tangible Personal Property (sometimes called a TPP Memo). Florida law recognizes and will enforce a written statement or list referred to in the decedent's will seeking to dispose of items of tangible property.[89] The writing must be signed by the testator and must describe the items and the devises with reasonable certainty.[90] The writing may be prepared before or after execution of the will; it may be revised after execution; and the latest-in-time TPP Memo will prevail of earlier conflicting versions.[91] Notably, the statute specifically provides for reference in a decedent's will as opposed to a trust. Although theoretically a settlor should be able to incorporate the terms of a Separate Writing in existence when the trust is executed, to be safe, any attempt to dispose of tangible personal

[87]*Id.* at 1207.
[88]Fla. Stat. § 733.212.
[89]Fla. Stat. § 732.515.
[90]*Id.*
[91]Fla. Stat. § 732.515.

property should be addressed either specifically in the trust (or the will), or by reference to a Separate Writing in the will.

IX. Fee Shifting in Trust Cases

The Florida Trust Code provides that a prevailing party in a breach of fiduciary duty, modification, or construction case may be entitled to assessment of legal fees and costs.[92] Specifically, Florida Statute § 736.1004 provides:

> (1)(a) In all actions for breach of fiduciary duty or challenging the exercise of, or failure to exercise a trustee's powers; and
> (b) In proceedings arising under ss. 736.0410-736.0417 [modification, construction, decanting],
> The court shall award taxable costs as in chancery actions, including attorney fees and guardian ad litem fees.
> (2) When awarding taxable costs under this section, including attorney fees and guardian ad litem fees, the court, in its discretion, may direct payment from a party's interest, if any, in the trust or enter a judgment that may be satisfied from other property of the party, or both.

Attorney fee claims under Fla. Stat. § 736.1004 are distinct from fee claims for attorneys who rendered services to the trust[93] and trustee's attorney fees.[94]

Florida statutes provide a specific procedure for dealing with the payment of a trustee's attorneys' fees during pendency of a breach of duty action.[95] The special procedure starts with the premise: "As between a trustee and the beneficiaries, a trustee shall administer the trust solely in the interests of the beneficiaries."[96] The argument, then, when trustees wished to use trust assets to pay their attorneys to defend against breach of trust claims, was that such use of trust funds for defense constituted a breach of the duty itself. Cases in Florida[97] created a problem for trustees who sought to defend themselves using trust assets. Thus, a statutory procedure was enacted to give clarity to both trustees and beneficiaries on this murky defense-fee issue.

Under Florida Statute §736.0802(10)(b), a trustee may pay attorney fees and costs in defense of a breach claim made in a filed pleading without approval of any person and without court authorization, but the trustee must serve a written notice of intent upon each qualified beneficiary of the trust whose share of the

[92]Fla. Stat. § 736.1004.
[93]Fla. Stat. § 736.1005.
[94]Fla. Stat. § 736.1007.
[95]Fla. Stat. § 736.0802(10).
[96]Fla. Stat. § 736.0802(1).
[97]J.P. Morgan Trust Co. v. Siegel, 965 So. 2d 1193 (Fla. 4th DCA 2007); Brigham v. Brigham, 934 So. 2d 544 (Fla. 3d DCA 2006); Shriner v. Dyer, 462 So. 2d 1122 (Fla. 4th DCA 1984).

trust may be affected by the payment of fees. The notice of intent must be served by commercial delivery service, by service of process, or if the court already has jurisdiction over the beneficiary, in the manner provided for service of pleadings (at this time, mostly electronic service through an e-filing portal or email service).

Once a beneficiary is served with the notice of intent, the onus is on the beneficiary to file a motion to prohibit payment of the trustee's defense fees and costs, and obtain a court order. The court shall deny the motion unless it finds a reasonable basis to conclude that there has been a breach of trust. The court may also deny the motion for good cause. If a trustee has paid defense fees and costs either prior to service of a notice of intent or after, a qualified beneficiary may move to compel repayment to the trust, with statutory interest. If a trustee fails to comply with an order prohibiting payment of attorney fees and costs, the court may impose sanctions including the striking of pleadings filed by the trustee.

In practice, the procedure based on Florida Statute § 736.0802(10) after a motion by a beneficiary to prohibit fees has been filed has been likened to a preliminary injunction hearing. The beneficiary will attempt to establish that the trustee has breached a duty, and the trustee will defend, using affidavits, discovery responses and deposition transcripts, and other evidence including witness testimony and documents.

Because a mini-trial is required for a beneficiary to prohibit payment of a trustee's attorney fees and costs defending a breach claim, a beneficiary may choose to forego pursuing such relief for fear of damaging his or her case if the judge finds in the trustee's favor. Conversely, a trustee seeking to pay his or her attorney fees must consider whether there is a possibility a court will pre-judge the case on scant evidence in order to preserve the status quo. These considerations are serious, and must be assessed on a case-specific basis.

X. Homestead in Trusts

1. Overview

Florida homestead is a very complex subject worthy of an entire treatise. It is a creation of constitutional law in Article X, § 4(c), of the Florida Constitution as well as Florida statutes. Homestead essentially encompasses three distinct principles: (1) ad valorem property tax exemption and limitation on increase; (2) protection from creditors; and (3) restrictions on devise.[98] Homestead laws apply to up to 160 contiguous acres of land if outside a municipality, and one-half acre

[98]For a discussion of homestead, *see "Florida Homestead,"* NYSBA Trusts and Estates Law Section Newsletter (Spring 2010).

of contiguous land if within a municipality.[99]Homestead protections inure to a surviving spouse or heirs of the owner.[100]

Most out-of-state practitioners understand homestead to apply to creditor protection but are unaware of the restrictions on devise. In Florida, the owner of homestead property is limited in his or her ability to devise the homestead if survived by a spouse or a minor child:

> The homestead shall not be subject to devise if the owner is survived by a spouse or minor child, *except* the homestead may be devised to the owner's spouse if there be no minor child. (Emphasis added)[101]

If an attempted devise of homestead is invalid (because the decedent was survived by a spouse and a minor child and the attempted devise is not a fee simple devise to spouse), the Florida law provides that the homestead passes by operation of law, with a life estate to spouse and remainder to the decedent's lineal descendants.[102] A spouse instead may elect a one-half tenant-in-common interest in the homestead property, which permits the spouse to force a partition sale.[103]

As a result of the homestead restrictions on devise, it is essential for New York lawyers who draft estate planning documents for Florida clients to understand how real property held in trust is viewed for homestead purposes.

2. What is Not Homestead

Homestead laws apply only to property which is the primary residence of the homestead owner.[104] Tenants-by-the-entireties property or property owned jointly with right of survivorship is not considered "protected homestead."[105] In addition, real property owned in an irrevocable trust is not considered homestead subject to the restrictions on devise, because it is not owned by "a natural person" as specified in the Florida Constitution.[106]

The meaning of homestead has different meanings depending on the context in which it is used: (1) exemption from ad valorem taxation, (2) protection

[99]Fla. Const., Art. X § 10.
[100]*Id.*
[101]*Id.*
[102]Fla. Stat. § 732.401(1).
[103]Fla. Stat. § 732.401(2).
[104]*See, e.g.,* Endsley v. Broward Cnty., 189 So. 3d 938 (Fla. 4th DCA 2016); Cutler v. Cutler, 994 So. 2d 341 (Fla. 3d DCA 2008).
[105]Fla. Stat. § 731.201(3)
[106]*But see* Cutler, 994 So. 2d at 343-344.

from forced sale by creditors, and (3) limitations on alienation and devise.[107] Because homestead involves several distinctly different concepts, what may constitute homestead for one purpose may not constitute homestead for another. It is important to identify what specific homestead concept is at issue when analyzing whether the subject property is, or is not, protected homestead.

3. Alienation of Homestead and Transfers to Irrevocable Trusts

Notwithstanding the homestead devise restrictions, property owners may give away or dispose of homestead property during their lifetimes, including by transfer to a trust. Section 732.4017, Florida Statutes, provides:

> (1) If the owner of homestead property transfers an interest in that property, including a transfer in trust, with or without consideration, to one or more persons during the owner's lifetime, the transfer is not a devise for purposes of s.731.201(10) or s.732.4015, and the interest transferred does not descend as provided in s.732.401 if the transferor fails to retain a power, held in any capacity, acting alone or in conjunction with any other person, to revoke or revest that interest in the transferor.
>
> (2) As used in this section, the term "transfer in trust" refers to a trust under which the transferor of the homestead property, alone or in conjunction with another person, does not possess a right of revocation as that term is defined in s.733.707(3)(e). A power possessed by the transferor which is exercisable during the transferor's lifetime to alter the beneficial use and enjoyment of the interest within a class of beneficiaries identified only in the trust instrument is not a right of revocation if the power may not be exercised in favor of the transferor, the transferor's creditors, the transferor's estate, or the creditors of the transferor's estate or exercised to discharge the transferor's legal obligations. This subsection does not create an inference that a power not described in this subsection is a power to revoke or revest an interest in the transferor.
>
> (3) The transfer of an interest in homestead property described in subsection (1) may not be treated as a devise of that interest even if:
>
> (a) The transferor retains a separate legal or equitable interest in the homestead property, directly or indirectly through a trust or other

[107]Stone v. Stone, 157 So. 3d 295 (Fla. 4th DCA 2014), *reh'g denied*, 2015 Fla. App. LEXIS 3971 (Fla. 4th DCA Mar. 16, 2015); Engelke v. Estate of Engelke, 921 So.2d 693, 695–96 (Fla. 4th DCA 2006) (*citing* Snyder v. Davis, 699 So.2d 999 (Fla.1997)).

arrangement such as a term of years, life estate, reversion, possibility of reverter, or fractional fee interest;
(b) The interest transferred does not become a possessory interest until a date certain or upon a specified event, the occurrence or nonoccurrence of which does not constitute a power held by the transferor to revoke or revest the interest in the transferor, including, without limitation, the death of the transferor; or
(c) The interest transferred is subject to divestment, expiration, or lapse upon a date certain or upon a specified event, the occurrence or nonoccurrence of which does not constitute a power held by the transferor to revoke or revest the interest in the transferor, including, without limitation, survival of the transferor.
(4) It is the intent of the Legislature that this section clarify existing law.[108]

This provision of Florida law clarifies that an inter vivos transfer of homestead property to other persons, including through a trust, is not a devise for homestead purposes, provided the transferor does not retain the power to revoke the transfer or revest title to the property in himself.

4. Homestead in Revocable Trusts

Section 732.4015, Fla. Stat., provides:

> (1) … the homestead shall not be subject to devise if the owner is survived by a spouse or a minor child or minor children, except that the homestead may be devised to the owner's spouse if there is no minor child or minor children.
> (2) For the purposes of subsection (1), the term:
> (a) "Owner" includes the grantor of a trust described in s. 733.707(3) that is evidenced by a written instrument which is in existence at the time of the grantor's death as if the interest held in trust was owned by the grantor.
> (b) "Devise" includes a disposition by trust of that portion of the trust estate which, if titled in the name of the grantor of the trust, would be the grantor's homestead.

Florida Statute § 733.707(3) refers to "[a]ny portion of a trust with respect to which a decedent who is the grantor has at the decedent's death a right of revocation, as defined in paragraph (e), either alone or in conjunction with any

[108]Fla. Stat. §732.4017.

other person…." Subsection (e) provides that a "right of revocation" is a power retained by the decedent, held in any capacity, to (1) amend or revoke the trust and revert the principal of the trust in the decedent, or (2) withdraw or appoint the principal of the trust to or for the decedent's benefit.

Some conflicting case law in Florida raised doubts as to whether homestead property held in a revocable trust was "protected homestead."[109] This question appears to have been settled.[110] Homestead which is titled in the name of a revocable trust is subject to the devise restrictions set forth in the Florida Constitution and Florida statutes. What this means is that if a married testator who owns homestead property, either in his own name or in his revocable trust, wishes to devise that homestead property in a way other than a fee simple outright devise to spouse, that devise will be deemed invalid, the spouse will get a life estate (or elect a fifty percent tenant-in-common interest), and the testator's lineal descendants will get the rest. This is true even if: (1) the attempted devise is to a marital trust or credit shelter trust for spouse's benefit, (2) the decedent expressly wished to disinherit one or more of his lineal descendants, and (3) the default disposition of homestead is expressly contrary to the testator's intent.

5. Waiver

The news is not all bad. Homestead can be waived by the spouse in a prenuptial agreement, a post nuptial agreement, or in a separate homestead waiver.[111] A recent Florida case, *Stone v. Stone*,[112] held that homestead rights were waived by a spouse when she executed a warranty deed transferring property into a QPRT (the grantor did not survive the QPRT term, the property reverted back into the grantor's estate, and the question was whether the grantor's attempt to devise the property to his daughter was an invalid devise).

Conclusion

Florida differs from New York in many ways other than the tropical landscape and balmy winter temperatures. While it is common for New York estate planning practitioners to encounter issues relating to Florida trusts, practitioners must be aware that significant variations in trust law issues and practice could have a major impact on the client. When dealing with Florida trust matters, the careful practitioner will not take for granted that the New York law or practice will apply in the Sunshine State. Careful research, and consultation with

[109] In re Bosonetto, 271 B.R. 403 (Bankr. M.D. Fla. 2001).
[110] Estate of Engelke, 921 So. 2d 693, 697 (Fla. 4th DCA 2006) (stating "revocable trusts are treated similarly to wills. *See, e.g.,* § 732.4015, Fla. Stat.").
[111] Fla. Stat. § 732.702.
[112] Stone, 157 So. 3d 295.

qualified Florida counsel, is the safest course to ensure that the client's objectives are properly implemented.

Florida Trust Considerations for the New York Practitioner

May 17, 2019

By: Michael S. Schwartz and Amy B. Beller

1

Introduction

- 10 unique features of Florida trust law that differ from New York law
- Drafting tips and ways to anticipate and deal with associated issues

2

10 Notable Features of Florida Trust Law

1. Who can serve as Trustee?
2. Trustee Compensation
3. In Terrorem Clauses
4. Rule Against Perpetuities
5. Modification and Decanting
6. Annual Accountings
7. Limitation Notice Procedures
8. Incorporation By Reference
9. Fee Shifting in Trust Cases
10. Homestead in Trusts

3

1. Who Can Serve As Trustee?

- Much less stringent requirements than those for a personal representative
  - Anyone capable of taking legal title or beneficial interest
  - Trust companies, state banking and savings institutions, and national banking associations and federal savings and loan associations

4

2. Trustee Compensation

- Fixed fee versus "reasonable compensation"
  - In New York, entitled to a fixed fee based on value of assets
  - In Florida, entitled to "compensation that is reasonable under the circumstances"
- What if the terms of the Trust specify compensation?
  - Court can allow more or less if the duties differ significantly than those initially contemplated or if the specified compensation is "unreasonably low or high"

5

2. Trustee Compensation (Continued)

- What is "reasonable?"
  - *West Coast* established factors, including:
    - Amount of capital and income received/disbursed
    - Salary customarily paid to others in the community for similar services
    - How successful the Trustee was
    - Whether usual skill or experience was utilized
    - Nature of work done in connection with the administration
    - Level of risk/responsibility
    - Time spent administering the Trust
  - Florida courts reject lodestar method (*Rauschenberg*)

6

3. In Terrorem Clauses

- What is an in terrorem clause?
  - Provision that purports to penalize an interested person for contesting a will or other proceedings relating to an estate
  - Generally enforceable in New York, depending on nature of claim
  - Unenforceable in Florida

7

3. In Terrorem Clauses (Continued)

- Potentially Enforceable Alternatives
  - Execute trust prior to moving to Florida
  - Use of conditional bequests

8

4. Rule Against Perpetuities

- New York's rule is codified in EPTL § 9-1.1
  - Lives in being plus 21 years
- Florida's rule is codified in Fla. Stat. § 689.225
  - 360 years

9

5. Modification and Decanting

- Modification
  - Trust instrument modification
  - Statutory modification: judicial
    - Trust reformation
    - Modification of charitable trusts
    - Modification not inconsistent with settlor's purpose
    - Modification in the best interests of the beneficiaries
    - Modification to achieve settlor's tax objectives
    - Modification or termination of uneconomic trust

10

5. Modification and Decanting (Continued)

- Ways to amend an otherwise irrevocable Trust
- Modification
  - Can be in the trust instrument itself
  - Judicial Reformation
  - Statutory modification: non-judicial
    - Settlement agreements
    - Consent agreements
    - Termination of uneconomic trusts
    - Division of trusts
    - Merger of trusts

11

5. Modification and Decanting (Continued)

- Decanting
  - Common law authority
    - Florida: *Phipps v. Palm Beach Trust Co.*
    - New York: *In re Hoppenstein*
  - State Statute
    - Florida: Revised decanting statute enacted in 2018
    - New York: 2011 amendments share much in common with Florida's revised statute

12

6. Annual Accountings

- NY: no annual accounting requirement
- FL: Trustee of an irrevocable trust must account at least annually.
  – Accounting to "qualified beneficiaries"
  – Cannot be drafted around
  – May be waived
  – Does not apply to revocable trusts

13

7. Limitation Notice Procedures

- Method to shorten statute of limitations for breach of trust from 4 years to 6 months
- Applies to information "adequately disclosed" in a "trust disclosure document"
  – can be anything from a bank statement to a formal accounting
  – what is adequately disclosed is a gray area
- Requires notice of limitation language

14

8. Incorporation By Reference

- A writing in existence when a will is executed may be incorporated by reference
  - Frequently used to incorporate the terms of a trust into a pour-over will
  - Trust must be executed first
- Beware the Pasquale issue
- Separate writing for tangible personal property

15

9. Fee Shifting in Trust Cases

- Florida has statutory fee shifting in breach of trust and other trust cases
- There is also a statutory procedure to prevent a trustee from paying fees to defend breach of trust claims

16

10. Homestead in Trusts

- Florida Constitution creates homestead rights
  - Ad valorem property tax benefits
  - Creditor protection
  - Restrictions on devise

17

10. Homestead in Trusts (Continued)

- If decedent is survived by a spouse or minor child, homestead may not be devised other than fee simple to spouse
- Devise in trust for spouse is not fee simple
- If invalid devise, then life estate to spouse, remainder to lineal descendants or spouse may elect 50/50 tenant-in-common ownership

18

10. Homestead in Trusts (Continued)

- Homestead in a revocable trust retains homestead character
- Homestead rights can be waived

19

11. Other Differences?

- Of course, this is not an exhaustive list
- For example, taxation of trusts is very different in New York versus Florida
- New York and Florida trust law differ in many significant ways
- Careful research required
- Consultation with Florida counsel recommended

20

Michael S. Schwartz

Partner
Curtis, Mallet-Prevost, Colt & Mosle LLP
Private Client Group
Trusts & Estates Group

(212) 696-8823
michael.schwartz@curtis.com

Mr. Schwartz is a partner in the Private Client and the Trusts and Estates practice groups of the law firm Curtis, Mallet-Prevost, Colt & Mosle LLP. His practice focuses on domestic and multijurisdictional estate and succession planning for high net worth individuals, extending to all facets of estate, gift and generation-skipping transfer tax planning. Mr. Schwartz's practice also encompasses all phases of estate and trust administration. He represents fiduciaries, including banks and trust companies, and beneficiaries, in contested fiduciary matters. He also has extensive experience with gift and estate tax audits.

Mr. Schwartz was the co-author of the recently published 14th edition of Stocker on Drawing Wills and Trusts. He also has written articles on a wide range of current topics relating to trusts, estate planning and administration for significant industry publications such as Estate Planning, Probate and Property, New York Law Journal, Law360, The Senior Lawyer and the New York State Bar Association Trusts and Estates Law Section Newsletter.

Education
- New York University, School of Law, J.D.
- University of Illinois, B.S.

Memberships
- Fellow, The American College of Trust and Estate Counsel (ACTEC)
- New York State Bar Association – Trusts and Estates Section
  - First District Representative
  - Estate and Trust Administration Committee, former Chair
- Society of Trust and Estate Practitioners
- The Estate Planning Council of New York City
  - Member of the Board of Directors

21

Amy B. Beller

Partner
Beller Smith, P.L.
A Florida Trusts and Estates Boutique Law Firm
(561) 994-4316
www.bellersmith.com
abeller@bellersmith.com

Ms. Beller is a founding member of Beller Smith, P.L., a full-service trusts and estates firm located in Boca Raton, Florida. Ms. Beller began her legal career in New York with firms such as White & Case and Chadbourne & Parke. Ms. Beller relocated to Florida in 2004, and was associated with Kaye Scholer's West Palm Beach office. Ms. Beller founded Beller Smith with fellow New York attorney, Yoshimi O. Smith, Esq., in late 2009. She is Board Certified in Wills, Trusts and Estates, and is a certified Circuit Civil Mediator. Ms. Beller's primary focus within the trusts and estates practice is in litigation and dispute resolution.

A prolific speaker and author, Ms. Beller has published in the *New York State Bar Association Trusts & Estates Section Newsletter*, the *Florida Bar Real Property, Probate and Trust Law Section's Actionline*, the *Florida Bar's Litigation Under the Probate Code (Eleventh Ed.),* and the American Bar Association's book, *The Road to Independence: 101 Women's Journeys to Starting Their Own Law Firms.* Ms. Beller has lectured for ACTEC, the New York State Bar, the Florida Bar, the City Bar (New York), and the Heckerling Institute, among others, on topics including Florida homestead, beneficiary rights, privity and malpractice, estate planning to avoid disputes, multistate estate planning, and mediation.

Education
- Maurice A. Deane School of Law at Hofstra University, J.D.
- Hofstra University, B.A.

Memberships
- Fellow, The American College of Trust and Estate Counsel (ACTEC)
- Executive Committee of the Real Property, Probate and Trust Law Section of the Florida Bar (RPPTL)
- Palm Beach County Bar Association
- South Palm Beach County Bar Association
- New York Bar Association's Trusts and Estate's Section

22

Breakfast with the Surrogates:

Successful Strategies for Securing the Removal of a Trustee

Hon. Stacy L. Pettit
Albany County Surrogate's Court, Albany

Hon. Peter J. Kelly
Queens County Surrogate's Court, Jamaica

Hon. John M. Czygier
Former Surrogate, Suffolk County Surrogate's Court, Riverhead

Hon. Margaret C. Reilly
Nassau County Surrogate's Court, Mineola

New York State Bar Association
Trusts & Estates Law Section
Spring Meeting
May 2019

Breakfast with the Surrogates

REMOVAL OF FIDUCIARIES

I. **Suspension, Modification, or Removal Without Process**

SCPA § 719 - In any of the following cases, the court may make a decree suspending, modifying or revoking letters issued to a fiduciary from the court or removing a lifetime trustee or modifying or suspending the powers of a lifetime trustee **without a petition or the issuance of process**:

(1) Where a fiduciary directed to account fails to appear on return date of process or fails to account without a satisfactory excuse.
(2) Where process cannot be served on the fiduciary by reason of absconding or concealing.
(3) Default in supplying information as ordered by the court or neglecting or refusing to obey the order.
(4) Where the will or lifetime instrument has been deemed invalid or ineffective.
(5) Failure to provide required bond.
(6) Convicted of a felony, judicially committed, or declared an incompetent.
(7) Mingles funds or deposits them in an account other than as fiduciary.
(8) Ancillary letters have been issued but original letters in domiciliary have been revoked.
(9) Return of an absentee who can serve, or a fiduciary or committee on his behalf (in the case of temporary letters).
(10) Where any of the facts of SCPA § 711 (*see infra*) are brought to the attention of the court.

Failure to Account

Matter of Allen, 2018 NYLJ LEXIS 875 (Sur Ct, Kings County 2018)

A trustee may be removed without a hearing when he fails to account after being ordered to do so by the court (SCPA § 719[1]). Here, the court cited the trustee's undisputed failure to account as a basis to suspend the trustee pending a hearing as to removal. Further, the court did not overlook the trustee's failure to notify the court of his change of address, thereby rendering personal service ineffectual; the utilization of the decedent's personal account as the trust's bank account; and the rejection of offers to purchase trust real estate, its subsequent sale for lesser

value, and the concomitant increase of liabilities.

Evading Service

Matter of Mitchell, 2018 NYLJ LEXIS 20 (Sur Ct, New York County 2018)

Co-trustee removed when respondent failed to notify the court of his change of address (SCPA § 711[5]), thereafter evaded service of petitioner's removal citation (SCPA § 719[2]), and ultimately defaulted.

Misconduct Established by Undisputed Facts or Facts Brought to the Attention of the Court

***Matter of Delaney**,* 2018 NY Misc LEXIS 4905 (Sur Ct, Nassau County 2018)

In this proceeding for revocation of letters testamentary, a suspended fiduciary, whose letters were reinstated for the sole purpose of preparing and filing a formal accounting and the payment of up to $50,000.00 in administrative costs, filed an accounting indicating that she paid upwards of $148,000.00 in expenses. The Surrogate found that this constituted an unequivocal showing of severe misconduct and letters were revoked pursuant to SCPA § 719 and SCPA § 711(3) (neglecting or refusing to obey a court order).

Matter of Kaufman, 137 AD3d 1034 [2d Dept 2016]

Removal of co-executors and appointment of PA will be deemed an abuse of discretion where facts are disputed, conflicting inferences can be drawn, or mitigating factors exist. However, the Surrogate can remove a fiduciary without a hearing where the misconduct is established by undisputed facts or concessions, where fiduciary's in court conduct causes such facts to be within the court's knowledge, or where facts are presented during a related evidentiary proceeding. Here, there was undisputed evidence of conflict and mismanagement and removal without a hearing was permissible (*compare Matter of Modell,* 2016 NYLJ LEXIS 2419 [Sur Ct, New York County 2016] [discussing the failure to demonstrate by undisputed facts an immediate threat to the well-being of the trust so as to warrant the fiduciary's suspension pending the removal proceeding]).

***Matter of Silberkleit**,* 50 Misc 3d 1226(A) (Sur Ct, Westchester County 2016)

After being compelled to submit to a psychiatric examination, which subsequently determined that she was indeed fit to serve as trustee and CEO of Archie Comics, respondent sought summary dismissal of her co-trustee's proceeding to revoke her letters of trusteeship. Co-trustee cross-moved, stating that the psychiatric report was insufficient, and that no hearing is required as the voluminous records before the court (which included accusations of erratic, abusive, and sexually inappropriate behavior towards Archie employees) clearly demonstrated respondent's

unfitness to serve (SCPA § 711[2],[8]). Given the sharply disputed factual contentions, the court determined that a hearing was necessary.

Matter of Mercer, 119 AD3d 689 (2d Dept 2014)

Surrogate Cygier's refusal to immediately suspend the fiduciary pursuant to SCPA § 719 was upheld. The removal of a fiduciary is akin to "a judicial nullification of the testator's choice and may only be decreed when the grounds set forth in the relevant statutes have been clearly established." Contrary to the appellant's arguments, the allegations of misconduct were sharply disputed, gave rise to conflicting inferences, and were identical to the objections to be determined in the accounting proceeding.

Matter of Siri, 2015 NYLJ LEXIS 4994 [Sur Ct, Queens County 2015]

In contravention of EPTL 5-4.6, the District Court presiding over decedent's wrongful death action occasioned by the crash of Flight 587 made a determination as to the allocation and distribution of the proceeds, lifted the Surrogate's Court restrictions in its letters of administration, discharged the fiduciary's bond, permitted deposit of the funds in an investment account, and discharged the administrator from all liability. There was no indication that an accounting had been filed, that creditors had been notified, or that a guardian ad litem had been appointed for the infant. The only contact the fiduciary had with the Surrogate's Court was the filing of her first accounting, and her subsequent failure to file 8 successive accountings. Suffice it to say, the Surrogate was not inclined to entertain the fiduciary's current application to withdraw additional funds. The Surrogate revoked the letters of guardianship based on the fiduciary's inability to obey court orders (SCPA § 719[10]; SCPA § 711).

Matter of Terranova, 2011 NYLJ LEXIS 3014 (Sur Ct, Queens County 2011)

On the eve of trial in a contested accounting proceeding, the trustee unceremoniously discharged his two prior attorneys and sent a third attorney in for the sole purpose of obtaining an adjournment, which was attempted by way of a letter from a medical practitioner's office claiming the trustee had an "irritable bowel" preventing his appearance. Ironically, the original of that letter was forwarded directly from the fiduciary to the court, with a return address that was entirely different than the one set forth in his petition. The Surrogate relied upon the catch all provision of SCPA § 719(10) and suspended the fiduciary immediately, noting that it was apparent that the fiduciary had changed his address without notifying the court (SCPA § 711[6]) and – by discharging his attorneys a week prior to trial, rejecting a previously agreed-to stipulation of settlement, and defaulting – was violating his trust as testamentary trustee (SCPA § 711[10]).

II. Suspension, Modification, Revocation or Removal for Disqualification or Misconduct (with process)

SCPA § 711 **-** In any of the following cases a co-fiduciary, creditor, person interested, any person on behalf of an infant or any surety on a bond of a fiduciary may present to the court having jurisdiction a petition praying for a decree suspending, modifying or revoking those letters and that the fiduciary may be cited to show cause why a decree should not be made accordingly:

(1) Respondent was, or has since become, ineligible or disqualified.
(2) Wasted or improvidently managed or injured property.
(3) Willfully refused or without good cause neglected to obey any lawful direction of the court.
(4) Grant of letters was obtained by false suggestion of material fact.
(5) By the terms of the will or trust, his office was to cease upon a contingency that has occurred.
(6) Failed without sufficient cause to notify court of change of address within 30 days.
(7) Removed property of the estate without the state without court approval.
(8) Does not possess qualifications of a fiduciary by reason of substance abuse, dishonesty, improvidence, want of understanding, or who is otherwise unfit for the execution of the office.
(9) In the case of a guardian, where he has removed or is about to remove from the state.
(10) Testamentary trustee that has violated or threatened to violate his trust or is insolvent or for any other cause is deemed an unsuitable person to execute the trust.
(11) Lifetime trustee, where the supreme court would have cause for removal.
(12) Failure to file an account as directed by the court.

SCPA § 712 - Petition, process thereupon; suspension

Upon the issuance of process the court may by order suspend the respondent wholly or partly from the exercise of his powers and authority during the pendency of the proceeding. A certified copy of the order so made must be served with process, but from the time it is made, the order is binding upon the respondent and upon all other persons, without service thereof, subject to the exceptions and limitations prescribed in SCPA § 720 and SCPA § 721.

SCPA § 713 - Hearing; decree

Upon the return of process issued as prescribed in the preceding section the court may make a decree suspending, modifying or revoking the letters issued to or removing the respondent or modifying the terms of his appointment or may dismiss the proceeding upon such terms as justice requires.

SCPA § 2205 - Compulsory account and related relief on a court’s own initiative or on petition;

who may petition

Subsection (1) allows the court to direct an accounting, suspend letters issued to a fiduciary for failing to appear on the return date of process without satisfactory excuse or failing to file an account as directed, appoint an eligible successor to succeed a fiduciary whose letters have been suspended, fix a date for a hearing on the issue of removal, and fix a date to take and state the account of a fiduciary who fails to file one or procure its settlement.

SCPA § 2206 - Compulsory account and related relief; proceedings thereupon

Subsection (1) indicates that a petition to compel an account pursuant to SCPA § 2205 may request additional relief such as removal, suspension, the appointment of a succeeding fiduciary or to take and state an account of a fiduciary who fails to account as directed by the court.

Within the Court's Discretion

Matter of Bennett, 2017 NYLJ LEXIS 2743 (Sur Ct, New York County 2017)

Although the decree appointing non-domiciliary aliens provided for their suspension in the event that their co-fiduciary, a New York State resident, moved outside of the state, the court refused to do so, despite the co-fiduciary's departure. The court distinguished between statutes aimed at the original grant of letters and statutes aimed at the revocation of letters already issued. Determining that the removal of the fiduciaries would disrupt the orderly administration of the estate, and in the absence of opposition, the court permitted the non-domiciliary aliens to continue to serve.

Matter of Buffalino, 2015 NYLJ LEXIS 1143 (Sur Ct, Suffolk County 2015)

Mother-son co-trustees of a disclaimer trust sought each other's respective removal. The court determined that the mother's removal of the son was expressly permitted and effective by the terms of the language of the instrument, and, therefore, resort need not be made to the fiduciary's alleged failings pursuant to SCPA § 711. As for the son's attempt to remove mom on the basis that she was acting "punitively" towards him, a remainder beneficiary, the court was not inclined to do so in the absence of a hearing pursuant to SCPA § 711(8).

Duell v Duell, 258 AD2d 382 (1st Dept 1999)

The First Department affirmed an order of Surrogate Roth which removed a co-trustee and split a trust into three separate trusts, holding that in light of the demonstrated antagonisms between the co-trustee and the trust beneficiaries, and the evidence establishing that those antagonisms resulted in actions by the co-trustee interfering with the proper administration of the estate, and upon proof tending to demonstrate that future cooperation was unlikely, the Surrogate's determination to remove the co-trustee was a proper exercise of discretion.

Waste, Mismanagement and Misconduct

Matter of Cassini, 43 Misc 3d 1211(A) (Sur Ct, Nassau County 2014)

Petitioner sought revocation and/or suspension pursuant to SCPA §§ 711, 712, and 719 for paying personal claims without court approval, failing to comply with discovery orders, failing to maintain records, and making false and contradictory statements. The court declined to revoke the executor's letters without a hearing, but determined that immediate suspension pending the hearing was warranted in light of the executor's deficient record-keeping and accounting, her payment of personal claims without court approval, and the hostility and constant litigation amongst the parties.

Matter of Cohen v Cohen, 129 AD3d 521 (1st Dept 2015)

Evidence of antagonism between the trustee and beneficiaries was insufficient to warrant removal in the absence of evidence that the trustee took any action that interfered or adversely impacted on the trust that was currently unfunded.

Matter of Psilakis, 2016 NY Misc LEXIS 3926 (Sur Ct, Nassau County 2016)

Distributee/objectant sought the revocation or suspension of preliminary letters issued to the sole beneficiary and named executor of the estate on the grounds that he was mishandling the estate by collecting rent in cash, converting funds to his own use, and interfering with the management and sale of real property that were also partly owned and managed by the objectant. The Surrogate observed that, although the standard for removal of a preliminary executor is less than that of an executor, the testator's selection was nevertheless entitled to great deference. Further, the issues raised by the objectant could be addressed in an accounting proceeding after a determination on the probate, when the status of the petitioner was known. Accordingly, the petition was denied.

Matter of Terzani, 45 Misc 3d 1221(A) (Sur Ct, Dutchess County 2014)

Decedent, a former Marine, was shot in a standoff with State Police. His estranged wife was appointed temporary administrator, ostensibly to commence a wrongful death action on behalf of the estate. The decedent's parents successfully removed her as fiduciary after a hearing demonstrated that she not only failed to commence the action, but cavalierly discarded the decedent's personal belongings, including his cherished military keepsakes. Where friction between the fiduciary and beneficiaries interferes with the proper administration of the estate, (here, the wife's deliberate failure to pursue the wrongful death claim that might enure to her former in-laws benefit), removal is warranted.

False Suggestion of Material Fact

Matter of Carey, 2016 NYLJ LEXIS 2967 (Sur Ct, New York County 2016)

Non-domiciliary alien represented in his petition that he was a U.S. citizen. The Attorney General's Office sought summary removal on the grounds that he was ineligible to serve with a non-resident co-fiduciary (SCPA § 711[1]) and because the letters had been obtained by false suggestion of material fact. The court refused, noting that revocation was not mandatory, calls for the "discriminating discretion" of the Surrogate, and a hearing was required to determine of the fiduciary wilfully misled the court.

Matter of King, 147 AD3d 1286 (3d Dept 2017)

The court affirmed the Surrogate's determination that the incorrect specification of the county of the decedent's domicile did not amount to a false suggestion of material fact (SCPA 711[4]) so as to warrant revocation of letters testamentary, noting that the Surrogate's Court had jurisdiction to issue the letters regardless of the error and that the decedent's choice of executor was entitled to "great deference."

Unfit for Office

Matter of Burack, 2015 NYLJ LEXIS 4598 (Sur Ct, New York County 2015)

Remainder beneficiary seeks removal of one of three trustees claiming that his disbarment rendered him unfit for office and that he was complicit with respect to his co-trustee's self-dealing. The court, emphasizing the testator's choice of the respondent, observed that respondent's voluntary resignation from the bar 20 years ago after acknowledging that he was the subject of an investigation concerning commingling of client assets did not, on its own, support a finding that the subject trust assets were in jeopardy. Moreover, there was no act of self-dealing on the part of respondent's co-trustee upon which to premise claims of complicity on the part of the respondent.

Matter of Gerschel, 2014 NYLJ LEXIS 4465 (Sur Ct, New York County 2014)

Petitioner sought removal of co-trustee and sole income beneficiary of two intervivos trusts, one dated 1950 and the other in 1969. This proceeding precipitated when respondent failed to comply with a settlement agreement providing for his resignation upon the filing of all tax returns due for the 1969 trust. Respondent contended that the proceeding was moot, as he filed the returns within one week of commencement of the proceeding. At a hearing, the sole witness testified that respondent conditioned the filing of his returns upon receipt of a distribution from the trust. The testimony was not rebutted. The court removed the respondent as trustee of the 1969 trust, noting that respondent could not "hold his fiduciary obligations hostage to his individual interests." Based on the outcome of that hearing, the court sua sponte removed respondent as trustee of the 1950 trust, deeming him "a person unsuitable" to execute that trust as well (EPTL § 7-2.6[a][2]; SCPA § 711[11]; SCPA § 719[10]).

Matter of Levinson, 166 AD3d 1196 (3d Dept 2018)

Surrogate properly refused to exercise discretionary power of removal of the successor trustee. Although the successor trustee failed to notify the court of his change in address (SCPA § 711[6]) the petitioner failed to demonstrate any prejudice to her rights or any negative impact on the trust.

Matter of Moran, 166 AD3d 1176 (3d Dept 2018)

Acknowledging that removal of a trustee is a "drastic" remedy and that not every fiduciary breach warrants removal, the court affirmed Surrogate Pettit's refusal to remove the trustee (*see Matter of Moran*, 2017 NY Misc LEXIS 9318 [Sur Ct, Albany County 2017]). Despite the trustee's delegation and lack of oversight regarding the management of trust assets, petitioner failed to demonstrate the trust assets suffered any harm. Additionally, although the fiduciary's invocation of the 5th Amendment privilege permitted the court to draw a negative inference, it did not relieve the petitioner of his burden to demonstrate that the trust assets were put at risk.

Matter of Shambo, 169 AD3d 1201 (3d Dept 2019)

Medicaid filed objections to an accounting alleging that the failure to promptly sell decedent's real property resulted in prolonged payment of carrying costs and diminution of estate assets that could have been used in payment of its claim. After 2211 examinations, summary judgment was granted by the Surrogate in favor of objectant on the issue of the administrator's unreasonable delay in selling the property. The Appellate Court affirmed the decision and found that the Surrogate was also correct in removing the administrator pursuant to SCPA § 711(2) (fiduciary unfit for having wasted or improvidently managing assets), and SCPA § 711(8)(does not possess qualifications required of fiduciaries, improvident or otherwise unfit).

Matter of Wingate (Perez), 2016 NY Misc LEXIS 634 (Sur Ct, Queens County 2016)

In a scathing decision, the Surrogate refused to entertain a petition commenced by malpractice attorneys, ostensibly as creditors, who complained that the fiduciary's refusal to settle a malpractice action constituted a breach of her fiduciary duty. The court noted that the respondent apparently rejected the proposed settlement as inadequate, and that her decision in this regard was subject to liability from the estate's distributees if any. Inasmuch as the petitioner and supporting papers failed to establish a prima facie basis for removal, the Surrogate refused to threaten the fiduciary with removal as a means to coerce a settlement for the benefit of the petitioner.

Constitutional Considerations in the State Taxation of Trusts

Toni Ann Kruse, Esq.
McDermott Will & Emery, NYC

STATE TAXATION OF TRUSTS: CONSTITUTIONAL CONSIDERATIONS

Toni Ann Kruse

McDermott Will & Emery LLP

May 2019

mwe.com

McDermott Will & Emery

TRUST SITUS

WHERE IS MY TRUST LOCATED?

2 **mwe.com**

TRUST SITUS

- Most states determine based on
  - Location of the trustee, and
  - Place of administration of the trust.
- Considerations:
  - Where is the trust principally administered?
  - Where are the assets physically located?
  - What states have the ability to tax the trust?
  - What courts have jurisdiction over the trust?

3 mwe.com

IMPACT OF TRUST SITUS

- Place of administration
- Validity
  - Rule against perpetuities
  - Execution requirements
- Governing law
  - Modification
  - Asset protection
- State taxation

4 mwe.com

DETERMINING SITUS: UNIFORM TRUST CODE

- Uniform Trust Code ("UTC")*:
  - No definition of trust situs.
  - **SECTION 107. GOVERNING LAW.** The meaning and effect of the terms of a trust are determined by: (1) **the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship** to the matter at issue; or (2) in the absence of a controlling designation in the terms of the trust, the law of the jurisdiction having the most significant relationship to the matter at issue.

*The UTC has been adopted by 35 states including: AL, AR, AZ, CO, DC, FL, KS, KY, MA, MD, ME, MI, MN, MO, MS, MT, NC, ND, NE, NH, NJ, NM, OH, OR, PA, SC, TN, UT, VA, VT, WI, WV, and WY. Note that CT and IL introduced the UTC in 2019, but not yet enacted.

DETERMINING SITUS: NEW YORK

- New York Estates, Powers and Trusts Law ("NY EPTL"):

  NY EPTL 7-1.10: Law governing trusts created by non-domiciliary
  - Whenever a person, not domiciled in this state, creates a trust **which provides that it shall be governed by the laws of this state**, such provision shall be given effect in determining the validity, effect and interpretation of the disposition in such trust of:

    Any **trust property situated in this state at the time the trust is created**.

    Personal property, wherever situated, if the **trustee of the trust is a person residing, incorporated or authorized to do business in this state or a national bank having an office in this state**.
- When a settlor does not provide which state law governs, the law of the jurisdiction with the most significant contacts will generally control. See *In re Moore*, 493 N.Y.S.2d 924 (N.Y. Sup. Ct. 1985). *See generally* 106 NY Jur trusts § 25.
- NY EPTL 3-5.1 provides conflict of laws rules for testamentary trusts.

DETERMINING SITUS: DELAWARE AND FLORIDA

Delaware: (12 Del. C. § 3332(b)):

(a) The duration of a trust and time of vesting of interests in the trust property shall not change merely because the place of administration of the trust is changed from some other jurisdiction to this State.

(b) Except as otherwise provided by the terms of a court order and notwithstanding a general choice of law provision in the governing instrument of a trust, such as a provision to the effect that the laws of a jurisdiction other than this State shall govern the trust or the administration of the trust, **the laws of this State shall govern the administration of the trust while the trust is administered in this State unless the governing instrument expressly provides that the laws of another jurisdiction govern the administration of the trust and further provides that the laws governing the administration of the trust shall not change on account of a change in the place of administration of the trust**.

(c) Notwithstanding the foregoing, if a fiduciary takes or fails to take any action, based upon a good faith belief that the laws of a foreign jurisdiction govern the administration of a trust while the trust is administered in this State, the fiduciary's liability under the governing instrument for the action or inaction shall be determined in accordance with the laws of the foreign jurisdiction.

Florida Statute 736.0107, Governing law

The meaning and effect of the terms of a trust are determined by:

(1) The law of the jurisdiction **designated in the terms of the trust, provided there is a sufficient nexus to the designated jurisdiction** at the time of the creation of the trust or during the trust administration, including, but not limited to, the location of real property held by the trust or the residence or location of an office of the settlor, trustee, or any beneficiary; or

(2) **In the absence of a controlling designation in the terms of the trust, the law of the jurisdiction where the settlor resides at the time the trust is first created**.

DETERMINING SITUS: PRACTICAL CONSIDERATIONS

– State the governing law in the trust instrument.
– Consider impact:
  - Applicable laws
  - Validity
  - Taxation
– Public policy
  - Is there a nexus?

STATE TAXATION OF TRUSTS

STATE TAXATION OF TRUSTS: OVERVIEW

- States have the power to tax.
  - "Unless restrained by constitutional provisions, the sovereign has power to tax all persons and property within its jurisdiction and enjoying the benefits and protection of its Laws." *Haavik v. Alaska Packers Ass'n.* 263, U.S. 510, 514 (1924).
  - "[T]he power of the State as to the mode, form, and extent of taxation is unlimited, where the subjects to which it applies are within her jurisdiction." *Shaffer v. Carter*, 252 U.S. 37,52 (1919), citing *State Tax on Foreign-Held Bonds*, 15 Wall. 319.
- Generally, trust is taxed on retained income, and beneficiary taxed on distributed income. (IRC §§ 641, 652, 662).
  - Grantor vs. nongrantor trusts
  - Simple vs. complex trusts
- For our discussion, the taxation of a complex nongrantor trust is most relevant.
  - Example: A complex nongrantor trust earned $1000 of income in year 1. In year 1, it distributes $200 of that income to beneficiary A, a U.S. individual resident, and retains the remaining $800 of income.

    $200 taxable to beneficiary wherever resident. $800 taxable at the trust level, wherever it is tax resident.

STATE TAXATION OF TRUSTS

- Resident trusts
  - Generally taxed on worldwide retained income and capital gains.
- Non-resident trusts
  - Generally taxed on state source income.
- Certain states do not impose income tax on trusts
  - e.g., AK, FL, NV, NH, SD, TX, WA, WY

TOP STATE TAX RATES

- California: 13.3%
- New York: 8.82%
- Delaware: 6.6%
- Massachusetts: 5.1%

STATE TAXATION OF TRUSTS: STATUTES

- State taxation statutes generally consider the following factors:
  - Residence of grantor (at time of death or time when trust became irrevocable)
  - Place of administration
  - Residence or place of business of trustee
  - Residence of beneficiary
  - Variety of factors
- Source of income
  - Income producing property or activity within a state is sufficient nexus for state taxation of income associated with that property or activity.
- Residency of grantor
  - Often used as a starting point under statutory definition of “resident” trust.
  - A statute that taxes a trust based on this factor alone may be unconstitutional.
- Factors vary state-to-state which presents planning opportunities for practitioners.

STATE TAXATION OF TRUSTS: NEW YORK

New York (N.Y. Tax Law § 605(b)(3)):

A **resident** … trust means:

(A) …

(B) a trust, or a portion of a trust, consisting of property transferred by will of a **decedent who at his death was domiciled in this state**, or

(C) a trust, or portion of a trust, consisting of the property of:

(i) a **person domiciled in this state at the time such property was transferred to the trust**, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or

(ii) a **person domiciled in this state at the time such trust, or portion of a trust, became irrevocable**, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

(D) (i) Provided, however, **a resident trust is not subject to tax** under this article **if all of the following conditions are satisfied**:

(I) all the **trustees are domiciled in a state other than New York**;

(II) the **entire corpus of the trusts, including real and tangible property, is located outside the state** of New York; and

(III) **all income and gains of the trust are derived from or connected with sources outside of the state** of New York, determined as if the trust were a non-resident trust.

STATE TAXATION OF TRUSTS: DELAWARE

Delaware (30 Del. C. § 1601(8)):

"Resident trust" means a trust:

a. Created by the will of a decedent who at death was domiciled in this State;

b. Created by, or consisting of property of, a person domiciled in this State; or

c. With respect to which the conditions of 1 of the following paragraphs are met during more than 1/2 of any taxable year:

1. The trust has only 1 trustee who or which is:
   A. A resident individual of this State, or
   B. A corporation, partnership or other entity having an office for the conduct of trust business in this State;
2. The trust has more than 1 trustee, and 1 of such trustees is a corporation, partnership or other entity having an office for the conduct of trust business in this State; or
3. The trust has more than 1 trustee, all of whom are individuals and 1/2 or more of whom are resident individuals of this State.

Nonresident beneficiary deduction for resident estates or resident trusts (30 Del. C. § 1636)

(a) *Allowance of deduction.* — A resident estate or resident trust shall be **allowed a deduction against the taxable income otherwise computed** under Chapter 11 of this title for any taxable year for the amount of its federal taxable income, as modified by § 1106 of this title which is, under the terms of the governing instrument**, set aside for future distribution to nonresident beneficiaries**.

STATE TAXATION OF TRUSTS: CALCULATION

- Generally starts with a certain amount of federal income.
- Allows deduction for distributions to beneficiaries.
- Trusts may be subject to tax in more than one state or no state.
- Certain states allows interstate credits.
  - The form and extent of the credit can differ.
  - Avoids double taxation on trust resident in one state with income sourced in another state.
  - State may condition allowance of credit on grant of corresponding credit in other state.

STATE TAXATION OF TRUSTS: NEW YORK

Type of Trust	NY Taxation
NY Resident Trust	Subject to NY income tax on **everything**.
NY Non-Resident Trust	Subject to NY income tax on **NY source income only**.
NY Exempt Resident Trust	Trust is **exempt from NY income tax**. However, NY resident beneficiaries may be subject to an accumulation tax on distributions from the trust.

STATE TAXATION OF TRUSTS: NY EXAMPLES

A New York resident sets up an irrevocable fully discretionary non-grantor trust.

- Trust has one individual trustee residing in Pennsylvania; the trust is administered by the trustee in Pennsylvania; all assets are intangible; no NY source income.
- The current beneficiary resides in New York.
- Trustee makes no distributions of principal or income for 3 years, though the trust earns $100 of income each year. In year 4, the trustee distributions $600 the beneficiary.
  - NY exempt resident trust; "throwback" tax applies.
  - NY income tax on $400 of income ($100 current income of the distribution, plus $300 of accumulated income from prior years).

Pennsylvania resident creates an irrevocable fully discretionary non-grantor trust.

- Trust has a corporate trust company acting as trustee in Delaware; the trust is administered by trustee in Delaware.
- Trustee accumulates income unless prudent to make a distribution to lifetime beneficiary, resident in New Jersey.
- The assets include rental properties situated in NY which are owned through LLCs as well as intangible assets.
- Results: NY Non-Resident Trust; NY tax only on NY source income.

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

- Case law holds that residence of grantor alone is not sufficient contact with a state to impose a tax on all of the trust's income under the Due Process Clause or the Commerce Clause.
- Disproportionate burden compared to the benefits received.
- Planning consideration:
  - Many state laws tax a trust *permanently* based on residence of grantor when trust created. Residency changes, and ongoing taxation may be unconstitutional.
- Due Process Clause: "No State shall make or enforce any law which shall…deprive any person of life, liberty, or property, without due process of law…."

  Does the state have a "minimal connection" to the trust to make it fair to impose tax?
- Commerce Clause: "Congress shall have power to lay and collect taxes" and to "regulate Commerce…among the several States."

  Does a state law interfere with interstate commerce?

  There must be a "sufficient nexus" with the state.

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

***Safe Deposit and Trust Co. v. Virginia*, 280 U.S. 83 (1929)**

- Facts:
  - Grantor was resident and domiciled in Virginia
  - Transferred corporate stocks and bonds to the Safe Deposit & Trust Company of Baltimore, Maryland, to be held in trust for the grantor's sons, also residents of Virginia
  - The trustee was a Maryland resident
  - The trust was revocable, but the grantor died a Virginia resident without revoking the trust
- A county in Virginia assessed an intangibles tax against trustee
- Holding: Imposition of intangibles tax by Virginia violated the Due Process Clause
  - Court focused primarily on probable double taxation because the trust property was held and administered in the state of Maryland

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

State prevailed:

- *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. 1997)
- *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999)

Taxpayer prevailed:

- *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490 (N.Y. 1964)
- *Taylor v. State Tax Commissioner*, 445 N.Y.S.2d 648 (3d Dept. 1981)
- *Pennoyer v. Taxation Div. Dir.*, 5 N.J. Tax 386 (Tax Ct. 1983)
- *Potter v. Taxation Div. Dir.*, 5 N.J. Tax 399 (Tax Ct. 1983)
- *In re Swift*, 727 S.W.2d 880 (Mo. 1987)
- *Blue V. Dep't of Treasury*, 462 N.W.2d 762 (Mich. Ct. App. 1990)
- *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)
- *McNeil v. Commonwealth* (Pa. Commonwealth Ct. 2013)
- *Linn v. Department of Revenue*, 2 N.E.3d 1203 (Ill. App. Ct. 2013)
- *Kimberly Rice Kaestner 1992 Family Trust v. NC* (NC Ct. App. 2016). Petition for writ of certiorari granted by U.S. Supreme Court, set for argument April 16, 2019. *North Carolina Dep't of Revenue v. Kaestner*, Docket No. 18-457.
- *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323 (Minn. 2018). Petition for writ of certiorari filed with the U.S. Supreme Court on November 15, 2018. *Comm'r v. Fielding*, Docket No. 18-664.

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

***Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490 (N.Y. 1964)**

- Facts:
  - Grantor died resident and domiciled in New York.
  - Grantor had created revocable trust during life; on grantor's death irrevocable and continued for benefit of spouse.
  - Trustee was domiciled in Maryland, administered in Maryland and intangibles held by the trust were under exclusive possession and control of trustee in Maryland.
- Holding: Imposition of New York income tax on trustee violated Federal due process because a state may not "levy taxes beyond its border"
  - "Statutes which would impose New York income tax on the trustee undertook to extend the taxing power beyond the jurisdiction of the State of New York in violation of due process."
- Following this case and *Taylor v. State Tax Comm'r*, 445 NYS2d 648 (3d Dept. 1963), NYS Department of Taxation and Finance codified these holdings under section 605(b)(3)(D), i.e., a trust otherwise NY resident is not taxable in NY if the trust has no NY trustees, assets or source income.

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

- Is the NY statute now constitutional challenge proof?
  - Still grantor based.
  - Requires additional nexus.
  - Small amounts of NY source income, with no other ties, preclude exempt resident trust status.
- Exempt resident trusts are now required to file Form IT-205 Fiduciary Income Tax Return and attach Form IT-205-C New York Resident Trust Nontaxable Certification.
  - Penalties apply if not filed.

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

***John S. Swift, Jr., Trust v. Dir. Of Revenue*, 727 S.W.2d 880 (Sup.Ct. Mo., 1987)**

- Facts:
  - Decedent created testamentary trusts, and died domiciled in Missouri.
  - The trusts had nonresident trustees, nonresident beneficiaries, out-of-state property.
  - The trust property was administered in Illinois.
- Holding: Imposition of income tax violated the state and federal due process clauses because the trust received no benefit or protection of Missouri law.
  - "An income tax is justified only when contemporary benefits and protections are provided the subject property or entity during the relevant taxing period. In determining whether this state has sufficient nexus to support the imposition of an income tax on trust income, we consider six points of contact: "(1) the domicile of the settlor, (2) the state in which the trust is created, (3) the location of trust property, (4) the domicile of the beneficiaries, (5) the domicile of the trustees, and (6) the location of the administration of the trusts. For purposes of supporting an income tax, the first two of these factors require the ongoing protection or benefits of state law only to the extent that one or more of the other four factors is present."

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

***Blue V. Dep't of Treasury*, 462 N.W.2d 762 (Mich. Ct. App. 1990)**

- Facts:
  - The settlor was domiciled in Michigan when he created the trust.
  - The trust did not have Michigan resident beneficiaries or trustees; no income producing trust property located in Michigan.
- Holding: Imposition of income tax violated the due process clause.
  - Court considered the following factors:
    - Domicile of settlor
    - State in which trust created
    - Location of trust property
    - Domicile of beneficiaries
    - Domicile of trustees
    - Location of administration of trust
  - The first two factors "require the ongoing protection for benefits of [Michigan] state law only to the extent that one or more of the other four factors is present."

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

***Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)**

- Facts:
  - Out-of-state mail order business with no outlets or sales representatives in North Dakota.
- State of North Dakota imposed use tax on mail order business.
- Holding: Imposition of tax was unconstitutional.
  - The Due Process Clause only requires "minimum contacts". Physical presence in a state is not required for state taxation.
  - The Commerce Clause has a stricter standard. To meet the "substantial nexus" text, physical presence in a state is required to tax a business engaging in interstate commerce.
  - Partially overturned by *South Dakota v. Wayfair, Inc.*, 585 U.S. ___ (2018); no physical presence prong required under Commerce Clause analysis.
- To satisfy Commerce Clause, a valid tax must:
  - Be applied to an activity with a substantial nexus with the taxing state.
    - Quill decision states the requirement of a physical presence in the state. Overturned by Wayfair, no physical presence required.
  - Be fairly apportioned.
  - Not discriminate against interstate commerce.
  - Be fairly related to the services provided by the state.

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

***Chase Manhattan Bank v. Gavin*, 733 A. 2d (Conn. 1999)**

- Facts:
  - Grantor created four testamentary trusts and one inter vivos trust.
  - Grantor was a resident of CT when he transferred the property to the irrevocable inter vivos trust and at the time of his death.
  - The trustee was a nonresident and the trust assets were situated out-of-state.
- Holding:
  - CT may constitutionally tax testamentary trusts when the settlor is domiciled in the state at death.
  - CT may constitutionally tax *inter vivos* trusts when the settlor is domiciled in the state at the time the trust becomes irrevocable and any noncontingent beneficiary is a resident of the state.
    - The court noted the responsibility of the state to continue to supervise the administration of the testamentary trusts.
    - Beneficiary had significant rights over the inter vivos trust (right to receive all trust assets age 45; power to appoint) and was resident of CT.

***Linn v. Department of Revenue*, 2 N.E.3d 1203 (Ill. App. Ct. 2013)**

- Facts:
  - The grantor was a resident of Illinois when the trust was created, and the trust was deemed an Illinois resident trust.
  - No income was earned in Illinois, no trust assets were located in Illinois, the trust was administered by a non-resident trustee, and the beneficiary was a non-resident.
- Holding: State taxation of the trust violated the Due Process Clause because there was not a sufficient minimum connection between the trust and state.

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

McNeil v. Commonwealth **(Pa. Commonwealth Ct. 2013)**

- Facts:
  - A Pennsylvania grantor created two inter vivos trusts.
  - The trusts were administered in Delaware, governed by Delaware law, the trustees were located in Delaware, and the trust assets were held in Delaware.
  - Discretionary beneficiaries lived in Pennsylvania.
- Holding: Imposition of Pennsylvania income tax by relying only on residence of discretionary beneficiaries violated the Commerce Clause.
  - "…the beneficiaries' status in Pennsylvania is similar to that of Quill's customers, who resided in North Dakota and whose purchases of Quill's products were the trigger for the tax imposed in *Quill*. In finding the state tax unconstitutional in *Quill*, the U.S. Supreme Court focused on whether the presence of Quill, as the taxpayer, in North Dakota was sufficient, and not on the fact that there were North Dakota citizens participating and benefiting from Quill's sale of products in North Dakota. Our focus here, likewise, must be on whether the Trusts' presence in Pennsylvania is sufficient, and not on the fact that there are discretionary beneficiaries who are Pennsylvania residents and who may, at some time in the future, benefit from the existence of the Trusts."

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

Fielding v. Comm'r of Revenue, 916 N.W.2d 323 (Minn. 2018)

- Facts:
  - A Minnesota domiciliary was grantor of four trusts when they became irrevocable.
  - Trusts were created in Minnesota with Minnesota law firm; trust documents held by Minnesota law firm.
  - Trusts designated Minnesota law to govern trust terms.
  - Primary beneficiary of one of the trusts was a Minnesota resident.
- Holding: Imposition of Minnesota income tax based on single factor of grantor's domicile when the trusts became irrevocable violated Due Process.
  - The court determined that to satisfy due process, a two-part test is required:
    - "minimum connection" between the state and the person, property or transaction subject to the tax
    - Income subject to the tax must be "rationally related" to the benefits conferred on the taxpayer by the state.
  - Decided on a narrow issue, but court examined under broader scope and determined that the facts were "irrelevant or too attenuated" to meet due process.
- Petition for writ of certiorari filed with the U.S. Supreme Court on November 15, 2018. *Comm'r v. Fielding*, Docket No. 18-664.

STATE TAXATION OF TRUSTS: CONSTITUTIONALITY

North Carolina Dep't of Revenue v. Kaestner 1992 Family Trust **(NC Sup. Ct.).**

- Facts:
  - NY resident established an inter vivos trust; trust split into three separate trusts for each of grantor's children.
  - One of the trusts was for the benefit of Kimberley Rice Kaestner, a North Carolina resident and domiciliary.
  - Trustee resided in Connecticut; no North Carolina assets; North Carolina law did not apply.
- Holding: Taxation of income of family trust based solely on North Carolina residence of beneficiaries was unconstitutional because the trust did not have sufficient minimum contacts with the State of North Carolina to satisfy due process.
  - Due process clause requires "minimum contacts" connecting a state with the property to which it will apply a tax.
  - Beneficiary's domicile as the sole connection to North Carolina did not establish sufficient contacts.
- Petition for writ of certiorari granted by U.S. Supreme Court, set for argument April 16, 2019. *North Carolina Dep't of Revenue v. Kaestner*, Docket No. 18-457.

STATE TAXATION OF TRUSTS: PLANNING CONSIDERATIONS

- Minimize/avoid state taxation:
  - Consider the rules of the situs to which the settlor and trust has ties.
  - Consider choice of trustees (e.g., use of private trust company).
  - Consider selection of governing law.
  - Build flexibility in trust instrument.
    - Provide mechanism to change situs/place of administration
    - Provide mechanism to remove and replace trustees
    - Allow for decanting
  - Challenge constitutionality of the law.
  - Change situs/place of administration.
- For New York trusts:
  - Avoid NY source income.

CHANGING TRUST SITUS: WHY BOTHER?

Why change trust situs?

- Favorable trust laws
  - Adopted UTC
  - Allow directed trusts
  - Allow decanting
  - Ability to modify trusts
- Convenience
- State income taxation
  - Particularly important if trust distributions not expected to be made

CHANGING TRUST SITUS: PRACTICAL CONSIDERATIONS

- Procedure:
  - Changing governing law or administration
    - Common law (*In the Matter of the Accounting of Bankers Trust Company, Trustee of Helen B. Hudson Trust*, 29 A.D.2d 145 (1968); *In the Matter of Henry Weinberger, as Trustee of a Trust for Leona Pattiz*, 21 A.D.2d 780 (1964))
    - Trust provisions
    - Statutory provisions
  - Trust modification
  - Judicial or non-judicial settlement
  - Decanting
- When changing situs, consider impact on the law governing validity, construction and administration.
- Consider any impact on GST.
- Allow flexibility of administration in trust instrument.
- Consider decanting.
- Consider impact of any remaining connections to the state.
  - Ex., if changing trustee or place of administration, consider impact of trust protector, investment advisor or committee.

CHANGING TRUST SITUS: IMPACT ON STATE TAXATION

- In certain states, changing the situs may change the residence of the trust for state income tax purposes.
- This could be a useful planning tool, if trust was initially resident in jurisdiction that taxes based on situs/place of administration.
  - Example:
    - A New York resident sets up a trust with one New York resident individual trustee.
    - The trust does not have any New York assets or New York source income.
    - The trust is a New York resident trust.
    - If the New York resident individual trustee is removed a replaced with a non-New York resident trustee (e.g., a Florida resident individual trustee), the trust will be exempt from New York tax.

THANK YOU!

Questions?

Toni Ann Kruse
McDermott Will & Emery LLP

This material is for general information purposes only and should not be construed as legal advice or any other advice on any specific facts or circumstances. No one should act or refrain from acting based upon any information herein without seeking professional legal advice. McDermott Will & Emery* (McDermott) makes no warranties, representations, or claims of any kind concerning the content herein. McDermott and the contributing presenters or authors expressly disclaim all liability to any person in respect of the consequences of anything done or not done in reliance upon the use of contents included herein.
*For a complete list of McDermott entities visit mwe.com/legalnotices.

©2019 McDermott Will & Emery. All rights reserved. Any use of these materials including reproduction, modification, distribution or republication, without the prior written consent of McDermott is strictly prohibited. This may be considered attorney advertising. Prior results do not guarantee a similar outcome.

Trusts Go to Washington: North Carolina Dept. of Revenue v. Kaestner Family Trust

Angelo M. Grasso, Esq.
Greenfield Stein & Senior, LLP, NYC

IN THE SUPREME COURT OF NORTH CAROLINA

No. 307PA15-2

Filed 8 June 2018

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST

v.

NORTH CAROLINA DEPARTMENT OF REVENUE

On discretionary review pursuant to N.C.G.S. § 7A-31 of a unanimous decision of the Court of Appeals, ___ N.C. App. ___, 789 S.E.2d 645 (2016), affirming an opinion and order of summary judgment dated 23 April 2015 entered by Judge Gregory P. McGuire, Special Superior Court Judge for Complex Business Cases appointed by the Chief Justice pursuant to N.C.G.S. § 7A-45.4, in Superior Court, Wake County. Heard in the Supreme Court on 11 October 2017.

Moore & Van Allen PLLC, by Thomas D. Myrick, Neil T. Bloomfield, Jonathan M. Watkins, and Kara N. Bitar, for plaintiff-appellee.

Joshua H. Stein, Attorney General, by Matthew W. Sawchak, Solicitor General, Tenisha S. Jacobs, Special Deputy Attorney General, and James W. Doggett, Deputy Solicitor General; and Law Office of Robert F. Orr, by Robert F. Orr, for defendant-appellant.

JACKSON, Justice.

In this case we consider whether defendant North Carolina Department of Revenue could tax the income of plaintiff The Kimberly Rice Kaestner 1992 Family Trust pursuant to N.C.G.S. § 105-160.2 solely based on the North Carolina residence of the beneficiaries during tax years 2005 through 2008. Because we determine that

plaintiff did not have sufficient minimum contacts with the State of North Carolina to satisfy due process requirements of the Fourteenth Amendment to the United States Constitution and Article I, Section 19 of the Constitution of North Carolina, we conclude that the taxes at issue were collected unconstitutionally and, therefore, affirm the decision of the Court of Appeals affirming the North Carolina Business Court's 23 April 2015 Opinion and Order on Motions for Summary Judgment in favor of plaintiff.

As the Business Court noted, the underlying, material facts of this case as established by the evidence in the record are not in dispute. The Joseph Lee Rice, III Family 1992 Trust was created in New York in 1992 for the benefit of the children of the settlor Joseph Lee Rice, III pursuant to a trust agreement between Rice and the initial trustee, William B. Matteson. In 2005 Matteson was replaced as trustee by David Bernstein, who was a resident of Connecticut. Bernstein remained in the position of trustee and remained a Connecticut resident during the entire period of time relevant to this case. The trust was and is governed by the laws of the State of New York, of which Rice was a resident. No party to the trust resided in North Carolina until Rice's daughter and a primary beneficiary of the trust, Kimberly Rice Kaestner, moved to North Carolina in 1997.

On 30 December 2002, the trust was divided into three share sub-trusts one each for the benefit of Rice's three children, including Kaestner. The sub-trusts were divided into three separate trusts in 2006 by Bernstein for administrative

convenience. Plaintiff is the separate share trust formed for the benefit of Kaestner and her three children, all of whom resided in North Carolina during the tax years at issue.

During the tax years at issue, the assets held by plaintiff consisted of various financial investments, and the custodians of those assets were located in Boston, Massachusetts. Documents related to plaintiff such as ownership documents, financial books and records, and legal records were all kept in New York. All of plaintiff's tax returns and accountings were prepared in New York.

None of the beneficiaries of plaintiff had an absolute right to any of plaintiff's assets or income because distributions could only be made at the discretion of Bernstein, who had broad authority to manage the property held by plaintiff. No distributions were made to beneficiaries in North Carolina, including Kaestner, during the tax years at issue; however, in January 2009, plaintiff loaned $250,000 to Kaestner at Bernstein's discretion to enable her to pursue an investment opportunity. This loan was repaid.

The terms of the original trust provided that the trustee was to distribute the trust assets to Kaestner when she reached the age of forty. Before her fortieth birthday on 2 June 2009, Kaestner had conversations with her father and Bernstein about whether she wished to receive the trust assets on that date. Ultimately, she requested to extend the trust, and accordingly, Bernstein transferred the assets of

plaintiff into a new trust, the KER Family Trust, in 2009. That transfer occurred after the tax years at issue, and KER Family Trust is not a party to this case.

In managing plaintiff, Bernstein provided Kaestner with accountings of trust assets, and she received legal advice regarding plaintiff from Bernstein and his firm. Kaestner and her husband also met with Bernstein in New York to discuss investment opportunities for the trust and whether Kaestner desired to receive income distribution as set forth in the original trust agreement.

During tax years 2005 through 2008, defendant taxed plaintiff on income accumulated each year, regardless of whether any of that income was distributed to any of the North Carolina beneficiaries. Plaintiff sought a refund of those taxes totaling more than $1.3 million, including $79,634.00 paid for 2005, $106,637.00 paid for 2006, $1,099,660.00 paid for 2007, and $17,241.00 paid for 2008. Defendant denied the refund request on 11 February 2011.

On 21 June 2012, plaintiff filed a complaint in Superior Court, Wake County, alleging that defendant wrongfully denied plaintiff's request for a refund because N.C.G.S. § 105-160.2 is both unconstitutional on its face and as applied to collect income taxes from plaintiff during those tax years. Plaintiff claimed that the taxes collected pursuant to section 105-160.2 violate the Due Process Clause because plaintiff did not have sufficient minimum contacts with the State of North Carolina. Plaintiff also claimed that the taxes violate the Commerce Clause on several grounds,

including that the tax was not applied to an activity with a substantial nexus to the taxing state. Plaintiff claimed that consequently, the tax also violated Article I, Section 19 of the state constitution. Based on these claims, plaintiff requested a declaration that section 105-160.2 is unconstitutional and an order from the court requiring defendant to refund any taxes, penalties, and interest paid by plaintiff for tax years 2005 through 2008, and enjoining defendant from enforcing any future assessments against plaintiff pursuant to section 105-160.2. Subsequent evidence indicated that penalties were assessed against plaintiff for tax years 2005 and 2006. These penalties were not paid by plaintiff and were ultimately waived at plaintiff's request, rendering moot that specific portion of plaintiff's claim for relief.

In accord with N.C.G.S. § 7A-45.4(b), this case was designated as a mandatory complex business case by the Chief Justice on 19 July 2012. On 11 February 2013, the Business Court issued an Opinion and Order on Defendant's Motion to Dismiss in which it granted the motion as to plaintiff's claim for injunctive relief, but denied the motion as to plaintiff's constitutional claims.

Relevant to this appeal, plaintiff filed a motion for summary judgment on its constitutional claims on 8 July 2014, and defendant filed its own motion for summary judgment on 4 September 2014. In its Opinion and Order on Motions for Summary Judgment, the Business Court observed that when a taxed entity such as plaintiff is not physically present in the taxing state, the taxed entity must "purposefully avail[ ] itself of the benefits of an economic market in the forum state" for the tax to satisfy

due process requirements. *Kimberley Rice Kaestner 1992 Family Trust v. N.C. Dep't of Revenue*, No. 12 CVS 8740, 2015 WL 1880607, at *4 (N.C. Super. Ct. Wake County (Bus. Ct.) Apr. 23, 2015), *aff'd*, ___, N.C. App. ___, 789 S.E.2d 645 (2016) (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 307, 112 S. Ct. 1904, 1910 (1992)). Determining that plaintiff did not purposefully avail itself of the benefits of the taxing state based solely on the beneficiaries' residence in North Carolina, the Business Court concluded that the provision of section 105-160.2 allowing taxation of trust income "that is for the benefit of a resident of this State," N.C.G.S. § 105-160.2 (2005), violated both the Due Process Clause and Article I, Section 19 of the state constitution as applied to plaintiff. Applying the four-pronged analysis for determining the constitutionality of a tax pursuant to the Commerce Clause as set forth by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079 (1977), the Business Court also determined that the same provision of section 105-160.2 violated the Commerce Clause as applied to plaintiff. Therefore, the Business Court denied defendant's motion for summary judgment, granted plaintiff's motion for summary judgment, and ordered that any taxes and penalties paid by plaintiff pursuant to section 105-160.2 be refunded with interest.

Defendant noticed its appeal to the Court of Appeals on 22 May 2015. Before that court, defendant challenged the substantive conclusions of the Business Court that taxation of the trust based solely on the residency of the beneficiaries violated both the Due Process and Commerce Clauses as applied to plaintiff. *Kaestner 1992*

Family Tr. v. N.C. Dep't of Revenue, ___ N.C. App. ___, ___, 789 S.E.2d 645, 647-48 (2016). Like the Business Court, the Court of Appeals also reasoned from the United States Supreme Court's guidance that "[t]he Due Process Clause requires [(1)] some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and [(2)] that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." *Id.* at ___, 789 S.E.2d at 649 (second and third alterations in original) (quoting *Quill*, 504 U.S. at 306, 112 S. Ct. at 1909-10 (citations and internal quotation marks omitted)). Noting that a trust has a separate legal existence for the purpose of income taxes pursuant to *Anderson v. Wilson*, 289 U.S. 20, 27, 53 S. Ct. 417, 420 (1933), *Kaestner 1992 Family Tr.*, ___ N.C. App. at ___, 789 S.E.2d at 650, the Court of Appeals held that the connection between North Carolina and the trust based solely on the residence of the beneficiaries was insufficient to satisfy due process requirements, *id.* at ___, 789 S.E.2d at 651. Consequently, the Court of Appeals affirmed the Business Court's order granting summary judgment for plaintiff. *Id.* at ___, 789 S.E.2d at 651. The Court of Appeals chose not to address whether taxation of plaintiff also violated the Commerce Clause. *Id.* at ___, 789 S.E.2d at 651.

On appeal to this Court from the decision of the Court of Appeals, defendant continues to argue that plaintiff had minimum contacts with the State of North Carolina sufficient to satisfy due process based on the presence of the beneficiaries in the state. Defendant also argues that plaintiff had sufficient minimum contacts with

North Carolina through certain acts of the trustee whereby plaintiff benefitted from "the ordered society maintained by taxation in North Carolina." We disagree.

"Our standard of review of an appeal from summary judgment is de novo." *In re Will of Jones*, 362 N.C. 569, 573, 669 S.E.2d 572, 576 (2008) (citing *Forbis v. Neal*, 361 N.C. 519, 523-24, 649 S.E.2d 382, 385 (2007)). "Under the *de novo* standard of review, the [Court] 'consider[s] the matter anew[ ] and freely [substitutes] its own judgment for' [that of the lower court]." *Midrex Techs., Inc. v. N.C. Dep't of Revenue*, 369 N.C. 250, 257, 794 S.E.2d 785, 791 (2016) (first and fifth alterations in original) (quoting *N.C. Dep't of Env't & Nat. Res. v. Carroll*, 358 N.C. 649, 660, 599 S.E.2d 888, 895 (2004) (second and third alterations in original)). On a motion for summary judgment, "[t]he judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." N.C.G.S. § 1A-1, Rule 56(c) (2017).

The relevant provision of section 105-160.2 has remained substantively unchanged since the tax years at issue and states that income tax on an estate or trust "is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State." *Id.* § 105-160.2 (2017). In its complaint and motion for summary judgment, plaintiff maintained that this section is both unconstitutional on its face and as applied to plaintiff. We presume "that any act

passed by the legislature is constitutional, and [we] will not strike it down if [it] can be upheld on any reasonable ground." *State v. Bryant*, 359 N.C. 554, 564, 614 S.E.2d 479, 486 (2005) (quoting *State v. Thompson*, 349 N.C. 483, 491, 508 S.E.2d 277, 281-82 (1998) (second alteration in original)). Consequently, "[a]n individual challenging the facial constitutionality of a legislative act 'must establish that no set of circumstances exists under which the [a]ct would be valid.' " *Thompson*, 349 N.C. at 491, 508 S.E.2d at 282 (second alteration in original) (quoting *United States v. Salerno*, 481 U.S. 739, 745, 107 S. Ct. 2095, 2100 (1987)). Given this exacting standard and that the allegations and evidence appear relevant solely to whether defendant unconstitutionally collected income taxes from plaintiff for tax years 2005 through 2008, we consider only whether section 105-160.2 is unconstitutional as applied to plaintiff to collect the taxes at issue.

In considering an as-applied challenge to the constitutionality of a statute, we look to whether the statute is constitutional in the limited context of the facts of the case before us. Then, as with any constitutional challenge, "[i]f there is a conflict between a statute and the Constitution, this Court must determine the rights and liabilities or duties of the litigants before it in accordance with the Constitution, because the Constitution is the superior rule of law in that situation." *Adams v. N.C. Dep't of Nat. & Econ. Res.*, 295 N.C. 683, 690, 249 S.E.2d 402, 406 (1978) (quoting *Nicholson v. State Educ. Assistance Auth.*, 275 N.C. 439, 447, 168 S.E.2d 401, 406 (1969)).

The Fourteenth Amendment directs that no State shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend XIV. Similarly, our state constitution declares that "[n]o person shall be . . . in any manner deprived of his life, liberty, or property, but by the law of the land." N.C. Const. art. I, § 19. Indeed, we have determined that "[t]he term 'law of the land' as used in Article I, Section 19, of the Constitution of North Carolina, is synonymous with 'due process of law' as used in the Fourteenth Amendment to the Federal Constitution." *Rhyne v. K-Mart Corp.*, 358 N.C. 160, 180, 594 S.E.2d 1, 15 (2004) (quoting *In re Moore*, 289 N.C. 95, 98, 221 S.E.2d 307, 309 (1976)). Accordingly, our analysis of plaintiff's due process challenge below also applies to plaintiff's state constitutional claim.

When applied to taxation, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' " *Quill*, 504 U.S. at 306, 112 S. Ct. at 1909 (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S. Ct. 535, 539 (1954)). Due process also requires that "the 'income attributed to the State for tax purposes must be rationally related to values connected with the taxing State,' " *id.* at 306, 112 S. Ct. at 1909-10 (internal quotation marks omitted) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273, 98 S. Ct. 2340, 2344 (1978)); however, in this case we are concerned only with the first requirement. This "minimum connection," which is more commonly referred to as "minimum contacts," *see id.* at 307, 112 S. Ct. at 1910 (citing *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316, 66 S. Ct. 154, 158 (1945)), exists when

the taxed entity "purposefully avails itself of the benefits of an economic market" in the taxing state "even if it has no physical presence in the State," *id.* at 307, 112 S. Ct. at 1910 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476, 105 S. Ct. 2174, 2184 (1985)). The Court in *Quill Corporation* therefore declared: "[T]o the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State" for imposition and collection of a tax, "we overrule those holdings as superseded by developments in the law of due process." *Id.* at 308, 112 S. Ct. at 1911. Applying that standard, the Court went on to hold that the plaintiff in *Quill Corporation* "purposefully directed its activities at North Dakota residents, that the magnitude of those contacts [was] more than sufficient for due process purposes, and that the use tax [was] related to the benefits Quill receive[d] from access to the State," *id.* at 308, 112 S. Ct. at 1911, when the plaintiff generated revenue of almost $1 million annually from selling office equipment and supplies to approximately 3,000 customers in North Dakota even though all merchandise was delivered from out of state by mail or common carriers, *id.* at 302, 112 S. Ct. at 1907-08.

We have similarly determined that a finding of minimum contacts sufficient to satisfy due process "will vary with the quality and nature of the [party's] activity, but it is essential in each case that there be some act by which the [party] purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Skinner v. Preferred Credit*, 361 N.C. 114, 123, 638 S.E.2d 203, 210-11 (2006) (quoting *Chadbourn, Inc. v. Katz*, 285

N.C. 700, 705, 208 S.E.2d 676, 679 (1974)). In light of *Quill Corporation* and our understanding of minimum contacts analysis, we therefore consider defendant's first argument in terms of whether plaintiff can be said to have minimum contacts with North Carolina based on the presence of its beneficiaries in our State.

The Supreme Court has observed that even though a "trust is an abstraction . . . . the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions." *Anderson*, 289 U.S. at 27, 53 S. Ct. at 420. The Internal Revenue Code imposes a separate tax on the income of trusts, *see* 26 U.S.C. § 1(e) (2012), implicitly recognizing, at least for tax purposes, that a trust is a separate entity to which income is separately attributed. Any tax on that income is physically paid by the fiduciary or trustee, with the amount of the tax being "computed in the same manner as in the case of an individual." *Id.* § 641(a)-(b). In North Carolina "[t]he taxable income of an estate or trust is the same as taxable income for such an estate or trust under the provisions of the Code." N.C.G.S. § 105-160.2. Neither the Code nor Chapter 105 conflates the income of the trust with the income of a beneficiary.

In *Brooke v. City of Norfolk* the Supreme Court considered whether the City of Norfolk and Commonwealth of Virginia had violated the Due Process Clause by taxing the body of a Maryland trust when none of the property held by the trust had ever been present in Virginia. 277 U.S. 27, 28, 48 S. Ct. 422, 422 (1928). Although

the Supreme Court applied presence-focused due process analysis that has since been supplanted by the minimum contacts test, *see Quill*, 504 U.S. at 308, 112 S. Ct. at 1911, the Court also recognized that a trust and its beneficiary are legally independent entities when it observed that the property held by the trust "is not within the State, does not belong to the [beneficiary] and is not within her possession or control. The assessment is a bare proposition to make the [beneficiary] pay upon an interest to which she is a stranger," *Brooke*, 277 U.S. at 29, 48 S. Ct. at 422.

That plaintiff and its North Carolina beneficiaries have legally separate, taxable existences is critical to the outcome here because a taxed entity's minimum contacts with the taxing state cannot be established by a third party's minimum contacts with the taxing state. *See Walden v. Fiore*, ___ U.S. ___, ___, 134 S. Ct. 1115, 1122 (2014) (stating that "unilateral activity of another party or a third person is not an appropriate consideration when determining whether a defendant has sufficient contacts with a forum State" (quoting *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 417, 104 S. Ct. 1868, 1873 (1984))); *Hanson v. Denckla*, 357 U.S. 235, 253, 78 S. Ct. 1228, 1239-40 (1958) ("The unilateral activity of those who claim some relationship with a nonresident [party] cannot satisfy the requirement of contact with the forum State."). Here it was plaintiff's beneficiaries, not plaintiff, who reaped the benefits and protections of North Carolina's laws by residing here. Because plaintiff and plaintiff's beneficiaries are separate legal entities, due process was not satisfied solely from the beneficiaries' contacts with North Carolina.

Defendant challenges this conclusion by citing to two decisions in which foreign jurisdictions allegedly reached the opposite result. The Supreme Court of Connecticut held that taxation of an *inter vivos* trust did not violate due process because the beneficiary of the trust was a Connecticut domiciliary. *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 204, 733 A.2d 782, 802, *cert. denied*, 528 U.S. 965, 120 S. Ct. 401 (1999). Describing the domicile of the beneficiary as the "critical link," the Court in *Gavin* went on to reason that the beneficiary "enjoyed all of the protections and benefits afforded to other domiciliaries. Her right to the eventual receipt and enjoyment of the accumulated income was, and so long as she is such a domiciliary will continue to be, protected by the laws of the state." *Id.* at 204, 733 A.2d at 802. Therefore, the Court concluded in *Gavin*:

> [J]ust as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws; it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits.

Id. at 205, 733 A.2d at 802 (internal citation omitted). Defendant also cites to a decision of the Supreme Court of California for the similar proposition that a "beneficiary's state of residence may properly tax the trust on income which is payable in the future to the beneficiary, although it is actually retained by the trust, since that state renders to the beneficiary that protection incident to his eventual enjoyment of such accumulated income." *McCulloch v. Franchise Tax Bd.*, 61 Cal. 2d 186, 196, 390 P.2d 412, 419 (1964) (emphasis omitted).

We do not find either *Gavin* or *McCulloch* persuasive in deciding the present case. The Court in *Gavin* erroneously failed to consider that a trust has a legal existence apart from the beneficiary and that, consequently, for taxation to satisfy due process pursuant to *Quill*, the trust itself must have "some definite link, some minimum connection" with the taxing state by "purposefully avail[ing] itself of the benefits of an economic market" in that state. *Quill*, 504 U.S. at 306-07, 112 S. Ct. at 1909-10. Furthermore, both the Court in *Gavin* and defendant, in its arguments before this Court, misconstrue a trust's existence as "a fiduciary relationship with respect to property, subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person," *Wescott v. First & Citizens Nat'l Bank of Elizabeth City*, 227 N.C. 39, 42, 40 S.E.2d 461, 462-63 (1946) (quoting Restatement (First) of Trusts § 2 (Am. Law Inst. 1935)), to mean that any possible benefit received by the beneficiary may be imputed to the trust. That conclusion simply does not follow.

In contrast to *Gavin*, several other jurisdictions have applied reasoning similar to our analysis here in the context of deciding whether taxation of a given trust violated due process. *See Linn v. Dep't of Revenue*, 2013 IL App (4th) 121055, ¶ 33, 2 N.E.3d 1203, 1211 (2013) (applying *Quill* and holding that there was insufficient contact between Illinois and the taxed trust to satisfy due process when the trust, *inter alia*, "had nothing in and sought nothing from Illinois" and conducted all of its business in Texas), *appeal dismissed*, 387 Ill. Dec. 512, 22 N.E.3d 1165 (2014);

Fielding v. Comm'r of Revenue, File Nos. 8911–R, 8912–R, 8913–R, 8914–R, 2017 WL 2484593, at *19-20 (Minn. T.C. May 31, 2017) (deciding that taxation of an *inter vivos* trust based solely on the in-state domicile of the grantor at the time the trust became irrevocable violated due process); *Residuary Tr. A v. Director, Div. of Taxation*, 27 N.J. Tax 68, 72-73, 78 (2013) (holding that neither the New Jersey domicile of a deceased testator nor the New Jersey business interests of several corporations in which the testamentary trust held stock justified New Jersey's taxation of "undistributed income from sources outside New Jersey" pursuant to the due process minimum contacts standard), *aff'd per curiam*, 28 N.J. Tax 541 (2015); *T. Ryan Legg Irrevocable Tr. v. Testa*, 149 Ohio St. 3d 376, 2016-Ohio-8418, 75 N.E.3d 184, at ¶ 68 (2016) (applying *Quill* and holding that a tax assessment by Ohio against a Delaware trust did not violate due process when the trust was created by an Ohio resident to dispose of his interest in a corporation that "conducted business in significant part in Ohio" and the settlor's "Ohio contacts [were] still material for constitutional purposes"), *cert. denied*, ___ U.S. ___, 138 S. Ct. 222 (2017).

McCulloch, on the other hand, was decided before *Quill Corporation*, and therefore has a limited ability to inform our application of the Court's due process analysis in *Quill*. Moreover, we find *McCulloch* to be factually distinguished from the present case because the taxed entity in that case was both a beneficiary and a trustee of the trust and also resided in the taxing jurisdiction. Indeed, in holding that the taxes at issue did not violate due process, the Court in *McCulloch* particularly

relied on the fact that the trustee was a domiciliary of the taxing jurisdiction. *See McCulloch*, 61 Cal. 2d at 194, 390 P.2d at 418. However, that circumstance is not present in this case.

As an alternative to its argument that due process was satisfied based on the North Carolina residence of the beneficiaries, defendant also presents the theory that taxation satisfied due process here because plaintiff "reached out to North Carolina by purposefully taking on a long-term relationship with the trust's beneficiaries, even though the trustees . . . never entered the state." In support, defendant notes that Bernstein restructured the original trust for Kaestner's benefit, regularly communicated with her about management of plaintiff, and directed a loan to Kaestner from plaintiff's assets—all actions that, according to defendant, indicated that plaintiff would have a continuing relationship with Kaestner while she was in North Carolina.

This argument stems from misapprehension of both the facts and law relevant to this case. The undisputed evidence in the record shows that contact between Bernstein and Kaestner regarding administration of the trust was infrequent—consisting of only two meetings during the tax years in question, both of which occurred in New York. Any connection between plaintiff and North Carolina based on the loan is also irrelevant given that the loan was issued in January 2009, after the tax years at issue. Additionally, the United States Supreme Court has directed that " 'minimum contacts' analysis looks to the defendant's contacts with the forum

State itself, not the defendant's contacts with persons who reside there." *Walden*, ___ U.S. at ___, 134 S. Ct. at 1122 (citations omitted). As we have already stated, for due process purposes plaintiff, as a separate legal entity in the context of taxation, would have needed to purposefully avail *itself* of the benefits and protections offered by the State. *See Quill*, 504 U.S. at 306-07, 112 S. Ct. at 1909-10. Mere contact with a North Carolina beneficiary does not suffice.

For taxation of a foreign trust to satisfy the due process guarantee of the Fourteenth Amendment and the similar pledge in Article I, Section 19 of our state constitution, the trust must have some minimum contacts with the State of North Carolina such that the trust enjoys the benefits and protections of the State. When, as here, the income of a foreign trust is subject to taxation solely based on its beneficiaries' availing themselves of the benefits of our economy and the protections afforded by our laws, those guarantees are violated. Therefore, we hold that N.C.G.S. § 105-160.2 is unconstitutional as applied to collect income taxes from plaintiff for tax years 2005 through 2008. Accordingly, we affirm the decision of the Court of Appeals that affirmed the Business Court's order granting summary judgment for plaintiff and directed that defendant refund to plaintiff any taxes paid by plaintiff pursuant to section 105-160.2 for tax years 2005 through 2008.

AFFIRMED.

Justice ERVIN dissenting.

As the majority correctly indicates, the proper resolution of this case hinges upon the extent, if any, to which the taxpayer had sufficient minimum contacts with North Carolina to satisfy federal due process requirements. Although we are required to make what I believe to be a close call in this case, I feel compelled to conclude, after careful scrutiny of the record in light of the applicable relevant legal standard, that taxpayer "purposefully avail[ed] itself of the benefits of an economic market" in North Carolina despite having "no physical presence in the State." *Quill Corp. v. North Dakota*, 504 U.S. 298, 307, 112 S. Ct. 1904, 1910, 119 L. Ed. 2d 91, 102-03 (1992) (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476, 105 S. Ct. 2174, 2184, 85 L. Ed. 2d 528, 543 (1985)). As a result, I respectfully dissent from my colleagues' decision.

According to the undisputed facts contained in the record as identified by the trial court, Joseph Lee Rice, III, established the Rice Family 1992 Trust for the benefit of his children in 1992. The Family Trust was created in New York, with the trust instrument providing that the Family Trust was to be governed by New York law. In 2005, David Bernstein, a resident of Connecticut, was appointed trustee of the Family Trust and continued to act in that capacity throughout the time period at issue in this case. In 2006, Mr. Bernstein, physically divided the Family Trust into three trusts, one of which, plaintiff Kimberly Rice Kaestner 1992 Family Trust, was intended to benefit Kimberly Rice Kaestner and her three children, "all of whom were

residents and domiciliaries of North Carolina in the tax years at issue." Mr. Bernstein served as the trustee of the Kaestner Trust following the division of the Family Trust into its three constituent parts.

Throughout the entire interval from 2005 through 2008, which are the tax years at issue in this case, the documents related to the Kaestner Trust were kept in New York, while the custodian of the Kaestner Trust's assets was located in Boston, Massachusetts. No distributions were made to any beneficiary of the Kaestner Trust during the 2005 through 2008 tax years. During the period from 2005 through 2008, Mr. Bernstein communicated with Ms. Kaestner regarding the Kaestner Trust and provided her with accountings relating to the Kaestner Trust covering the periods from 22 December 2005 through 31 December 2006 and 23 June 2006 through 8 October 2009. In addition, Mr. Bernstein and the law firm with which he was affiliated provided Ms. Kaestner with legal advice regarding matters relating to the Kaestner Trust.

As the entire Court appears to agree, the resolution of this case hinges upon a proper understanding of the decision of the United States Supreme Court in *Quill*, which involved a Delaware corporation that sold office equipment and had physical offices and warehouses in Illinois, California, and Georgia. *Quill*, 504 U.S. at 302, 112 S. Ct. at 1907, 119 L. Ed. at 100. Quill solicited business by using catalogs, flyers, and telephone calls and placing advertisements in national periodicals. *Id.* at 302, 112 S. Ct. at 1907, 119 L. Ed. at 100. As a result of its business activities, Quill had

about 3,000 customers and made $1 million in sales in North Dakota during the relevant period. *Id.* at 302, 112 S. Ct. at 1908, 119 L. Ed. at 100. A North Dakota statute provided that retailers, including mail-order companies, were subject to a use tax "even if they maintain no property or personnel in North Dakota." *Id.* at 303, 112 S. Ct. at 1908, 119 L. Ed. at 100. The State argued that, despite Quill's lack of a physical presence within North Dakota, the State "had created 'an economic climate that fosters demand for' Quill's products, maintained a legal infrastructure that protected that market, and disposed of 24 tons of catalogs and flyers mailed by Quill into the State every year." *Id.* at 304, 112 S. Ct. at 1908-09, 119 L. Ed. at 101.

According to the United States Supreme Court, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax' and that the 'income attributed to the State for tax purposes must be rationally related to values connected with the taxing State.' "[1] *Id.* at 306, 112 S. Ct. at 1909-10, 119 L. Ed. 2d at 102 (first quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S. Ct. 535, 539, 98 L. Ed. 744 (1954); then quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273, 98 S. Ct. 2340, 2344, 57 L. Ed. 2d 197 (1978)). As the United States Supreme Court noted, it has "abandoned more formalistic tests that focused on [an entity's] 'presence' within a State in favor of a more flexible inquiry into . . . [an entity's] contacts with the forum." *Id.* at 307,

[1] The extent to which the second prong of the due process analysis has been satisfied does not appear to be before us in this case at this time.

112 S. Ct. at 1910, 119 L. Ed. 2d at 102 (citing, *inter alia*, *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 66 S. Ct. 154, 90 L. Ed. 95 (1945)). "Applying these principles, we have held that if a foreign [entity] purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's" collection of taxes "even if it has no physical presence in the State." *Id*. at 307, 112 S. Ct. at 1910, 119 L. Ed. 2d at 103 (citing *Burger King Corp.*, 471 U.S. 462, 105 S. Ct. 2174, 85 L. Ed. 2d 528). As a result, given that Quill had "purposefully directed its activities at North Dakota residents," its contacts with North Dakota were "more than sufficient for due process purposes." *Id*. at 308, 112 S. Ct. at 1911, 119 L. Ed. 2d at 104.

The parties have spent considerable time and effort debating the extent, if any, to which the fact that the beneficiaries of the Kaestner Trust resided in North Carolina during the relevant tax years has any bearing on the required due process analysis. In reaching the conclusion that the residence of the beneficiaries has no bearing upon the proper resolution of this case, my colleagues have deemed *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 733 A.2d 782, *cert. denied*, 528 U.S. 965, 120 S. Ct. 401, 145 L. Ed. 2d 312 (1999), and *McCulloch v. Franchise Tax Board*, 61 Cal. 2d 186, 390 P.2d 412 (1964), to be essentially irrelevant. I am not inclined to completely disregard either of those decisions, which, to the best of my knowledge, appear to be the only cases decided by state courts of last resort to address the question that is before us in this case, while recognizing that there are distinguishing

features which may serve to render them somewhat less persuasive than they might otherwise be.

Admittedly, the assertion of taxing authority over the inter vivos trust at issue in *Gavin* arose from a situation in which "the settlor of the trust was a Connecticut domiciliary when the trust was established and the beneficiary is a Connecticut domiciliary." *Gavin*, 249 Conn. at 183, 733 A.2d at 790. However, in upholding the taxability of the undistributed income held in an inter vivos trust, the Connecticut Supreme Court specifically stated that, "just as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws," "it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits." *Id.* at 205, 733 A.2d at 802. As a result, the Connecticut Supreme Court's decision with respect to the taxability of the undistributed income held in the inter vivos trust appears to me to hinge upon the residence of the beneficiary rather than the fact that the settlor had been a resident of Connecticut at the time that the inter vivos trust had been created.

I am loath to completely disregard *McCulloch* for similar reasons. Although the beneficiary of the trust at issue in *McCulloch* also served as one of the trustees, the California Supreme Court's analysis in that case clearly relies upon the status of the person in question as a beneficiary rather than upon his status as a trustee, with this fact being evidenced by the California Supreme Court's statement that "the

beneficiary's state of residence may properly tax the trust on income which is payable in the future to the beneficiary, although it is actually retained by the trust, since that state renders to the beneficiary that protection incident to his eventual enjoyment of such accumulated income." *McCulloch*, 61 Cal. 2d at 196, 390 P.2d at 419 (emphasis omitted). Similarly, while *McCulloch* antedates *Quill* and *Burger King*, the logic utilized by the California Supreme Court appears to me to rest upon the same considerations that underlie the United States Supreme Court's modern due process jurisprudence. For example, the California Supreme Court states that "[t]he tax imposed by California upon the beneficiary is constitutionally supported by a sufficient connection with, and protection afforded to, plaintiff as such beneficiary." *Id.* at 196, 390 P.2d at 419. As a result, I am unable to agree with my colleagues' determination that neither *Gavin* nor *McCulloch* has any bearing upon the proper resolution of this case and am inclined to be persuaded by their logic to believe that, while not dispositive, the presence of the beneficiaries of the Kaestner Trust in North Carolina has some bearing on the proper performance of the required due process analysis.

I also cannot concur in the argument adopted by the Court of Appeals to the effect that the United States Supreme Court has already made our decision for us in *Brooke v. City of Norfolk*, 277 U.S. 27, 48 S. Ct. 422, 72 L. Ed. 767 (1928). Although *Brooke* has not been overruled, it antedates *Quill* and *Burger King* and rests upon the sort of formalistic, presence-focused approach that the United States Supreme

Court rejected in those cases in favor of a less rigid "minimum connections" approach. *See Quill*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91; *Burger King*, 471 U.S. 462, 105 S. Ct. 2174, 85 L. Ed. 2d 528. In addition, *Brooke* involved an attempt by one state to tax a trust corpus held in another state, which is a very different undertaking than an attempt to tax the undistributed income of a non-North Carolina trust that is held for the benefit of a North Carolina resident.[2] The same logic renders the Kaestner Trust's reliance upon the decision of the United States Supreme Court in *Safe Deposit & Trust Co. of Baltimore v. Commonwealth of Virginia*, 280 U.S. 83, 50 S. Ct. 59, 74 L. Ed. 180 (1929), which involved an attempt to tax the corpus, rather than the undistributed income, of a non-jurisdictional trust based upon the existence of a resident beneficiary that the Court rejected on the basis of a pre-*Quill* method of analysis, unpersuasive. As a result, neither of these cases supports, much less compels, a decision in the Kaestner Trust's favor. Instead, my review of the decisions cited by both parties compels me to conclude that the only way to properly resolve this case involves reliance upon a very fact-specific analysis of the extent, if any, to which the Kaestner Trust "purposefully avail[ed] itself of the benefits of an economic market in the forum State," *see Quill*, 504 U.S. at 307, 112 S. Ct. at 1910, 119 L. Ed.

[2] Admittedly, this Court has not adopted the Court of Appeals' treatment of *Brooke* as dispositive in its opinion. Instead, the Court simply cites *Brooke* for the unexceptionable proposition that "a trust and its beneficiary are legally independent entities." For the reasons set forth in the text of this dissenting opinion, I believe that a proper due process analysis focused upon the activities of the Kaestner Trust in light of Ms. Kaestner's residence suffices to establish sufficient "minimum contacts" to support the Department of Revenue's attempt to tax the undistributed income applicable to Ms. Kaestner.

2d at 103, with this analysis deeming the presence of the beneficiary in North Carolina to be relevant, but not dispositive.

As the Supreme Court explained in *Burger King*,

> it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contact can defeat personal jurisdiction there.

471 U.S. at 476, 105 S. Ct. at 2184, 85 L. Ed. 2d at 544 (citations omitted). Although the assets contained in the Kaestner Trust were held in Boston, and the relevant documents were held in New York and although the trustee worked in New York and resided in Connecticut during the tax years at issue in this case, "business [was] transacted . . . by mail and wire communications across state lines," including those of North Carolina. *See id*. at 476, 105 S. Ct. at 2184, 85 L. Ed. 2d at 544. Among other things, Ms. Kaestner was known to be a resident of North Carolina at the time that the Kaestner Trust was created for her benefit. In addition, the trustee transmitted information to Ms. Kaestner, provided advice to Ms. Kaestner, and communicated with Ms. Kaestner in other ways with full knowledge of the fact that she resided in North Carolina. The Kaestner Trust could not have successfully carried out these functions in the absence of the benefits that North Carolina provided to Ms. Kaestner during the time that she lived here. As a result, I am unable

to conclude, given the applicable standard of review, that the Kaestner Trust lacked sufficient contacts with North Carolina to permit the State to tax the undistributed income held by the Kaestner Trust for Ms. Kaestner's benefit. Therefore, I see no due process violation. As a result, for all of these reasons, I respectfully dissent from my colleagues' decision to affirm the Court of Appeals' decision.

No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

**On Writ Of Certiorari To The
Supreme Court Of North Carolina**

PETITIONER'S BRIEF

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
RYAN Y. PARK
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

Does the Due Process Clause prohibit states from taxing trusts based on trust beneficiaries' in-state residency?

TABLE OF CONTENTS

QUESTION PRESENTED....................................... i
TABLE OF CONTENTS ii
TABLE OF AUTHORITIES iv
INTRODUCTION 1
OPINIONS BELOW.. 3
JURISDICTION... 4
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 4
STATEMENT.. 6
I. Background.. 6
II. The trusts at issue... 6
III. The taxes on the Kaestner Trust..................10
IV. The proceedings below.................................12
SUMMARY OF ARGUMENT 15
ARGUMENT..19
I. The Due Process Clause does not prohibit a state from taxing a trust with beneficiaries in that state 19
A. The two-part test in *Quill* governs the due-process analysis here.......................19
B. Under the Due Process Clause, a trust beneficiary's contacts with a state justify taxing her trust 22
1. For due-process purposes, a trust is an abstraction, not a distinct legal entity..22

2. The contacts that count for due-process purposes are the contacts of a trust's constituents 25

3. A trust beneficiary is a constituent of a trust—indeed, the most important constituent 29

4. The benefits and protections that states give a trust beneficiary justify taxing her trust 30

C. Ms. Kaestner's residency in North Carolina justifies the state's exercise of tax jurisdiction over her trust 33

1. Ms. Kaestner's North Carolina residency satisfies the first element of *Quill* 34

2. North Carolina's limited tax satisfies the second element of *Quill* 36

II. The Due Process Clause does not mandate the tax shelter that the Trust seeks here 39

A. This case presents an opportunity for the Court to reject a judicially created tax shelter.. 39

B. The Trust has actively sought to exploit the tax shelter at issue 43

CONCLUSION... 46

TABLE OF AUTHORITIES

Cases

Americold Realty Tr. v. Conagra Foods, Inc., 136 S. Ct. 1012 (2016) 16, 22, 23, 24, 25

Anderson v. Wilson, 289 U.S. 20 (1933) 22

ASARCO Inc. v. Idaho Tax Comm'n, 458 U.S. 307 (1982) 20

Brooke v. City of Norfolk, 277 U.S. 27 (1928) 24

Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985) 21, 26, 27

Chase Manhattan Bank v. Gavin, 733 A.2d 782 (Conn. 1999) 28, 30, 32, 33

Commonwealth v. Stewart, 12 A.2d 444 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941)...................29

Compania Gen. de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87 (1927) 32

Curry v. McCanless, 307 U.S. 357 (1939) 28

Daimler AG v. Bauman, 134 S. Ct. 746 (2014).....21, 28

Dows v. City of Chicago, 78 U.S. (11 Wall.) 108 (1871) 19, 42

Greenough v. Tax Assessors, 331 U.S. 486 (1947) ....*passim*

Hanson v. Denckla, 357 U.S. 235 (1958)...............21, 24

Int'l Shoe Co. v. Washington, 326 U.S. 310 (1945) 21, 27, 45

Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue, 814 S.E.2d 43 (N.C. 2018) 8

Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue, No. 12 CVS 8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015) 3

McCulloch v. Franchise Tax Bd., 390 P.2d 412 (Cal. 1964) 30, 33

McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819)..19

MeadWestvaco Corp. v. Ill. Dep't of Revenue, 553 U.S. 16 (2008) 20

Miller Bros. v. Maryland, 347 U.S. 340 (1954).....15, 20

Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978)..15, 20, 37

New York ex rel. Cohn v. Graves, 300 U.S. 308 (1937)..32

Pennoyer v. Neff, 95 U.S. 714 (1878)...........2, 20, 27, 28

Quill Corp. v. North Dakota, 504 U.S. 298 (1992)...*passim*

Safe Deposit & Trust Co. v. Virginia, 280 U.S. 83 (1929)...27, 28

South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018)...*passim*

Stone v. White, 301 U.S. 532 (1937) 24

Taylor v. Davis' Adm'x, 110 U.S. 330 (1884)...............23

Walden v. Fiore, 571 U.S. 277 (2014)..........................21

Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)... 31, 36

Constitutional Provisions

N.C. Const. art. I, § 15 35

N.C. Const. art. IX, § 2(1)....................35

U.S. Const. amend. XIV, § 1 ....*passim*

Statutes

28 U.S.C. § 1257(a)....................4

44 R.I. Gen. Laws § 44-30-5(c)....................6

Act of Mar. 3, 1923, ch. 4, § 205, 1923 N.C. Sess. Laws 67 6

Ala. Code § 40-18-1(33)....................6

Cal. Rev. & Tax. Code § 17742(a)....................6

Conn. Gen. Stat. § 12-700(a)(10) 7, 10, 44

Conn. Gen. Stat. § 12-701(a)(4) 6

Conn. Gen. Stat. § 12-701(a)(4)(D)(i) 7, 10, 43

Ga. Code Ann. § 48-7-22(a)(1)(A)....................6

Mo. Rev. Stat. § 143.331(1)(b)....................6

Mont. Admin. R. 42.30.101(16)....................6

N.C. Gen. Stat. § 105-160.2 ....5, 6, 37

N.C. Gen. Stat. § 116-4 35

N.C. Gen. Stat. § 116-144 35

N.D. Admin. Code 81-03-02.1-04 6

Ohio Rev. Code Ann. § 5747.01....................6

Tax Injunction Act, 28 U.S.C. § 1341....................12

Tenn. Code Ann. § 67-2-110(a) 6

Unif. Trust Code § 103 23
Unif. Trust Code § 404 29

Other Authorities

Charles Schwab Trust Company website 41
The Federalist No. 32 (Alexander Hamilton) 19
Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434 (1998) 41
Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* 10, 23
Internal Revenue Service, SOI Tax Stats—Fiduciary Returns—Sources of Income, Deductions, and Tax Liability—Type of Entity: 2014 39
John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165 (1997) 30
Restatement (Second) of Trusts 23
Restatement (Third) of Foreign Relations Law 21
Restatement (Third) of Trusts 23, 29, 32
Kent D. Schenkel, *Trust Law & the Title-Split: A Beneficial Perspective*, 78 UMKC L. Rev. 181 (2009) 29

Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 Vand. L. Rev. 1945 (2014) 42

Robert Sitkoff & Max Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L.J. 356 (2005) 42

Jay A. Soled & Mitchell M. Gans, *Asset Preservation and the Evolving Role of Trusts in the Twenty-First Century*, 72 Wash. & Lee L. Rev. 257 (2015) 41, 42

Ilya Somin, *Revitalizing Consent*, 23 Harv. J.L. & Pub. Pol'y 753 (2000) 31

Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*, 85 Cornell L. Rev. 1035 (2000) 41

John Warnick & Sergio Pareja, *Selecting a Trust Situs in the 21st Century*, 16 Probate & Property 53 (2002) 42

INTRODUCTION

Kimberley Rice Kaestner is the beneficiary of a trust that her father created to transfer his wealth. During the tax years at issue in this case, Ms. Kaestner's trust generated millions of dollars of income. If the trust prevails here, however, it will avoid state income taxes on nearly all of that income.

That outcome is possible only because of a mistaken interpretation of the Due Process Clause. The North Carolina Supreme Court held here that when a trust's beneficiary lives in a state, that residency does not establish the connection with the state that due process requires.

That interpretation of the Due Process Clause results in a judicially created tax shelter.

Here, Ms. Kaestner's family skillfully exploited this tax shelter. The trust at issue had a trustee from Connecticut, a state that does not tax trusts under the circumstances here. Thus, the trust paid no income taxes in Connecticut.

In North Carolina, where Ms. Kaestner and her children lived, the trust did face state taxes, but it challenged the state's trust-tax statute on due-process grounds. The trust argued that North Carolina—the state where Ms. Kaestner lived, raised a family, and attended a state-funded university—lacked a "minimum connection" to her trust.

The North Carolina Supreme Court accepted the trust's arguments. It reasoned that Ms. Kaestner is a

mere "third party" to the trust that bears her name. On that theory, the court held that Ms. Kaestner's extensive North Carolina contacts did not count for due-process purposes. After concluding that the Kaestner Trust was not physically present in North Carolina, the court held that the Due Process Clause barred North Carolina from taxing the trust's income.

This *Pennoyer*-like formalism has no place in modern due-process doctrine. *See Pennoyer v. Neff*, 95 U.S. 714, 733–34 (1878). This Court's modern teachings on due process elevate fairness over formalism.

Under a fairness-based analysis, as well as settled principles of trust law, a beneficiary is the central figure in a trust. Serving the beneficiary's interests is the trust's reason for being. For these reasons, when a trust beneficiary lives in a state and benefits from the state's services, her trust has the required connection with that state.

Upholding taxes on that basis follows not only from modern due-process analysis, but also from federalism. This Court has long recognized the importance of the states' authority to tax. The due-process rule that the state supreme court adopted here, however, lays waste to the states' taxing authority. That rule invalidates a taxing approach that North Carolina has followed for almost a century.

The state supreme court's holding, moreover, creates a tax shelter that few large trusts will be able to resist. To avoid state income taxes under that holding, all one needs to do is select a trustee in a state

with no trust-income tax. Trusts in this country earn about 120 billion dollars of income every year. With that much income at stake, constitutionalizing a tax shelter would deal a serious blow to the fiscal health of many states.

Nothing in the Due Process Clause requires such a result. Under this Court's teachings, due process does not bar the states from taxing trusts based on a trust beneficiary's residency.

Because the state supreme court reached the opposite conclusion, its decision should be reversed. The tax shelter here deserves the same fate that befell a similar judicially created tax shelter last Term. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2094 (2018).

OPINIONS BELOW

The opinion of the Supreme Court of North Carolina (Pet. App. 1a–26a) is reported at 814 S.E.2d 43 (N.C. 2018).

The opinion of the North Carolina Court of Appeals (Pet. App. 27a–40a) is reported at 789 S.E.2d 645 (N.C. Ct. App. 2016).

The state trial court's decision (Pet. App. 41a–69a) is available on Westlaw. *See Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, No. 12 CVS 8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015).

JURISDICTION

The judgment below, affirming a final judgment on constitutional grounds, was entered on June 8, 2018. Pet. App. 1a. The petition for certiorari was filed on October 9, 2018, and granted on January 11, 2019. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Fourteenth Amendment provides that "[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1.

The North Carolina tax statute at issue states, in relevant part:

> The tax imposed by this Part applies to the taxable income of estates and trusts as determined under the provisions of the [United States Internal Revenue] Code except as otherwise provided in this Part. The taxable income of an estate or trust is the same as taxable income for such an estate or trust under the provisions of the [Internal Revenue] Code, [subject to certain adjustments]. The tax is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to

> the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State. . . . The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provisions of this Part.

N.C. Gen. Stat. § 105-160.2 (2017).

STATEMENT

I. Background

Eleven states tax trusts, in whole or in part, based on trust beneficiaries' in-state residency.[1]

Before this lawsuit, North Carolina's trust-tax statute (or one of its predecessors) had been in force and unchallenged since 1923.[2] The statute taxes "the amount of the taxable income of [a] . . . trust that is for the benefit of a resident of" North Carolina. N.C. Gen. Stat. § 105-160.2 (2017).

II. The trusts at issue

In 1992, Joseph Lee Rice, III, created the Rice Family Trust to transfer wealth to his descendants. Pet. App. 2a. Mr. Rice referred to this trust as a "family asset." App. 51. He named his three children, including his daughter, Kimberley Rice Kaestner, as the trust's beneficiaries. Pet. App. 2a–3a.

Mr. Rice appointed William B. Matteson, a lawyer, as the Rice Family Trust's trustee. *See* Pet. App. 2a. Mr. Rice directed Mr. Matteson to distribute the trust's

---

1 Those states (besides North Carolina) are Alabama, *see* Ala. Code § 40-18-1(33); California, *see* Cal. Rev. & Tax. Code § 17742(a); Connecticut, *see* Conn. Gen. Stat. § 12-701(a)(4); Georgia, *see* Ga. Code Ann. § 48-7-22(a)(1)(A); Missouri, *see* Mo. Rev. Stat. § 143.331(1)(b); Montana, *see* Mont. Admin. R. 42.30.101(16); North Dakota, *see* N.D. Admin. Code 81-03-02.1-04; Ohio, *see* Ohio Rev. Code Ann. § 5747.01; Rhode Island, *see* 44 R.I. Gen. Laws § 44-30-5(c); and Tennessee, *see* Tenn. Code Ann. § 67-2-110(a).

2 *See* Act of Mar. 3, 1923, ch. 4, § 205, 1923 N.C. Sess. Laws 67, 128.

assets "liberal[ly]" to "meet the needs of [the trust's] [b]eneficiaries." App. 51.

In 1997, Ms. Kaestner moved to North Carolina, where she and her husband raised a family. *See* Pet. App. 2a–3a.

In 2002, while Ms. Kaestner was living in North Carolina, the Rice Family Trust was divided informally into three separate shares. One of these three shares was for the benefit of Ms. Kaestner and her children. Pet. App. 3a.

In 2005, Mr. Matteson stepped down as the trustee of the Rice Family Trust. He was succeeded by David Bernstein, a lawyer at Debevoise & Plimpton LLP, the law firm that represents the Rice and Kaestner families. *See* Pet. App. 2a–3a; App. 41, 93.

Mr. Bernstein, by his own description, is "not a trust and estate lawyer." App. 92. Even so, he has another attribute that makes him a useful trustee: He is a resident of Connecticut, Pet. App. 2a, a state that does not tax trust income based on a trustee's residency alone.[3]

Soon after Mr. Bernstein became the trustee of the Rice Family Trust, he used Ms. Kaestner's share of that trust to form a new trust: the Kimberley Rice Kaestner 1992 Family Trust, the respondent in this case. Pet. App. 3a. The Kaestner Trust was established

[3] *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i).

for the benefit of North Carolinians: Ms. Kaestner and her children. *See* Pet. App. 3a.[4]

The trust instrument names Ms. Kaestner and her children as the Trust's beneficiaries. Pet. App. 44a.[5] Throughout the tax years at issue, 2005 to 2008, these beneficiaries lived in North Carolina. Pet. App. 3a.

During the tax years at issue, Mr. Bernstein administered the Trust to satisfy Ms. Kaestner's needs. He and Ms. Kaestner communicated by phone, by e-mail, by mail, and in person. *See* App. 106; N.C. R. pp. 177, 217. At times, Mr. Bernstein and Ms. Kaestner would have "a number of calls in a couple weeks." N.C. R. p. 177.

On at least two occasions, Mr. Bernstein met with Ms. Kaestner in New York to discuss trust business. They discussed, among other topics, whether Ms. Kaestner wanted to receive distributions of her trust's income. Pet. App. 4a; App. 106.

---

[4] From this point on, this brief uses the terms "the Trust" and "the Kaestner Trust" to refer to the Kimberley Rice Kaestner 1992 Family Trust. As far as the Department is aware, and as far as the record here shows, the same trust instrument that formed the Rice Family Trust also governs the Kaestner Trust. App. 44–75.

[5] The Trust has referred to Ms. Kaestner as its "sole primary beneficiary." Plaintiff-Appellee's Brief at 2, *Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, 814 S.E.2d 43 (N.C. 2018) (No. 307PA15-2). In references to the facts here, this brief uses the term "the beneficiary" to refer to Ms. Kaestner, unless the context requires a more specific reference.

Ms. Kaestner also received accountings in North Carolina on the financial status of her trust. *See* Pet. App. 4a.

During the tax years at issue, the assets of the Kaestner Trust totaled about thirteen million dollars. App. 118. Mr. Bernstein, however, did not make any distributions of trust income or trust principal during those years. Pet. App. 3a. Instead, the Trust accumulated income for Ms. Kaestner's benefit. *See* Pet. App. 3a–4a.

At some point between late 2008 and January 2009, Ms. Kaestner asked Mr. Bernstein for a loan from the Trust's assets, so she could pursue a commodities investment. *See* Pet. App. 3a; App. 99–100, 113. She received a loan of $250,000 from the Trust's assets in January 2009, the first month after the tax years at issue. Pet. App. 3a. Ms. Kaestner was a North Carolinian then as well. The Trust made the loan at the lowest interest rate that the IRS allows without imposing a gift tax. *See* Pet. App. 46a–47a.

In June 2009, Ms. Kaestner turned 40. Pet. App. 3a. The trust instrument provided that when Ms. Kaestner turned 40, the Trust would terminate and its assets would be distributed to her. Pet. App. 3a. Before Ms. Kaestner turned 40, however, she talked with her father and Mr. Bernstein about whether she should receive this distribution. Pet. App. 3a–4a. Ms. Kaestner ultimately decided that she would rather wait for the distribution. Pet. App. 3a–4a.

Following Ms. Kaestner's wishes, Mr. Bernstein did not distribute the assets of the Trust to Ms. Kaestner in 2009. Instead, he "decanted" most of those assets into yet another trust that was created for her benefit.[6] Pet. App. 4a.

III. The taxes on the Kaestner Trust

Over the tax years at issue, the Kaestner Trust and its predecessor trust sought to avoid state income taxes in every state that might have imposed such a tax.

The Rice Family Trust used Mr. Matteson as its first trustee. In 1995, Mr. Matteson moved to Florida. App. 11. Florida has no income tax, so the Rice Family Trust avoided all state income taxation there.

In 2005, the Florida trustee was replaced with Mr. Bernstein, a Connecticut resident. Pet. App. 2a. Connecticut does not tax trust income based on a trustee's residency alone. *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i). By having Mr. Bernstein serve as trustee, the Rice Family Trust and the Kaestner Trust avoided state income taxes in Connecticut.

They avoided most state income taxes in New York as well. After Mr. Bernstein became the trustee, he filed an amended trust-tax return for the Rice Family

---

[6] Decanting a trust means distributing "some or all of a trust's assets to another trust." Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 567, at 138 (Supp. 2018).

Trust in New York for 2005. That amended return invoked the Due Process Clause, stating that since Mr. Matteson's move to Florida in 1995, the Rice Family Trust "ha[d] been administered solely by a trustee domiciled outside the State of New York." App. 76. Mr. Bernstein went on to argue that the Rice Family Trust's "only contacts with [New York] in 2005 were the domicile of its [grantor] at the time the trust was created many years earlier and a negligible amount of income from intangible assets" in New York. App. 78.

Those due-process arguments relieved the Rice Family Trust from paying taxes on all of its income except $2,165 from New York sources. *See* App. 76–79. The trust's total income in 2005 was about $2,350,000. *See* App. 76–79. On virtually all of that income, the trust, by having Florida and Connecticut trustees, paid no state income taxes in New York.

In North Carolina, the Kaestner Trust sought to avoid state income taxes as well. Those efforts led to this lawsuit.

From 2005 through 2008, as noted above, the beneficiaries of the Kaestner Trust—Ms. Kaestner and her three children—were North Carolina residents. Pet. App. 3a–4a. The Trust earned millions of dollars of income during those years. Under North Carolina's trust-tax statute, that income generated a tax liability of about $1,280,000. The Trust paid these taxes under protest, then sued for a refund.

When the Trust sued North Carolina, it did not deny New York residency, as it had done in New York. Instead, in its North Carolina complaint, the Trust alleged that it was "a trust with a situs in New York." App. 9.

IV. The proceedings below

The Kaestner Trust brought this lawsuit as a constitutional challenge in state court.[7] Among its claims, the Trust asserted an as-applied challenge under the Due Process Clause of the Fourteenth Amendment. Pet. App. 4a–5a. In support of that challenge, the Trust alleged that it lacked a constitutionally sufficient connection with North Carolina. Pet. App. 4a–5a.

The state trial court concluded that North Carolina's assessment of taxes on the Trust violated the Due Process Clause.[8] Accordingly, the court ordered a refund of the taxes at issue. Pet. App. 69a.

---

[7] The Tax Injunction Act, 28 U.S.C. § 1341 (2012), required Ms. Kaestner's Trust to file this lawsuit in state court. The Act provides that federal courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." *Ibid.*

[8] The Trust also pursued a Commerce Clause claim. The state trial court ruled in the trust's favor on that ground as well, holding that the court's due-process reasoning also showed a violation of the dormant Commerce Clause. Pet. App. 68a–69a. Neither of the state appellate courts addressed that part of the trial court's decision. *See* Pet. App. 7a–8a, 40a.

The North Carolina Court of Appeals affirmed. Pet. App. 27a.

In a 6-1 decision, the North Carolina Supreme Court affirmed the decision of the court of appeals. Pet. App. 2a. Applying the Due Process Clause, the court held that the in-state residency of trust beneficiaries is not a constitutionally sufficient connection with a state.

The court started its analysis by reasoning that a trust is an entity separate from its beneficiaries—in other words, that beneficiaries are third parties to a trust. Pet. App. 13a. Next, the court observed that third parties' contacts with a forum state do not count for due-process purposes. Pet. App. 13a. Finally, the court merged those two points and concluded that the North Carolina residency of the Kaestner Trust's beneficiaries does not establish any connection between the Trust and North Carolina. On that basis, the court held that North Carolina's trust-tax statute was unconstitutional as applied to the Trust. Pet. App. 18a.

Justice Sam J. Ervin, IV, dissented. In his opinion, he criticized the majority's "formalistic, presence-focused" analysis of due process. Pet. App. 24a. He opined that this Court's due-process decisions require a wider-ranging analysis of the Trust's connection with North Carolina—an analysis that gives weight to the in-state residency of the Trust's beneficiaries. Pet. App. 24a. Applying that analysis, Justice Ervin concluded that the Trust had a constitutionally sufficient

connection with North Carolina—a connection that brought the Trust within North Carolina's jurisdiction to tax. Pet. App. 24a.

SUMMARY OF ARGUMENT

The Due Process Clause does not bar a state from taxing a trust whose beneficiaries live in that state. Prohibiting those taxes, as the state supreme court did here, would harm the states in ways that the Due Process Clause does not compel.

To establish a due-process violation here, the Trust has the burden of satisfying two elements.

- First, the Trust must show that North Carolina lacks a "minimum connection" with "the person, property or transaction it seeks to tax." *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344–45 (1954)).
- Second, the Trust must show that the "income attributed to the State for tax purposes" is not "rationally related to 'values connected with the taxing State.' " *Quill*, 504 U.S. at 306 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).

Here, the Kaestner Trust cannot satisfy either of these elements.

First, Ms. Kaestner's residency in North Carolina establishes the required connection with the state.

The "minimum connection" standard centers on fairness, not formalism. *See infra* pp. 20–22. Indeed, this Court has specifically warned against using

"formalistic tests" to assess jurisdiction to tax. *Quill*, 504 U.S. at 30.

Under a fairness-based analysis, a trust has the required connection with a taxing state when a trust beneficiary lives in that state. A trust, after all, is not a distinct entity like a corporation. Instead, it is just an abstraction that describes a fiduciary relationship between people. *See Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016).

Because a trust has no entity status, the state supreme court erred by demanding connections between the Kaestner Trust "itself" and North Carolina. Pet. App. 18a. For purposes of due-process connections with the states, a trust has no "self."

Instead, the only way a trust can make contact with a state is through the trust's constituents—the grantor, the trustee, and the beneficiary. That conclusion follows not only from trust law, but also from *Greenough v. Tax Assessors*, 331 U.S. 486 (1947), and *Americold*, 136 S. Ct. 1012. *See infra* pp. 25–28.

Out of the three constituents in a trust, trust beneficiaries have the most important jurisdictional contacts. Under trust law, the beneficiary is the central figure in the trust relationship—the trust's reason for being. *See infra* pp. 29–30. As these points show, the state supreme court erred by treating Ms. Kaestner as a "third party" to the trust that bears her own name.

Once formalism is cast aside, the analysis here becomes simple. Ms. Kaestner and her children lived in North Carolina throughout the tax years at issue. North Carolina offered them wide-ranging protection and services—benefits that spared the Trust from having to pay for equivalent services. Those benefits and protections made it only fair for North Carolina to demand a return in the form of trust-income taxes. *See infra* pp. 34–37.

For all these reasons, North Carolina has far more than a "minimum connection" with the Kaestner Trust. The state's connection with the Trust satisfies the first element under *Quill*.

The tax here also satisfies the second element under *Quill*. The tax was "rationally related to values connected with" North Carolina. *Quill*, 504 U.S. at 306. One hundred percent of the Trust's income during the years at issue was earned for the benefit of North Carolinians.

In sum, due process does not justify the doctrine that the Trust seeks here: a rule that the only state that can tax trust income is the state where a trustee lives.

That rule would construct a "judicially created tax shelter" of the first magnitude. *Wayfair*, 138 S. Ct. at 2094. If that rule became the law, any rational grantor would choose a trustee in a state without trust-income taxes. That choice, moreover, would not require much effort: Trust companies and online services stand ready to assign favorably located trustees.

These tax-reducing strategies are far from hypothetical. In this case, the Rice and Kaestner families used similar strategies. The families' trusts worked with trustees in Florida and Connecticut, states with no applicable trust-income taxes.

Trusts generate 120 billion dollars of our nation's income every year. In view of that figure, an endorsement of the tax shelter the Trust seeks here would harm the fiscal health of many states. *See infra* pp. 41–43.

For these reasons and others, the Due Process Clause does not mandate the judicially created tax shelter that the Kaestner Trust is seeking.

ARGUMENT

I. The Due Process Clause does not prohibit a state from taxing a trust with beneficiaries in that state.

A. The two-part test in *Quill* governs the due-process analysis here.

As the Framers recognized, the states have always had "an independent . . . authority to raise their own revenues for the supply of their own wants." The Federalist No. 32, at 197 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

The states' authority to tax is a cornerstone of federalism. As Chief Justice Marshall noted in *McCulloch v. Maryland*, "the power of taxing the people and their property, is essential to the very existence of government." 17 U.S. (4 Wheat.) 316, 428 (1819). This power covers "[a]ll subjects over which the sovereign power of a state extends." *Id.* at 429.

Acting on these principles of federalism, this Court has cautioned that the "modes adopted [by the states] to enforce the taxes levied should be interfered with as little as possible." *Dows v. City of Chicago*, 78 U.S. (11 Wall.) 108, 110 (1871).

This Court's modern case law on tax jurisdiction embraces these principles of federalism. As recently as last Term, the Court described state taxes as a "valid exercise of the States' sovereign power." *Wayfair*, 138 S. Ct. at 2096.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court applied the Due Process Clause consistently with the above principles. The Court held that, in a due-process challenge to a tax, the taxpayer must satisfy two elements. *Id.* at 306.

First, the taxpayer must show that the taxing state lacks even a "minimum connection[] between [the] state and the person, property or transaction it seeks to tax." *Ibid.* (quoting *Miller Bros.*, 347 U.S. at 345).

Second, the taxpayer must show that the "income attributed to the State for tax purposes" is not "rationally related to 'values connected with the taxing State.'" *Quill*, 504 U.S. at 306 (quoting *Moorman*, 437 U.S. at 273).

Both of these tests center on "fundamental fairness." *Quill*, 504 U.S. at 312. To test for fairness, this Court asks whether the state's exercise of jurisdiction is related to the benefits and protections that the state has provided—that is, "whether the state has given anything for which it can ask [for taxes in] return." *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24–25 (2008) (quoting *ASARCO Inc. v. Idaho Tax Comm'n*, 458 U.S. 307, 315 (1982)).

This fairness-based analysis has replaced the rigid, presence-focused analysis that prevailed in the years after *Pennoyer*, 95 U.S. 714. In *Quill*, the Court eliminated the "physical presence" rule under the Due Process Clause. *Quill*, 504 U.S. at 308. The Court also

warned against using other "formalistic tests" to assess jurisdiction to tax.[9] *Id.* at 307.

Just last Term, the Court underscored these principles in *Wayfair*, 138 S. Ct. 2080. The Court reaffirmed *Quill*'s holding that a taxpayer "need not have a physical presence in a state to satisfy the demands of due process." *Id.* at 2093 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985)). The

---

9 This shift away from presence-based tests parallels developments in the area of jurisdiction to adjudicate. *See*, *e.g.*, *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 319 (1945); *see also Daimler AG v. Bauman*, 134 S. Ct. 746, 761 n.18 (2014) (noting this shift in adjudicative-jurisdiction doctrine).

Although tax jurisdiction parallels adjudicative jurisdiction in many respects, the two are not identical. *See Quill*, 504 U.S. at 319–20 (Scalia, J., concurring). As Justice Scalia discussed in *Quill*, tax jurisdiction resembles prescriptive jurisdiction: a state's power "to make its law applicable to the activities, relations, or status of persons, or the interests of persons in things." Restatement (Third) of Foreign Relations Law § 401 (Am. Law Inst. 1987); *see Quill*, 504 U.S. at 319–20 (Scalia, J., concurring). Adjudicative jurisdiction, in contrast, describes a state's power "to subject persons or things to the process of its courts or administrative tribunals, whether in civil or in criminal proceedings, whether or not the state is a party to the proceedings." Restatement (Third) of Foreign Relations Law § 401.

Because adjudicative jurisdiction and tax jurisdiction play different roles, one should take care before applying precedents from one sphere in the other sphere. *Cf.* Pet. App. 13a, 17a (relying extensively on *Walden v. Fiore*, 571 U.S. 277 (2014), and *Hanson v. Denckla*, 357 U.S. 235 (1958), decisions on adjudicative jurisdiction).

Here, there is no dispute over adjudicative jurisdiction, because Ms. Kaestner's Trust sued the Department in North Carolina's courts.

Court also condemned "arbitrary, formalistic" distinctions that lower courts had used to "prevent States from collecting taxes." *Wayfair*, 138 S. Ct. at 2092.

Through these decisions, the Court has repeatedly cautioned that a proper due-process analysis of taxation centers on fairness, not formalism. That movement away from formalism is especially important in this case.

B. Under the Due Process Clause, a trust beneficiary's contacts with a state justify taxing her trust.

1. For due-process purposes, a trust is an abstraction, not a distinct legal entity.

Here, the state supreme court reasoned that for the Kaestner Trust to have a constitutionally valid connection with North Carolina, the connection would have to involve the "trust itself." Pet. App. 18a. The court's reasoning overlooked this Court's analysis of the relationship between states and trusts.

American law has traditionally refused to recognize a trust as "a distinct legal entity." *Americold*, 136 S. Ct. at 1016.

Instead, this Court has described a trust as an "abstraction." *Greenough v. Tax Assessors*, 331 U.S. 486, 493 (1947) (quoting *Anderson v. Wilson*, 289 U.S. 20, 27 (1933)). That description reflects the reality that a

trust is "not a legal person." Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 712, at 273 (2009) [hereinafter Bogert]; *cf. Taylor v. Davis' Adm'x*, 110 U.S. 330, 335 (1884) ("[t]he trust estate cannot promise").

In *Americold*, the Court clarified the nature of a trust. 136 S. Ct. at 1016. The Court explained that a trust is merely a "'fiduciary relationship' between multiple people."[10] *Ibid.* (quoting Restatement (Second) of Trusts § 2 (1957)); *accord* Restatement (Third) of Trusts § 2 (Am. Law Inst. 2012).

That fiduciary relationship begins when the grantor of an irrevocable trust contributes property to the trust. Unif. Trust Code § 103 (Unif. Law Comm'n 2000); Bogert, *supra*, § 1, at 8–10. The people in the fiduciary relationship itself are the trust beneficiary and the trustee. Bogert, *supra*, § 1, at 11.

The beneficiary is the person for whose benefit the trustee holds the trust property. *Ibid*. "The trustee is the individual or entity (often an artificial person such as a corporation) that holds the trust property for the benefit of [the beneficiary]." *Id.* at 7. These two people—in some cases, multiple people—are the ones who make up the trust relationship. *Americold*, 136 S. Ct. at 1016.

---

[10] Because of the abstract nature of a trust, *Americold* held that a real-estate-investment trust does not have a distinct entity-level citizenship for purposes of diversity jurisdiction. 136 S. Ct. at 1016.

When the North Carolina Supreme Court applied due-process analysis here, it misunderstood how that analysis applies to trusts. The court treated the Kaestner Trust as a separate legal entity. Pet. App. 12a. Taking this "separate entity" theory further, the court held that, for due-process purposes, Ms. Kaestner is a "third party" to her trust. Pet. App. 13a. The court cited *Brooke v. City of Norfolk*, 277 U.S. 27 (1928), for the proposition that a trust and its beneficiaries are separate for tax purposes. Pet. App. 12a–13a.

That "separateness" theory was rejected, however, in *Stone v. White*, 301 U.S. 532 (1937). There, in the context of a tax-refund claim, this Court equated trusts' interests with beneficiaries' interests. The Court held that when a trust pays a tax, "only [the beneficiary] is ultimately burdened." *Id.* at 538. Thus, the Court refused to "shut its eyes to the fact that in the realm of reality it [is] the beneficiary's money which [pays] the tax." *Id.* at 535.

When the state supreme court held that Ms. Kaestner is a mere third party to her trust, the court also cited *Hanson v. Denckla*, 357 U.S. 235 (1958). *Hanson*, however, does not control here. The issue there was adjudicative jurisdiction over a *trustee*, not tax jurisdiction over a trust. *Id.* at 253. The *Hanson* Court had no occasion to decide whether a beneficiary's residency in a state allows that state to tax the beneficiary's trust income.

Based on these and other errors, the state supreme court treated a trust beneficiary as a stranger to the trust that bears her name. That kind of formalism has no place in a modern due-process analysis, which centers on fairness. *See supra* pp. 20–22. Under a fairness-based analysis, it makes no sense to limit the inquiry to the jurisdictional contacts of a mere abstraction.

2. The contacts that count for due-process purposes are the contacts of a trust's constituents.

Because a trust is an abstraction, it cannot have physical contacts with a state. *See Americold*, 136 S. Ct. at 1016 (noting that the "[trust] relationship was not a thing that could be haled into court"). Instead, a trust makes jurisdictional contact with states through the people who make up the trust relationship.

The Court established this principle in *Greenough v. Tax Assessors*, 331 U.S. 486 (1947). There, the Court considered a question closely related to the question here: whether the Due Process Clause barred Rhode Island from taxing a trust based on the in-state residency of a trustee. *See id.* at 488–89. The Court held that the Due Process Clause did not bar such a tax. *Id.* at 498.

The *Greenough* Court began by analyzing the unique, abstract nature of trusts. *Id.* at 493. The Court pointed out that it has treated a trust as an abstraction, not as a separate entity. *Ibid.*

The federal tax code sometimes treats a trust as a separate taxpayer, but the Court described that treatment as a statutory decision, not as a constitutional command. *Id.* at 493–94 ("This is because Congress has seen fit so to deal with the trust.").

In contrast, when the Court assessed the jurisdictional contacts of the trust in *Greenough*, the Court did not treat the trust as a taxpayer with a "separate existence." *Id.* at 493. Instead, the Court focused on the jurisdictional contacts of the trust's *constituents*. *Id.* at 496.

Because of the facts in *Greenough*, the constituent at issue was a trustee. *Id.* at 488. In that context, the Court held that a benefit to a trustee is a benefit to the trust abstraction itself. *Ibid.* Because of the unique relationship between a trust and its constituents, the Court recognized that a trustee's contacts with a state can justify taxing a trust. *Id.* at 496. Through that reasoning, the *Greenough* Court treated a trust and its constituents as inextricably intertwined.[11]

---

[11] The same conclusion also flows from one of this Court's key decisions on adjudicative jurisdiction: *Burger King Corp. v. Rudzewicz*, 471 U.S. 462. There, the Court held that the nature and intensity of a relationship can justify a court's exercise of power over a person. *Id.* at 480.

The relationship between a beneficiary and her trust is far more intensive than the franchise relationship at issue in *Burger King*. A beneficiary is not a contractor with a trust; she is the trust's very heart. As shown below, the trust cannot exist without her. *See infra* pp. 29–30.

Greenough's approach is significant, because that decision departs from a *Pennoyer*-era decision on the due-process limits of trust taxation. *See Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929).

In *Safe Deposit*, the Court held that Virginia could not assess property taxes on trust property that was being held in Maryland for a Virginia beneficiary. *Id.* at 94. *Safe Deposit* applied a rigid, *Pennoyer*-era due-process test—one that turned on the literal taxpayer's "actual presence" in the taxing state. *Id.* at 92.

The taxpayer at issue in *Safe Deposit* was a trust. *Id.* at 90. Under *Pennoyer*-era reasoning, once the Court decided that the trust property itself was not physically present in the taxing state, the case was over. *Ibid.* The Court expressly declined to consider whether, in light of the trust relationship, the contacts of the trust's beneficiaries should count for due-process purposes. *See id.* at 92 ("We need not make any nice inquiry concerning the ultimate or equitable ownership of the [trust property] or the exact nature of the interest held by the [beneficiaries].").

Greenough—a case decided a generation after *Safe Deposit* and two years after *International Shoe*—shows how the Court's analysis of trust contacts has turned away from formalism. In *Greenough*, the Court did what it declined to do in *Safe Deposit*: It examined the nature of the trust relationship, rather than

focusing on the literal taxpayer's physical presence. *See Greenough*, 331 U.S. at 493. By performing that analysis, the Court showed that the contacts of the people in the trust relationship count in a due-process analysis.

When one compares *Greenough* with *Safe Deposit*, it becomes clear that one decision involves a modern due-process analysis, and one does not. *Greenough*, with its emphasis on fairness, tracks a modern due-process analysis. *Safe Deposit*, with its formalistic, presence-based reasoning, clashes with this Court's modern teachings on due process.[12] *See supra* pp. 20–22 (discussing those teachings).

In the related context of adjudicative jurisdiction, this Court has cautioned that *Pennoyer*-era precedents "should not attract heavy reliance today." *Daimler*, 134 S. Ct. at 761 n.18. Discarding *Safe Deposit* and upholding *Greenough* would reinforce that caution.

In sum, the analysis here should follow the central point of *Greenough*: In trust-tax cases, the contacts of the people in the trust relationship are the contacts that matter.

---

12 *Safe Deposit* is no longer good law for another reason as well: It is premised on the view that the Due Process Clause prohibits double taxation. 280 U.S. at 92. The Court later abandoned that view in *Curry v. McCanless*, 307 U.S. 357, 363 (1939). *See*, *e.g.*, *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 803 (Conn. 1999) (noting that concerns over double taxation were "[c]entral to the Court's reasoning in *Safe Deposit*," but that those concerns had "long been abandoned as a limitation on taxation under the due process clause").

3. A trust beneficiary is a constituent of a trust—indeed, the most important constituent.

As shown above, *Greenough* holds that trustees' in-state residency justifies state taxes on trusts.

That conclusion applies with even greater force when the state resident at issue is a trust beneficiary. As shown below, a beneficiary is not only another constituent of a trust; she is a trust's most important constituent. Because of a beneficiary's central role in a trust, her residency in a state forms the required link between the taxing state and the trust. *See Quill*, 504 U.S. at 327 (requiring such a link).

The beneficiary is a trust's reason for being. Under settled principles of trust law, a trust exists solely "for the benefit of its beneficiaries." Unif. Trust Code § 404 (Unif. Law Comm'n 2000). The trust abstraction is simply "incidental to and derivative of the purpose of benefiting the trust beneficiary." Kent D. Schenkel, *Trust Law & the Title-Split: A Beneficial Perspective*, 78 UMKC L. Rev. 181, 183 (2009). Indeed, a trust cannot exist without beneficiaries. *See* Restatement (Third) of Trusts § 44 (Am. Law Inst. 2012).

A trust beneficiary, moreover, has an ownership interest in trust property—a "right, title, and estate in and to" that property. *Commonwealth v. Stewart*, 12 A.2d 444, 447 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941). In contrast, a trustee's interest in trust property is "merely nominal, with real ownership

remaining in the beneficiary." John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 181 (1997).

As these points show, a beneficiary is not just one of the people in the trust relationship; she is the *most important* person in that relationship.

4. The benefits and protections that states give a trust beneficiary justify taxing her trust.

Because of the central role that a beneficiary plays in a trust, the principle of *Greenough* applies equally to this case. Under that principle, a trust constituent's residency in a state connects the trust to the state. *See Greenough*, 331 U.S. at 495; *see also McCulloch v. Franchise Tax Bd.*, 390 P.2d 412, 419 (Cal. 1964) (same); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 802 (Conn. 1999) (same).

Another principle in *Greenough* applies here as well: The benefits and protections that a state gives a trust constituent justify taxing the trust.

In *Greenough*, the Court pointed out that the trust constituent at issue, the trustee, was "entitled to the same advantages from Rhode Island laws as [was] any natural person there resident." 331 U.S. at 495.

The Court also stressed the many benefits and protections that Rhode Island gave the trustee. The state offered the trustee all of the "benefits and protection inherent in the existence of an organized

government," including the "privileges of citizenship" and "the protection of his domiciliary government." *Id.* at 493.

The Court held, moreover, that it did not matter whether the trust constituent actually used these benefits; all that mattered was that he had the opportunity to do so. *See ibid.* The Court upheld the tax at issue even though "nothing appeared as to any specific benefit or protection which the trustee had actually received." *Id*. at 495.

The benefits and protections that a state offers a trust beneficiary are even more important than the benefits that a state offers a trustee. *See id.* at 493–97 (citing those benefits).

The fulfillment of a trust's purpose—serving the trust beneficiary—"assumes solvent state and local governments." *Wayfair*, 138 S. Ct. at 2096. That purpose depends on the benefits that a state confers by maintaining "an orderly, civilized society." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

For example, if a beneficiary's home state did not protect "sound local banking institutions," a trust could not make secure distributions to the beneficiary. *Wayfair*, 138 S. Ct. at 2096 (quoting *Quill*, 504 U.S. at 328). More fundamentally, if the beneficiary did not receive the physical protection and security that her state government provides, including the "police and fire departments that protect [her]," she would be in no position to receive or enjoy her distributions. *Wayfair*, 138 S. Ct. at 2096; *see also* Ilya Somin, *Revitalizing*

Consent, 23 Harv. J.L. & Pub. Pol'y 753, 759 (2000) (describing the enormously expensive services that states provide).

Indeed, state benefits and protections relieve a trust from making outlays on its beneficiaries' behalf. For example, a common purpose of a trust is to pay for beneficiaries' education. Restatement (Third) of Trusts § 50 cmt. d(2) (Am. Law Inst. 2012). All states, however, offer free public schools to their school-age residents. Because a state offers that expensive service for free, a trust that has a duty to provide for the education of its beneficiaries need not spend thousands of dollars per year on private schools. Free education and other taxpayer-subsidized benefits allow a trust to save its income and garner investment returns.

The privileges that flow from a beneficiary's in-state residency "are inseparable from responsibility for sharing the costs of government." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937). As Justice Holmes famously observed, "taxes are what we pay for [a] civilized society." *Compania Gen. de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

This close relationship between state taxation and state protection of trust beneficiaries has led other state courts to uphold state trust taxes against due-process claims.

In *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, for example, the Connecticut Supreme Court drew the same parallel to *Greenough* that this brief draws. *See*

supra pp. 30–31. The court held: "[J]ust as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws[,] it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits." *Id.* at 802 (citing *Greenough*, 331 U.S. at 496).

Likewise, in *McCulloch v. Franchise Tax Board*, 390 P.2d 412, the California Supreme Court agreed that a beneficiary's home state can tax undistributed trust income. The court emphasized the protection that a state offers a trust during the years when the trust is accumulating income. During those years, the state gives the beneficiary "the interim protection of its laws so that [she] may ultimately obtain the benefit of the accumulated income." *Id.* at 419.

As these courts rightly held, a trust beneficiary's residency in a state gives her, and her trust, enormously valuable services and protection. Those services, plus the close connection between the beneficiary and the trust, establish the required connection between the state and the trust. *See Quill*, 504 U.S. at 306. That principle decides this case.

C. Ms. Kaestner's residency in North Carolina justifies the state's exercise of tax jurisdiction over her trust.

As shown above, the Trust's due-process challenge to North Carolina's trust-tax statute is governed by the

two-part test that this Court announced in *Quill*. *See Quill*, 504 U.S. at 306; *supra* p. 20.

The statute satisfies both parts of the *Quill* test.

1. Ms. Kaestner's North Carolina residency satisfies the first element of *Quill*.

As applied to the Kaestner Trust, North Carolina's trust-tax statute satisfies the first element of the *Quill* test, the "minimum connection" element. As shown above, when a trust beneficiary lives in a state, so does her trust. Here, the beneficiaries of the Kaestner Trust were North Carolina residents during the tax years at issue.

As in-state residents, Ms. Kaestner and her children were offered all of the taxpayer-funded benefits and protections that come with residency in North Carolina. These benefits and protections parallel the benefits that, *Greenough* held, would justify the exercise of tax jurisdiction over a trust. 331 U.S. at 493–97; *supra* pp. 30–31.

Indeed, the case for taxation here is even stronger than in *Greenough*. There, the Court noted that the record did not show "any specific benefit or protection" that any trust constituent had actually received. *Greenough*, 331 U.S. at 495. Here, in contrast, Ms. Kaestner received wide-ranging benefits and protections from North Carolina. In fact, those state benefits replaced services that the Trust otherwise would have had to buy for Ms. Kaestner.

For example, one of the Trust's purposes was "to provide for [its beneficiaries'] education." App. 51. North Carolina gave Ms. Kaestner the opportunity to send her children to the state's excellent public schools at no charge. Indeed, the North Carolina Constitution secured the children's right to a free education in the public schools. N.C. Const. art. I, § 15 ("The people have a right to the privilege of education, and it is the duty of the State to guard and maintain that right."); *id.* art. IX, § 2(1) (mandating "free public schools").

Similarly, before the tax years at issue, Ms. Kaestner enrolled at the University of North Carolina at Chapel Hill and earned a master's degree. App. 81. North Carolina's taxpayers subsidized that public university. *See* N.C. Gen. Stat. §§ 116-4, -144. During the tax years at issue, if Ms. Kaestner wished to pursue further studies in the UNC system, those educational services were available to her at taxpayer-subsidized rates. *See* App. 81.

Another one of the Kaestner Trust's main purposes was to provide for the beneficiaries' health and welfare. App. 51. North Carolina shouldered that responsibility by giving Ms. Kaestner and her children all of the critical public-safety services needed to protect their health and welfare, including police and fire departments. *See Wayfair*, 138 S. Ct. at 2096. By taking on those responsibilities, North Carolina relieved the Trust of the enormous expense that equivalent services would have required.

The trust instrument also directed the trustee to help Ms. Kaestner if she "set[] up a business." App. 51. When Ms. Kaestner did so, North Carolina's state government stepped in again to help the Trust. Near the end of the tax years at issue, the Trust loaned Ms. Kaestner $250,000 to invest in commodities. Pet. App. 3a. That loan was facilitated by North Carolina's sound local banking institutions. *See Wayfair*, 138 S. Ct. at 2096. If the loan had generated any legal disputes, North Carolina's state courts and state laws were at hand to resolve those disputes. *See Greenough*, 331 U.S. at 495–97 (citing the availability of a state's legal system as a benefit to a trust).

In these ways and more, North Carolina benefited the Kaestners by maintaining the "orderly, civilized society" that made their lifestyle in North Carolina possible. *J.C. Penney*, 311 U.S. at 444.

In view of those benefits, as well as the inseparable relationship between Ms. Kaestner and her trust, her life in North Carolina establishes the required "minimum connection" between North Carolina and the Trust. That connection satisfies the first element under *Quill*.

2. North Carolina's limited tax satisfies the second element of *Quill*.

This case also satisfies the second element of *Quill*: North Carolina's taxation of the Trust's income was "rationally related to values connected with" the

state. *Quill*, 504 U.S. at 306 (quoting *Moorman*, 437 U.S. at 273).

The state supreme court did not reach this issue. *See* Pet. App. 10a ("[I]n this case we are concerned only with the first [*Quill*] requirement."). Even so, the record makes clear that the tax at issue satisfies the second element under *Quill*.

North Carolina taxed Ms. Kaestner's Trust only on income that was earned for Ms. Kaestner's benefit. North Carolina's statute taxes only "the amount of the taxable income . . . that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2. That narrowing language ensures that North Carolina's trust taxes are apportioned to match the interests held by North Carolina beneficiaries.

Here, 100 percent of the Trust's income during the years at issue was earned for the benefit of North Carolinians. The Trust's own complaint alleged that, during the tax years at issue, the Trust's "current beneficiaries" were "Kimberly Rice Kaestner and her three children, all of whom were residents and domiciliaries of North Carolina." App. 11. Thus, the share of the Trust's income that was connected with North Carolinians—and therefore connected with state services to those North Carolinians—was 100 percent. That was the share of the Trust's income that North Carolina taxed. *See Moorman*, 437 U.S. at 269.

* * *

For these reasons, North Carolina's trust-tax statute, as applied to the Kaestner Trust, satisfies both elements of the *Quill* test. By reaching the opposite conclusion, Pet. App. 18a, the state supreme court made an error of federal constitutional law.

II. The Due Process Clause does not mandate the tax shelter that the Trust seeks here.

As shown above, when trust beneficiaries live in a taxing state, taxing trust income comports with due process. That conclusion becomes even clearer when one considers the harmful effects of the opposite rule that the state supreme court applied here. That rule is no better than a judicially created tax shelter—a type of doctrine that this Court has not hesitated to reject.

A. This case presents an opportunity for the Court to reject a judicially created tax shelter.

In the recent *Wayfair* decision, the Court condemned "judicially created tax shelter[s]" in the context of sales taxes. *Wayfair*, 138 S. Ct. at 2094. This case presents an opportunity for the Court to close an equally undesirable tax shelter: one that shelters massive trust income from state taxes.

In 2014 alone, trusts filed more than 2.7 million federal tax returns. Collectively, those trusts reported income of more than 120 billion dollars.[13]

---

[13] *See* Internal Revenue Service, SOI Tax Stats—Fiduciary Returns—Sources of Income, Deductions, and Tax Liability—Type of Entity: 2014, *available at* https://www.irs.gov/statistics/soi-tax-stats-fiduciary-returns-sources-of-income-deductions-and-tax-liability-by-type-of-entity. This figure includes returns filed on behalf of complex trusts, simple trusts, grantor trusts, qualified-disability trusts, split-interest trusts, and pooled-income funds. It does not include returns filed on behalf of

Taxes on these billions of dollars are a critical source of funding for states' essential government services. At least eleven states currently tax undistributed trust income when a trust beneficiary lives in the taxing state. *See supra* p. 6 n.1.

The result the Trust seeks here, however, would make it possible for trusts to shelter their entire undistributed income from state income taxes. To achieve that result, all a trust would need to do is select a trustee in a state that does not tax trust income based on the trustee's residency—for example, Connecticut, where Mr. Bernstein lived, or Florida, where the predecessor trustee lived. *See supra* p. 10.

After selecting such an out-of-state trustee, beneficiaries like Ms. Kaestner could live in their home states, consume state resources, and accept other protections from the state on a tax-free basis.

Indeed, the ruling that the Kaestner Trust seeks would allow beneficiaries to avoid paying state income taxes forever. Beneficiaries like Ms. Kaestner could accumulate income in their trusts over several decades, avoid taxes on that income, and then, before taking a distribution from their trusts, simply move to a state without income taxes.

This tax shelter, if endorsed by this Court, would create an opportunity that few trusts could resist. As scholars agree, trusts are "particularly well suited" for

decedents' estates, Chapter 7 bankruptcy estates, and Chapter 11 bankruptcy estates.

"fiscal and regulatory avoidance." Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434, 479 (1998).

Unlike a human being, a trust can change its situs instantaneously. *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*, 85 Cornell L. Rev. 1035, 1065 (2000). For example, "[f]or a California trust to relocate to Alaska, no individual has to change her domicile. A trust can relocate to Alaska without the use of bricks or mortar." *Ibid.*

Indeed, in this age of widespread online services, technology has made it remarkably easy to select a trustee in a state with no trust-income tax.[14] If a trust has an existing trustee in a state with unfavorable tax laws, a beneficiary can simply "request that the trustee resign." Jay A. Soled & Mitchell M. Gans, *Asset Preservation and the Evolving Role of Trusts in the Twenty-First Century*, 72 Wash. & Lee L. Rev. 257, 277 n.129 (2015).

Because of these options, "mov[ing] an income-accumulation trust from a high income tax state to a low income tax state" is now "[o]ne of the most significant reasons for moving the situs of [an existing]

[14] For example, Charles Schwab Trust Company offers trustee services, promising to "leverag[e] the advantages of a favorable trust situs" in Nevada, a state that does not tax trust income. Charles Schwab Trust Company, https://www.schwab.com/public/schwab/investing/accounts_products/personal_trust_services (last visited Feb. 20, 2019).

trust." John Warnick & Sergio Pareja, *Selecting a Trust Situs in the 21st Century*, 16 Probate & Property 53, 57 (2002).

These techniques have led sophisticated planners to view trusts as "an income tax savior." Soled & Gans, *supra*, at 280. Empirical studies have shown that record amounts of assets have started flowing into trusts. *See* Robert Sitkoff & Max Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L.J. 356, 391 (2005). A study that tracked the aggregate assets in trusts from 1985 through 2003 showed an increase from 400 billion dollars to 1.2 trillion dollars. *See ibid.*

In sum, the rule of constitutional law that the Trust seeks here would endorse "an extraordinary stratagem by which wealthy individuals are able to avoid all state income taxes on investment income through the use of a carefully crafted out-of-state trust." Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 Vand. L. Rev. 1945, 1997 (2014).

Such a rule would also end the states' ability to adopt tax approaches that would combat this tax-avoidance technique. Sound principles of federalism counsel against such a result. *See Dows*, 78 U.S. at 110 ("[The] modes adopted [by the states] to enforce the

taxes levied should be interfered with as little as possible.").

Finally, constitutionalizing the tax shelter at issue here would deprive the states of hundreds of millions of dollars in tax revenue annually—losses that could reach a billion dollars in North Carolina over the next decade alone. Pet. 13.

Just last Term, this Court struck down a similar tax shelter, expressing concern over the "significant revenue losses to the States" that the tax shelter posed. *Wayfair*, 138 S. Ct. at 2093–94. The same ruling is justified here.

B. The Trust has actively sought to exploit the tax shelter at issue.

The facts of this case are a graphic example of the tax avoidance that would be produced by the rule the Trust seeks here.

During the tax years at issue, Ms. Kaestner expressed alarm to her trustee, Mr. Bernstein, about the number of expensive lawyers who were working to optimize her trust arrangements. N.C. R. p. 225. Mr. Bernstein reassured her that the legal fees would be "immaterial compared to the major tax savings" that the lawyering would achieve. N.C. R. p. 225.

If the Trust prevailed here, that outcome would prove Mr. Bernstein right.

As noted above, the predecessor of the Kaestner Trust, the Rice Family Trust, used a Florida trustee for

a decade.[15] Florida has no income tax, so the trust avoided state income taxes in Florida during those years.

In 2005, the Florida trustee was replaced by a Connecticut trustee, Mr. Bernstein. Pet. App. 2a. Connecticut does not tax trust income based on a trustee's residency alone.[16] Thus, the Rice Family Trust avoided state taxes in Connecticut as well.

Having avoided taxes in Connecticut, Mr. Bernstein then challenged New York's jurisdiction to tax the Rice Family Trust's income. He invoked the Due Process Clause, arguing that the trust lacked sufficient connections to New York. App. 76–79. On that basis, the trust avoided any residency-based taxes in the Empire State. Instead, it reported only $2,165 in income from New York sources—less than 0.1% of the trust's income that year. App. 76–79.

In North Carolina, in contrast, the Kaestner Trust faced a more significant challenge to its tax-avoidance efforts. North Carolina assessed income taxes on the Trust, because the Trust's beneficiaries lived in North Carolina and had access to extensive state services. *See supra* pp. 34–36.

To resist those taxes, the Trust filed this lawsuit. Although Mr. Bernstein had argued a few years earlier that the Trust's predecessor had insufficient

---

[15] Mr. Matteson, the original trustee, moved to Florida in 1995. App. 11.

[16] *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i).

connections with New York, he argued to the North Carolina courts that the Kaestner Trust was "a trust with a situs in New York." App. 9.

Those tactics, so far, have enabled the Kaestner Trust and its predecessor to avoid state income taxes on virtually all of their income during the years described above.

During these years of maneuvering, there was one constant: North Carolina remained home to Ms. Kaestner, the beneficiary of the trust that bears her name.

If the Trust prevails here, it will have benefitted from Ms. Kaestner's consumption of North Carolina's services for years, yet will have avoided paying any trust-income taxes to fund those services. That outcome would clash with the "traditional notions of fair play and substantial justice" that shape modern analysis under the Due Process Clause. *International Shoe*, 326 U.S. at 320.

CONCLUSION

The state supreme court's decision should be reversed.

Respectfully submitted,

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
RYAN Y. PARK
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

February 22, 2019

No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

ON WRIT OF CERTIORARI TO
THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE RESPONDENT

THOMAS DEAN MYRICK
MOORE & VAN ALLEN PLLC
100 North Tryon Street
Charlotte, N.C. 28202
704-331-1126
tommyrick@mvalaw.com

DAVID A. O'NEIL
Counsel of Record
ANNA A. MOODY
LAURA E. O'NEILL
DEBEVOISE & PLIMPTON LLP
801 Pennsylvania Ave. N.W.
Washington, D.C.
(202) 383-8000
daoneil@debevoise.com

Counsel for Respondent

QUESTION PRESENTED

May a State assert jurisdiction over a nonresident trustee based solely on the fact that a contingent beneficiary resides in that State?

TABLE OF CONTENTS

QUESTION PRESENTED.. i

TABLE OF AUTHORITIES......................................vi

INTRODUCTION...1

STATEMENT OF THE CASE 2

I. THE TRUSTEE OWNED AND CONTROLLED THE TRUST PROPERTY, AND THE BENEFICIARIES HAD NO VESTED RIGHT TO TRUST ASSETS................2

A. The Agreement Between the Settlor and Trustee Granted the Trustee Absolute Discretion over the Trust Property 3

B. The Beneficiaries Did Not Own or Control the Assets and Were Not Guaranteed Ever to Receive a Distribution 3

II. THE TRUSTEE HAD NO CONTACTS WITH NORTH CAROLINA 5

A. The Trust Agreement, Trust Property, Settlor, and Trustees Had No North Carolina Contacts...5

B. The Trustee and Trust Property Had No Contacts with North Carolina as a Result of the Beneficiary's Residence.............7

III. NORTH CAROLINA TAXED THE TRUSTEE ON ALL OF THE TRUST INCOME, AND ALL OF THE NORTH CAROLINA COURTS HELD THE TAX UNCONSTITUTIONAL.......................................9

SUMMARY OF ARGUMENT..................................11

ARGUMENT 16

I. THIS COURT'S DECISIONS RESOLVE THIS CASE AND COMPEL THE HOLDING BELOW...16

A. *Safe Deposit* and Its Corollary Decisions Invalidate the North Carolina Tax...16

1. This Court has rejected the tax North Carolina imposed 16

2. *Safe Deposit* is part of a fair, principled, and practical due process framework 20

B. *Hanson v. Denckla* Confirms the *Safe Deposit* Result and Resolves this Case 23

1. *Hanson* rejected jurisdiction over a trustee based on the residence of a beneficiary..24

2. *Hanson* is materially indistinguishable 27

II. DUE PROCESS PRINCIPLES COMPEL THE DECISION BELOW AND REFUTE THE STATE'S JURISDICTIONAL THEORIES 31

A. The State Cannot Show the Minimum Connection or Rational Relationship Necessary to Assert Jurisdiction 31

1. Jurisdiction depends on the contacts of the taxpayer with the State and cannot rest solely on the

taxpayer's relationship with a forum resident 32

2. There are no minimum contacts between the trustee and North Carolina 33

3. There is no rational relationship between the taxed income and North Carolina's fiscal values 35

B. The Contacts of Any "Trust Constituent" Are Not Attributable to Everyone Else in the Trust Relationship..35

1. The beneficiary and trustee are not agents, and the beneficiary does not represent the trust property....................36

2. This Court's decisions in the trust context focus on the contacts of the person over whom the State asserts jurisdiction 38

3. North Carolina law treats beneficiary and trustee as separate and distinct entities 41

C. The State Cannot Assert Jurisdiction over the Trustee on the Basis of Public Services Provided to a Beneficiary 44

D. A Fiduciary Relationship with a Forum Resident Does Not Constitute Purposeful Availment by the Trustee 47

III. NORTH CAROLINA DOES NOT ACQUIRE JURISDICTION BECAUSE IT DISAGREES WITH THE TAX POLICY OF OTHER STATES 49

A. States Have Ample Means of Taxing Trust Income Undisturbed by the Decision Below 50

B. Differences in Tax Policy Are a Consequence of Federalism and Do Not Expand North Carolina's Jurisdiction 53

C. *Wayfair* Is Not Relevant 56

CONCLUSION 57

TABLE OF AUTHORITIES

CASES

Americold Realty Tr. v. Conagra Foods, Inc., 136 S. Ct. 1012 (2016) 30, 36, 41

Asahi Metal Industry Co., Ltd. v. Superior Ct., 480 U.S. 102 (1987) 30

Bristol-Myers Squibb Co. v. Superior Court, 137 S. Ct. 1773 (2017) 30, 33, 54

Brooke v. City of Norfolk, 277 U.S. 27 (1928) .... *passim*

Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985) .... *passim*

Commissioner v. Newman, 159 F.2d 848 (2d Cir. 1947) 56

Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787 (2015) 19

Daimler AG v. Bauman, 571 U.S. 117 (2014) 35

Fidelity & Columbia Tr. Co. v. City of Louisville, 245 U.S. 54 (1917) 19

Giaccio v. Pennsylvania, 382 U.S. 399 (1966) 28

Goodyear Dunlop Tires Operations, S.A. v. Brown, 564 U.S. 915 (2011) 30, 33

Greenough v. Tax Assessors of Newport, 331 U.S. 486 (1947) .... *passim*

Guaranty Tr. Co. v. Virginia, 305 U.S. 19 (1938) 21, 22

TABLE OF AUTHORITIES—Continued

Hanson v. Denckla,
357 U.S. 235 (1958)....................................*passim*

Haynes v. Haynes,
72 A.D.3d 535 (N.Y. App. Div. 2010).................. 5

Helicopteros Nacionales de Colombia, S.A. v. Hall, 466 U.S. 408 (1984).................................. 33

Ins. Corp. of Ir., Ltd. v. Compagnie des Bauxites de Guinee, 456 U.S. 694 (1982)......... 30

International Shoe Co. v. Washington,
326 U.S. 310 (1945)....................................*passim*

J. McIntyre Machinery Ltd. v. Nicastro,
564 U.S. 873 (2011)............................... 28, 30, 31

Keeton v. Hustler Magazine, Inc.,
465 U.S. 770 (1984)..................................... 32, 55

Kulko v. Superior Court,
436 U.S. 84 (1978)................................. 31, 44, 45

Lawrence v. State Tax Commission,
286 U.S. 276 (1932)..................................... 21, 51

Maguire v. Trefry,
253 U.S. 12 (1920)... 21

Miller Bros. Co. v. Maryland,
347 U.S. 340 (1954)... 23

Navarro Sav. Ass'n v. Lee,
446 U.S. 458 (1980)... 41

New York ex rel. Cohn v. Graves,
300 U.S. 308 (1937)... 21

Polar Tankers, Inc. v. City of Valdez,
557 U.S. 1 (2009)... 29

TABLE OF AUTHORITIES—Continued

Quill Corp. v. North Dakota,
504 U.S. 298 (1992)....................................*passim*

Raymond Loubier Irrevocable Tr. v. Loubier,
858 F.3d 719 (2d Cir. 2017) 30, 37

Rush v. Savchuk,
444 U.S. 320 (1980).. 49

Sabine v. Gill,
51 S.E.2d 1 (N.C. 1948)............................... 43, 45

Safe Deposit & Tr. Co. v. Virginia,
280 U.S. 83 (1929)......................................*passim*

Shaffer v. Heitner,
433 U.S. 186 (1977)....................................*passim*

South Dakota v. Wayfair, Inc.,
138 S. Ct. 2080 (2018)........................... 28, 56, 57

St. Louis v. Ferry Co.,
78 U.S. (11 Wall.) 423 (1870)............................ 28

Stone v. White,
301 U.S. 532 (1937)..................................... 40, 41

Walden v. Fiore,
571 U.S. 277 (2014)....................................*passim*

Wisconsin v. J.C. Penney Co.,
311 U.S. 435 (1940).. 35

World-Wide Volkswagen Corp. v. Woodson,
444 U.S. 286 (1980)......................... 30, 44, 45, 54

CONSTITUTIONAL PROVISIONS

U.S. Const. amend. XIV, § 1 ....*passim*

U.S. Const. art. 1, § 8, Cl. 3...................... 10, 19, 56

TABLE OF AUTHORITIES—Continued

STATUTES

26 U.S.C.A. § 671 51

26 U.S.C.A. § 676 51

26 U.S.C.A. § 678 51

Ariz. Rev. Stat. Ann. § 43-1301 51

Ark. Code Ann. § 26-51-203 51

Cal. Rev. & Tax. Code § 17742 .... 51, 52

Cal. Rev. & Tax. Code § 17745 52

Colo. Rev. Stat. § 39-22-103 51

Ga. Code Ann. § 48-7-22(a)(1)(C) 52

H.B. 209, 2006 Leg., Reg. Sess. (Fla. 2006) 55

H.R. 534, 110th Gen. Assemb., Reg. Sess. (Tenn. 2017) 52

H.R. 675, 124th Gen. Assemb., Reg. Sess. (Ohio 2002) 55

Me. Stat. tit. 36, § 5163 51

Me. Stat. tit. 36, § 5175-A 51

Mich. Comp. Laws § 206.110 51

N.C. Gen. Stat. § 58-1-5 43

N.C. Gen. Stat. § 36C-1-103 43

N.C. Gen. Stat. § 36C-2-202 42

N.C. Gen. Stat. § 36C-2-203 42

N.C. Gen. Stat. § 36C-5-504 42

N.C. Gen. Stat. § 36C-8-811 41

TABLE OF AUTHORITIES—Continued

N.C. Gen. Stat. § 36C-8-813 42

N.C. Gen. Stat. § 36C-8-815 41

N.C. Gen. Stat. § 36C-8-816 42

N.C. Gen. Stat. § 105-160.2 .... 9, 29, 43

N.Y. Est. Power & Tr. Law § 10-6.6 5

N.Y. Tax Law § 612 52

61 Pa. Code § 105.5(c) 52

R.I. Gen. Laws § 44-30-16 51

R.I. Gen. Laws § 44-30-35 51

S.C. Code Ann. § 12-6-30 51

Tenn. Code § 67-2-110 52

Unif. Tr. Code § 816 37

OTHER AUTHORITIES

Austin W. Scott, William F. Fratcher & Mark L. Ascher, *Scott & Ascher on Trusts* (5th ed. 2007) 36, 37, 38, 42

Cal. Franchise Tax Bd., Technical Advice Mem. 2006-2002 (Feb. 17, 2016) 52

George Gleason Bogert et al., *The Law of Trusts and Trustees* (2018) 37

Initiative Measure No. 1098, Sec'y of State of Wash. (Apr. 27, 2010) 55

Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* (2019) 50

TABLE OF AUTHORITIES—Continued

Key Industries in North Carolina – Business & Financial Services, North Carolina Dep't of Commerce (March 14, 2019) 54

Restatement (Second) of Conflict of Laws (Am. Law Inst. 1971) 42

Restatement (Third) of Trusts (Am. Law Inst. 2003) ....*passim*

INTRODUCTION

This case concerns North Carolina's attempt to exercise jurisdiction over a person with whom it has no contacts. That person, a nonresident trustee, did not engage in any conduct purposefully availing himself of North Carolina, and the State disavows any argument to the contrary. Instead, the State seeks to base jurisdiction on a single fact: that a different person, a contingent trust beneficiary, happened to reside there.

Relying on that fact alone, the State taxed the nonresident trustee on the worldwide income of the trust property. The State imposed that tax even though the beneficiary was unaware of the trust for most of its existence, did not meet the trustee until halfway through the four-year tax period, and neither received nor was entitled to any trust income during the years involved.

All of the North Carolina courts rejected the State's assertion of power as a violation of fundamental principles of due process. Those decisions are correct and should be affirmed.

This Court has twice addressed and resolved the question presented, including in the foundational case of *Hanson v. Denckla*, 357 U.S. 235 (1958). There, the Court held that a State may not assert jurisdiction over a nonresident trustee based solely on the fact of a beneficiary's forum residence. That case resolves this one. The same result follows from the core principles this Court has applied in evaluating due process limits on state jurisdiction under *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

The State asks the Court to ignore the precedents that govern this case. Instead, the State justifies its jurisdictional overreach with exaggerated and misplaced policy concerns about the impact of the decision below on tax revenues. In reality, States have ample means of taxing trust income in ways that the decision below does not affect. At issue here is a highly unusual tactic that very few States have even attempted.

Ultimately, North Carolina's grievance is not that the States lack constitutional power to tax, but rather that the States with constitutional power to tax have chosen not to exercise it. That disagreement with the policy decisions of voters in other States does not grant North Carolina license to expand its jurisdiction beyond settled constitutional bounds.

STATEMENT OF THE CASE

I. THE TRUSTEE OWNED AND CONTROLLED THE TRUST PROPERTY, AND THE BENEFICIARIES HAD NO VESTED RIGHT TO TRUST ASSETS

The trust in this case was created in 1992 by a written agreement between a New York settlor and a New York trustee. The agreement granted the trustee ownership of the trust property and absolute discretion to control all trust matters, including investments and distributions. The beneficiaries were third parties to that agreement, with no present right to trust income or principal nor any guarantee that they would ever receive either.

A. The Agreement Between the Settlor and Trustee Granted the Trustee Absolute Discretion over the Trust Property

The settlor established the trust when he executed an agreement with the trustee "assign[ing], transfer[ring], and convey[ing] to the trustee" all of the trust property. App. 45. A non-grantor trust in the traditional common law model, the trust was "irrevocable and unamendable by the Settlor." Art. 10, App. 69. The settlor retained no control over the transferred assets.

Instead, the agreement bestowed "absolute discretion" over the administration and disposition of the trust property on the trustee. Art. 1 §§ 1.1, 1.2, 1.4, App. 45–46, 50–51. The trustee was empowered to "do all such acts, take all such proceedings and exercise all such rights and privileges . . . with respect to any such property, as if the absolute owner thereof and in connection therewith to make, execute and deliver any instruments and to enter into any covenants or agreements binding any trust hereunder." Art. 5 § 5.2(r), App. 60. Under the agreement, the trustee would make distributions of assets only "as the Trustee in the Trustee's absolute discretion may from time to time determine." Art. 1 § 1.1, App. 46. The trustee was also entitled to terminate the trust "at any time in [his] discretion." Art. 2, App. 51–52.

B. The Beneficiaries Did Not Own or Control the Assets and Were Not Guaranteed Ever to Receive a Distribution

The trust agreement conferred no property or authority on the beneficiaries, who were defined only as "a class of persons consisting of the Settlor's

descendants, whenever born." Art. 1 § 1.1(a), App. 45. In addition to that class of contingent primary beneficiaries, the trust identified as secondary beneficiaries the settlor's spouse and sister. App. 52.

Because the trustee had sole and absolute discretion over trust administration, the beneficiaries could not compel distributions of any income or principal for any reason, including for financial support or for their health, education, or welfare. Art. 1, App. 44–46, 51. To guide the trustee's discretion, the trust agreement identified certain milestones that might warrant distributions, Art. 1 § 1.4, App. 50–51, but the power to make decisions about when, whether, and how to distribute trust property remained solely with the trustee. *Id.*

The trust agreement explicitly prohibited the beneficiaries from alienating or assigning trust property. Art. 12, App. 70–71. The beneficiaries' creditors could not reach trust assets, even upon the death of the beneficiaries, because the trust agreement prevented a beneficiary from appointing the balance of her interest to her estate creditors prior to termination. Art. 1 § 1.2(c)(2)(i), App. 47–48. The beneficiaries were not provided the right to influence, or even to receive notice of, investment decisions.

Any particular contingent beneficiary, moreover, was not guaranteed ever to receive any funds from the trust. The trustee was specifically empowered to pay some or all trust property to any one member of the contingent beneficiary class to "the exclusion of other [beneficiaries] in such manner as the Trustee may deem advisable." Art. 1 § 1.4, App. 50. Thus, although the trust contemplated distribution of

assets to each of the settlor's descendants as they reached age 40, Art. 1, § 1.2(c)(1), App. 47, by that time the trustee could have distributed the entire trust to other beneficiaries. In addition, New York law permitted the trustee to exercise his discretion not to distribute on the beneficiary's fortieth birthday and instead to decant the assets into a new trust without the termination provision. N.Y. Est. Power & Tr. Law § 10-6.6(b); App. 96.

Ultimately, the contingent beneficiaries' only right with respect to the trust property was standing to sue. If a beneficiary disagreed with the trustee's decisions, she could bring an equitable action in New York alleging that the trustee abused his discretion. Restatement (Third) of Trusts § 50 (Am. Law Inst. 2003) ("A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee."). Such a suit would face a formidable standard, requiring a showing of "abuses that are arbitrary or the result of bad faith." *Haynes v. Haynes*, 900 N.Y.S. 2d 22, 22 (N.Y. App. Div. 2010).

II. THE TRUSTEE HAD NO CONTACTS WITH NORTH CAROLINA

From its creation, the trust agreement and property had nothing to do with North Carolina. The trustee had no connection with that State, before or after the contingent beneficiary moved there.

A. The Trust Agreement, Trust Property, Settlor, and Trustees Had No North Carolina Contacts

The settlor and initial trustee were both residents and domiciliaries of New York. App. 39. They

executed the trust agreement in New York, App. 75, and specified that it was subject to New York law. Art. 10, App. 69.

None of the trust property was located in North Carolina, and none of the trust income was derived directly from a North Carolina source. App. 41–42. The trust assets did not include any real property, in North Carolina or elsewhere. App. 41. The custodian of the trust assets was located in Massachusetts. *Id.* Other ownership documents and records were kept in New York. *Id.*

The initial trustee moved to Florida in 1995 and continued to administer the trust until he retired in 2005. App. 39. The settlor then appointed as trustee David Bernstein, who remained in that position during the relevant period. App. 39–41. Bernstein, who paid the tax at issue, was a resident and domiciliary of Connecticut when the settlor appointed him and throughout the relevant tax years. App. 40–41.[1]

---

[1] The trust agreement contemplated an initial term of 10 years, after which the trustee would divide the trust into separate shares for each of the settlor's then-living children, or if deceased, the children's then-living descendants. Art. 1 §§ 1.1, 1.2, App. 45–46. In 2002, the initial trustee informally divided the trust into three separate sub-trusts. App. 91. Bernstein formalized the division into separate trusts, including the named respondent here. App. 92. The same trust agreement continued to govern. Art. 1 § 1.2, App. 46.

B. The Trustee and Trust Property Had No Contacts with North Carolina as a Result of the Beneficiary's Residence

In 1997, five years after the trust's creation, one of the settlor's children, Kimberley Kaestner, moved to North Carolina. App. 11. During the tax years at issue, Ms. Kaestner, a contingent beneficiary, lived with her family in that State. *Id.*

For 10 years after she moved to North Carolina, and for the first 15 years the trust existed, Ms. Kaestner had no contact at all with the trustee. App. 84–86. The initial trustee and Ms. Kaestner were literal strangers; they never met or interacted. App. 83. Indeed, Ms. Kaestner did not even know that the trust existed when she moved to North Carolina. App. 84. She did not learn about the trust until nearly a decade later, in 2006—the second of the four tax years at issue—and her first meeting with Bernstein about the trust was not until 2007 in New York. App. 121, 106–07.

For the rest of the tax period, the trustee's interactions with Ms. Kaestner were "very infrequent[]." App. 127. He did not regularly inform her about the trust's performance, nor did he send her annual or quarterly reports about its status. *Id.*

There is no support for the State's incorrect assertion that the trustee "administered the Trust to satisfy Ms. Kaestner's needs." Pet. Br. 8.[2] In fact,

---

[2] The State mischaracterizes the record in several respects to portray inaccurately the interactions between trustee and beneficiary. It states, for example, that the trustee met with Ms. Kaestner "[o]n at least two occasions." Pet. Br. 8. As the North Carolina Supreme Court explained, "[t]he undisputed *(continued)*

the trustee met with Ms. Kaestner only twice: once in 2007 and once in 2008. App. 106–07. Both meetings took place in New York and consisted of purely informational reports to educate Ms. Kaestner about the trust. App. 103–04. At no point did the trustee seek or accept investment input from Ms. Kaestner or any other beneficiary. App. 42. The trustee had no further meetings with the beneficiary during the tax years and, until this suit was filed, never traveled to North Carolina in his trustee capacity. App. 106–07.

Before Ms. Kaestner turned 40 in June 2009, after the tax years in dispute, the trustee exercised his discretion under New York law to decant the trust property into a new trust rather than distribute the assets. App. 96–97.

The trustee never distributed any of the trust income at issue here to Ms. Kaestner or any other North Carolina beneficiary during the tax period. App. 43.

---

evidence in the record shows that contact between Bernstein and Kaestner regarding administration of the trust was infrequent—consisting of only two meetings during the tax years in question." Pet. App. 17(a).

Similarly, the State incorrectly asserts that the trustee made a loan to Ms. Kaester "[n]ear the end of the tax years at issue." Pet. Br. 36. As the North Carolina Supreme Court noted, that loan was made in 2009, after the tax period. Pet. App. 3(a). That court correctly concluded that "[a]ny connection between plaintiff and North Carolina based on the loan is . . . irrelevant given that the loan was issued in January 2009, after the tax years at issue." Pet. App. 17(a); *see also* App. 113 (noting that the loan was in 2009).

III. NORTH CAROLINA TAXED THE TRUSTEE ON ALL OF THE TRUST INCOME, AND ALL OF THE NORTH CAROLINA COURTS HELD THE TAX UNCONSTITUTIONAL

North Carolina taxed the trustee on the worldwide income of the trust for the years 2005 to 2008, even though none of that income had been generated in North Carolina or received by a North Carolina resident. The sole basis for the tax was the fact that a contingent trust beneficiary lived there during those years, triggering a statute requiring "the fiduciary responsible for administering the . . . trust [to] pay" tax on the income of the trust property "that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105–160.2 (2017).

The trustee paid under protest and then brought suit in the name of the trust challenging the constitutionality of the tax. All of the North Carolina courts held that the tax violated both the Due Process Clause of the Fourteenth Amendment and the North Carolina Constitution.

The North Carolina Business Court invalidated the tax primarily on the basis of *Quill*, 504 U.S. 298, and the minimum-contacts analysis that case prescribes. The court noted the State's agreement that "the only connection" supporting the tax "is the residence of the beneficiaries." Pet. App. 54a. Premising jurisdiction on that single fact, the court reasoned, failed for a number of reasons. That theory contradicted the fundamental principle that "[t]he focus of the due process inquiry must be on the entity being called upon to pay taxes," *id.* at 51a, and instead "conflat[ed] the beneficiaries' contact[s]" with those of the taxpayer. *Id.* at 54a. Moreover, the

court noted, the State's argument "ignores the undisputed facts that [the beneficiaries] had no control over [trust] assets or ability to generate income from those assets, and had no authority to compel [the trustee] to distribute income." *Id.* at 55a.

The court therefore concluded that the State lacked the minimum connection necessary to justify the tax. The court further held that *Quill* invalidated the tax for the similar reason that the taxed income bore no rational relationship with the State. *Id.* at 58a. In addition, the court reasoned that the tax failed Commerce Clause scrutiny on multiple grounds, including that "the mere presence of the beneficiaries" was not a "substantial nexus" with that State for a tax on undistributed trust income. *Id.* at 65a, 67a–68a.

The Court of Appeals unanimously affirmed the Business Court, concluding that "North Carolina did not demonstrate the minimum contacts necessary to satisfy the principles of due process." Pet. App. 27a. That conclusion rested on the same observations that drove the Business Court's holding and on this Court's decisions addressing due process limits on taxation of trust income. *Id.* at 38a–40a. The Court of Appeals deemed it unnecessary to reach the Commerce Clause.

The North Carolina Supreme Court affirmed. Like the lower courts, that court considered whether the State could tax the trust income "solely based on the North Carolina residence of the beneficiaries during the tax years." Pet. App. 2a. The court reasoned that, under *Quill*'s requirement of a "minimum connection[—]more commonly referred to as minimum contacts"—the taxpayer's "minimum

contacts with the taxing state cannot be established by a third party's" actions. *Id.* at 10a, 13a. Applying this Court's cases elaborating on due process guarantees, the North Carolina Supreme Court concluded that "[w]hen, as here, the income of a foreign trust is subject to taxation solely based on its beneficiaries availing themselves of the benefits of our economy and the protections afforded by our laws, those guarantees are violated." *Id.* at 18a.

One justice dissented. Even that justice, however, did not adopt the State's argument that the fact of a beneficiary's residence alone supports jurisdiction. Instead, the dissenting justice agreed that the "proper due process analysis focuse[s] upon the activities of" the trustee in light of the beneficiary's residence, which is "relevant, but not dispositive." Pet. App. 24a–25a & n.2. Thus, not a single judge in the North Carolina system who reviewed this case agreed with the State's position.

The State sought certiorari limited to the "narrow question" of whether the challenged tax is justified based "solely on the presence of an in-state beneficiary." Pet. Rep. in Supp. of Cert. 6–7 ("[T]his case is an ideal vehicle: It presents the beneficiary's in-state residency in clean form, allowing the Court to resolve the question presented without the need to consider other types of jurisdictional contacts.").

SUMMARY OF ARGUMENT

North Carolina's exercise of jurisdiction over a nonresident trustee with no connection to the State, based solely on the fact that a contingent beneficiary lived there, violates the Due Process Clause.

I. This Court has twice addressed and decided the question presented, and those precedents control here.

A. As part of a series of decisions on the constitutional limits of trust taxation, this Court held that the State where a beneficiary resided could not, on that basis alone, tax a nonresident trustee on trust property the resident beneficiary neither received nor controlled. *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83 (1929). That decision rested on practical considerations of actual control and ownership, and it aligns with the principles of fundamental fairness that animate contemporary due process cases. The State's effort to dismiss *Safe Deposit* as based on the physical location of the taxed property mischaracterizes its reasoning and ignores its central place in a principled, practical, and fair framework for defining the outer bounds of state jurisdiction to tax trust property.

B. This Court reached the same conclusion in *Hanson v. Denckla*, 357 U.S. 235 (1958), a pillar of due process jurisprudence. In *Hanson*, the Court held that a State may not assert jurisdiction over a nonresident trustee based solely on the forum residence of beneficiaries. Focusing on the trustee's own actions, the Court articulated the requirement of "purposeful availment" that remains the constitutional touchstone. The Court specifically refused to attribute a beneficiary's forum contacts to the trustee, reasoning that "[t]he unilateral activity of those who claim some relationship with a nonresident . . . cannot satisfy the requirement of contact with the forum State." *Id.* at 253.

Hanson is not distinguishable in any material respect. There is no practical difference between asserting jurisdiction over the trust property and asserting jurisdiction over the trustee who owns the trust property. And state jurisdiction to tax is informed by the same principles governing jurisdiction to adjudicate. *Hanson*'s reasoning and result control this case, and unless this Court repudiates both, North Carolina cannot prevail here.

II. The due process principles elaborated in this Court's subsequent decisions confirm the holding of *Safe Deposit* and *Hanson* and invalidate the North Carolina tax.

A. Due process requires minimum contacts between the State and the taxpayer and a rational relationship between the tax and fiscal values connected to the State. *Quill*, 504 U.S. 298.

Under this Court's decisions, the focus of the minimum-contacts inquiry must be the taxpayer's own conduct. The State does not argue that the taxpayer engaged in any conduct by which he purposefully availed himself of North Carolina. Instead, the State supports jurisdiction solely by pointing to a different person's conduct—the decision of a contingent trust beneficiary to live there. That argument fails: a nonresident's relationship with a forum resident, without more, cannot establish the necessary minimum connection. Similarly, taxing the trustee for the worldwide income of the trust based on the possibility that a contingent beneficiary might someday receive it in North Carolina does not qualify as the rational fiscal relationship that *Quill* requires.

B. The State principally contends that the forum contacts of any one "trust constituent" are attributable to anyone else in the trust relationship, including the trustee. But this Court's precedent and the distinct roles of trustees and beneficiaries under basic tenets of trust law foreclose the State's effort to fuse them for jurisdictional purposes. And what the State decries as the "separateness theory" of trust constituents is a consequence of North Carolina's own law, which treats the trustee and beneficiary as independent actors who cannot bind one another.

C. Jurisdiction over the trustee cannot rest on the ground that the State provided public services to the beneficiary. This Court has previously rejected that argument, which, like the State's main theory, focuses on the wrong party and does not show that the *trustee* purposefully availed himself of the forum.

The argument also assumes facts that are not true. The State claims that the beneficiary consumed state resources without paying taxes in return, but in fact, she did pay taxes on all income she had actually received and enjoyed during the tax years. She had not received—and might never have received—income of a trust she did not control and did not know existed, and there is no basis to treat that income as if it were hers. Similarly, the State asserts that the protections it provided the beneficiary spared the trustee from having to furnish equivalent services. In truth, the trustee had no obligation to provide the beneficiary anything in the tax years other than the good-faith exercise of his absolute discretion.

The State's public-benefits argument is boundless. It would permit jurisdiction over the trustee not just

in any State where a contingent beneficiary resides, but also in any State that, because the beneficiary spent time there, could claim to have provided her the interim protections of its laws.

D. The existence of a fiduciary relationship with a forum resident does not create jurisdiction over the trustee wherever any beneficiary decides to move. This Court has repeatedly held that assuming a role with fiduciary obligations to a resident does not constitute purposeful availment. The circumstances of this case demonstrate why the State's argument is incorrect. The trustee and beneficiary were literal strangers for the first 15 years of the trust's existence, and their interactions thereafter were "very infrequent[.]" App. 127.

III. Misplaced policy concerns about the impact of the decision below on state tax revenues do not justify the State's jurisdictional overreach. Those concerns are greatly exaggerated. States have ample means of taxing trust income unaffected by the ruling below. States make individual decisions about whether to tax trust income within their jurisdiction, and those choices reflect considered judgments about tax policy. Limits on state jurisdiction are a consequence of federalism, which promotes and respects the sovereign right of each State to set its tax policy without interference from other States that lack a legitimate interest. North Carolina's jurisdiction does not expand because it disagrees with the policy choices of other States to refrain from exercising their constitutional power.

ARGUMENT

I. THIS COURT'S DECISIONS RESOLVE THIS CASE AND COMPEL THE HOLDING BELOW

This Court's decisions foreclose North Carolina's attempt to exercise jurisdiction over a taxpayer with no forum contacts. Cases decided specifically in the context of trust taxation have already addressed and rejected the State's position. And the foundational minimum-contacts case of *Hanson v. Denckla* confirms the correctness of the Court's previous decisions in the *International Shoe* framework.

A. *Safe Deposit* and Its Corollary Decisions Invalidate the North Carolina Tax

The Court has resolved the question presented as part of a series of decisions that establish common-sense and fair due process limits on trust taxation. Under those decisions, a State may tax a resident trustee for property he owns, and it may tax a resident beneficiary for property she receives or controls. A State may not, however, tax a nonresident trustee for no reason other than the residence in the State of a beneficiary who has not received and lacks possession or control of the trust property.

1. This Court has rejected the tax North Carolina imposed

In *Brooke v. City of Norfolk*, 277 U.S. 27 (1928), this Court considered whether a State may tax a resident beneficiary on the assets of an out-of-state trust. The trust was created by the will of a Maryland citizen conveying the trust property to a Maryland trustee for the benefit of the Virginia-resident petitioner and her descendants. The petitioner had paid Virginia "without question a tax

upon the income received by her," but she challenged Virginia's power to tax her for the undistributed Maryland trust property. *Id.* at 28.

The Court held the tax unconstitutional on the basis of fundamental principles of fairness. The premise of the attempted tax, the Court observed, was "that the petitioner is chargeable as if she owned the whole" trust, and not just the income she actually received. *Id.* Rejecting that premise, the Court contrasted the petitioner's situation with that of a taxpayer who "actually us[ed]" the property. *Id.* at 29. Here, the Court explained, "the property is not within the State, does not belong to the petitioner and is not within her possession or control. The assessment is a bare proposition to make the petitioner pay upon an interest to which she is a stranger. This cannot be done." *Id.*

One year later, the Court addressed the corollary question to *Brooke*, which is also the question presented in this case: If the State may not tax a resident beneficiary on undistributed out-of-state trust property, may the State tax an out-of-state trustee on the sole ground that the beneficiary is a resident? Considering the same realities of actual control and ownership underlying *Brooke*, the Court held that such a tax offends due process. *Safe Deposit*, 280 U.S. 83.

The trust property in *Safe Deposit* was held by a Maryland trustee for the benefit of the settlor's two Virginia-resident sons. Under the trust agreement, the trustee was to own the property until distribution of half of the assets to each son as he reached 25. Although neither son had yet received any distribu-

tions, Virginia taxed the Maryland trustee based on the fact of the beneficiaries' Virginia residence.

This Court invalidated the Virginia tax on the trustee as a violation of the Due Process Clause, focusing on the practical realities of the trust relationship. Under the doctrine that intangible property follows its owner, the Court reasoned, Virginia could as a general matter assert jurisdiction over trust property even though it was located outside the State's territorial borders. That general rule applied, however, only if it aligned with reality—only if, as the State contended, the beneficiaries "really owned the [trust] fund." *Id.* at 91.

In truth, the Court recognized, the State's argument "plainly conflict[ed] with fact"; the beneficiaries did not own the trust assets and "no person in Virginia ha[d] present right to their enjoyment or power to remove them." *Id.* at 92. Because "nobody within Virginia ha[d] present right to their control or possession, or to receive income therefrom, or to cause them to be brought physically within her borders," the Court held that Virginia lacked jurisdiction to tax the trust assets through the nonresident trustee. *Id.* at 91.

The Court distinguished previous cases that had permitted taxation by highlighting practical differences in true ownership and control. In those other cases, the Court reasoned, the resident had either "full power to control the deposits" or "control and present right to all benefits arising from the property"; "[t]he legal title was not held by another with the duty to retain possession, as in the present cause." *Id.* at 94. The Court thus concluded that taxation of a nonresident trustee based solely on the

forum residence of a beneficiary "would result in inescapable and patent injustice," violating the principles of fairness the Due Process Clause protects. *Id.* at 92.[3]

As this description illustrates, there is no merit to Petitioner's effort to dismiss *Safe Deposit* as beholden to a "rigid" *Pennoyer*–based rule of "physical presence." Pet. Br. 27–28. *Safe Deposit* relied on the same "traditional notions of fair play and substantial justice" that continue to animate due process jurisprudence. The Court did *not* reject Virginia's exercise of jurisdiction because the trust property was physically located outside of the State's border. Quite the contrary, the Court noted that it could—and ordinarily would—uphold jurisdiction based on the intangibles-follow-the-owner fiction even though the property was not physically present

[3] The State seizes on references in *Safe Deposit* to "double taxation" in an effort to cast that decision as resting on outdated concerns. In fact, this Court had already held more than a decade before—in a case *Safe Deposit* specifically cited—that the Due Process Clause does not categorically forbid "double taxation." *See Fidelity & Columbia Tr. Co. v. City of Louisville*, 245 U.S. 54, 58 (1917) ("[L]iability to taxation in one State does not necessarily exclude liability in another.").

The Court's driving concern in *Safe Deposit* was instead that the attempted tax was "double and oppressive" because it would permit any State in which a beneficiary or trustee lived to tax the whole trust as a resident. That concern remains just as vital today and independently dooms the North Carolina tax under the Commerce Clause. *See Comptroller of the Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1795 (2015) (holding that the Constitution prohibits a state tax scheme that risks "double taxation of income earned out of the State" in a manner that disfavors interstate activity).

in the State. The Court rejected that fiction precisely because it "plainly conflict[ed] with fact": the beneficiaries did not really own the trust property, nor did they own, control, or actually receive any trust income.[4]

The State's characterization of *Safe Deposit*'s reasoning—that "once the Court decided that the trust property itself was not physically present in the State, the case was over"—is simply wrong. Pet. Br. at 27. In fact, the reasoning in *Safe Deposit* reflects the "highly realistic" approach that this Court has prescribed for due process inquiries. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 479 (1985).

2. *Safe Deposit* is part of a fair, principled, and practical due process framework

Brooke and *Safe Deposit* form part of a fairness-based framework for constitutional jurisdiction in the trust taxation context. Complementing those decisions, and completing the principles they established, is an additional pair of cases confirming that States may assert jurisdiction when doing so aligns with the reality of actual ownership and control of trust property.

[4] Similarly, there is no merit to *amicus*' argument that the result in *Safe Deposit* and *Brooke* depended on the particular type of tax involved. *See* Brief for Tax Law Professors at 16–18. In both cases, the Court concluded that the tax was unconstitutional because it attributed to the beneficiaries ownership of intangible property that was not actually theirs, and to which they were "a stranger." *Brooke*, 277 U.S. at 29. That rationale has nothing to do with whether the tax is on principal or instead on income.

First, in *Guaranty Trust Co. v. Virginia*, 305 U.S. 19 (1938), the Court held that Virginia could tax a resident beneficiary on income she actually received from an out-of-state trust. *Id.* at 23; *see also Maguire v. Trefry*, 253 U.S. 12 (1920). Rejecting the beneficiary's Due Process Clause challenge, the Court relied on decisions upholding taxes imposed on income to those who actually "recei[ved] and enjoy[ed]" it. *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932) (permitting taxes on "the economic interest realized by the receipt of income or represented by the power to control it"); *New York ex. rel. Cohn v. Graves*, 300 U.S. 308, 312 (1937) (noting that the petitioner actually "received" the taxed funds "as a part of her income in the tax years").

Second, in *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947), the Court upheld a tax on a resident trustee for trust property he legally owned. Although the beneficiary, the other trustee, and the records were elsewhere, the Court again focused on ownership and control, reasoning that the State could tax the resident trustee because "the intangibles are subject to [his] immediate control" and the State "offer[s] benefit and protection through its law to the resident trustee as the owner of intangibles." *Id.* at 493, 496. The Court cited and specifically distinguished *Safe Deposit* on the ground that, in that case, the trust assets were "actually in the hands of the nonresident trustee and not subject to the control" of the resident beneficiary. *Id.* at 496.

The State relies heavily on *Greenough*, attempting to portray it as a repudiation of *Safe Deposit* and a fundamental shift in reasoning. This, too, is a

mischaracterization. *Greenough* did not endorse a nebulous inquiry permitting the State to blend "the contacts of people in the trust relationship," such that the jurisdictional contacts of any one person in that relationship can be attributed to any other. Pet. Br. 28. To the contrary, *Greenough* followed the same path marked by *Brooke*, *Safe Deposit*, and *Guaranty Trust*, focusing on the particular person whom the State sought to tax and evaluating whether the realities of *that* person's circumstances supported jurisdiction. That focus remains a central requirement of due process. *See infra* pp. 32–33; *Walden v. Fiore*, 571 U.S. 277, 284 (2014) (forum contacts must be those of the "defendant *himself*"). In *Greenough*, the Court upheld jurisdiction because the person with forum contacts owned and controlled the property; in *Safe Deposit*, there was no jurisdiction because the person with forum contacts did not own or control the property.

Greenough and *Safe Deposit* are in harmony with one another and with *Brooke* and *Guaranty Trust*. Together, they establish an analytical construct consistent with first principles of fairness. A State may tax a resident beneficiary on income that she actually receives or controls (*Guaranty Trust*), and a State may tax a resident trustee on trust income that he owns and controls (*Greenough*). But a State may not tax a resident beneficiary on out-of-state trust income that she neither actually receives nor controls (*Brooke*), and, absent some other jurisdictional basis, a State may not tax a nonresident trustee for trust income that a resident beneficiary neither actually receives nor controls (*Safe Deposit*).

This framework, and particularly the holding of *Safe Deposit*, compelled the conclusion of every court to consider this case. Here, as in *Safe Deposit*, the State sought to tax the trust based solely on the residence of a beneficiary. As in *Safe Deposit*, the State relied on the beneficiary's forum contacts by arguing that the resident beneficiary "really own[s]" the trust property. *Safe Deposit*, 280 U.S. at 91. Here, as there, that argument "plainly conflicts with fact"; neither the beneficiary nor anyone else "within [the taxing State] ha[d] present right to [the funds'] control or possession" or "present right to their enjoyment." *Id.* at 91–92. Thus, as in *Safe Deposit*, the North Carolina tax is "unjust and oppressive," an effort to confiscate property over which the State has no constitutional jurisdiction. *Id.* at 93; *see Miller Bros. Co. v. Maryland*, 347 U.S. 340, 342 (1954) ("[S]eizure of property by the State under pretext of taxation when there is no jurisdiction or power to tax is simple confiscation and a denial of due process of law.").

B. *Hanson v. Denckla* Confirms the *Safe Deposit* Result and Resolves this Case

The outcome in *Safe Deposit* is confirmed by *Hanson v. Denckla*, 357 U.S. 235 (1958). The issue in that canonical due process case was whether a State could exercise jurisdiction over a nonresident trustee based on, among other things, the fact that the trust beneficiaries resided there. The Court held that the beneficiaries' residence in the State did not supply the minimum contacts necessary to sustain jurisdiction over the trustee.

1. *Hanson* rejected jurisdiction over a trustee based on the residence of a beneficiary

Hanson concerned a trust agreement executed in Delaware between a Pennsylvania-domiciled settlor and a Delaware trustee. The trustee was to provide income for life to the settlor as a beneficiary, with the remainder to be paid to other beneficiaries that the settlor designated. The settlor later moved to Florida, where she executed a power of appointment naming certain beneficiaries.

After the settlor's death, two of her children sued in Florida state court challenging the validity of the appointment. The beneficiaries, who were Florida residents, appeared as defendants, but the nonresident Delaware trustee was not served and did not appear. The defendants moved to dismiss on the ground that jurisdiction over the Delaware trustee would violate the Due Process Clause. The Florida courts rejected that contention and held the appointment invalid.

This Court reversed on the ground that Florida lacked jurisdiction over the trustee. The Court began by noting that, "[a]s technological progress has increased the flow of commerce between States, the need for jurisdiction over nonresidents has undergone a similar increase." *Id.* at 250–51. Nevertheless, the Court cautioned, "it is a mistake to assume that this trend heralds the eventual demise of all restrictions" on constitutional jurisdiction, and, even under the "flexible standard of *International Shoe*," the Court concluded that the trustee was not within the State's power. *Id.* at 251.

Whether jurisdiction is proper, the Court explained, depends on the existence of "minimal

contacts" with the trustee "that are a prerequisite to [the State's] exercise of power." *Id.* (internal citations omitted). The Court "fail[ed] to find such contacts in the circumstances of this case": The trustee "has no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in that State." *Id.* In addition, the Court observed, the trust was created "without any connection with the forum State": "The agreement was executed in Delaware by a trust company incorporated in that State and a settlor domiciled in Pennsylvania. The first relationship Florida had to the agreement was years later when the settlor became domiciled there, and the trustee remitted the trust income to her in that State." *Id.* at 252.

Throughout the analysis, the Court trained its focus on the trustee's own actions and conduct, rejecting efforts to attribute to the trustee forum contacts of other parties to the trust relationship. Thus, the Court noted that while the settlor and life beneficiary "carried on several bits of trust administration" in Florida, "the record discloses no instance in which the *trustee* performed any acts in Florida" that would support jurisdiction. *Id.* (emphasis added).

The Court similarly rejected the contention that Florida acquired jurisdiction over the trustee because the settlor and life beneficiary exercised the power of appointment in that State. It was specifically in this context that the Court articulated what is now a hallmark principle of due process:

> The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State. The application of that rule will vary with the quality and nature of the defendant's activity, but it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. The settlor's execution in Florida of her power of appointment cannot remedy the absence of such an act in this case.

Id. at 253–54 (internal citation omitted).

Finally, the Court addressed directly the argument that jurisdiction over the Delaware trustee was proper "because the settlor and most of the appointees and beneficiaries were domiciled in Florida." *Id.* at 254; *see id.* at 258 (Black, J., dissenting) (contending that Florida had power over the trustee because "the primary beneficiaries also lived in that State"). Basing jurisdiction on the presence of a beneficiary, the Court concluded, "is a nonsequitur." *Id.* at 254. While that fact could empower Florida to adjudicate the rights of the resident parties, it did not create jurisdiction over a different, nonresident entity. The issue, the Court explained, is jurisdiction, "not choice of law," and the jurisdictional question "is resolved . . . by considering the acts of the trustee," not those of other parties. *Id.* at 253–54.

Like *Safe Deposit*, *Hanson* resolves this case. In *Hanson*, as here, the issue was the validity of jurisdiction over a trustee as owner of the trust property in dispute. Like the State in this case, the *Hanson* petitioners and the dissenting opinion argued that the fact of in-state beneficiaries supported jurisdiction. The Court's response to that argument—that jurisdiction must be based on "the acts of the trustee," not the "unilateral activity" of a different person in the trust relationship, *id.* at 253—is dispositive here.

2. *Hanson* is materially indistinguishable

The State attempts to distinguish *Hanson* on two grounds, neither of which has merit.

First, the State contends that *Hanson* does not apply because it addressed jurisdiction to adjudicate, rather than jurisdiction to tax. The same principles govern in both contexts. *International Shoe* itself addressed jurisdiction both to tax and to adjudicate, reasoning that the "activities which establish[ed] [the corporation's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." 326 U.S. at 321; *see id.* (concluding that minimum contacts gave the State "constitutional power to lay the tax and to subject appellant to a suit to recover it"). The very decision that the State describes as establishing the controlling test, *Quill Corp. v. North Dakota*, resolved the tax dispute there by relying on adjudicative jurisdiction cases. 504 U.S. at 307–08 (discussing *International Shoe*, *Shaffer v. Heitner*, and *Burger King*). The *Quill* Court "framed the relevant inquiry as whether" the taxpayer "had minimum contacts with the jurisdiction 'such that the [tax] does not offend traditional notions of fair

play and substantial justice.'" *Id.* at 307 (quoting *Int'l Shoe Co.*, 326 U.S. at 316).

The *Quill* Court's reliance on adjudicative jurisdiction cases was correct. "Jurisdiction is as necessary to valid legislative as to valid judicial action." *St. Louis v. Ferry Co.*, 78 U.S. (11 Wall.) 423, 430 (1870). The Due Process Clause "protect[s] a person against having the Government impose burdens upon him except in accordance with the valid laws of the land," *Giaccio v. Pennsylvania*, 382 U.S. 399, 403 (1966), and that principle "is no less true with respect to the power of a sovereign to resolve disputes through judicial process than with respect to the power of a sovereign to prescribe rules of conduct for those within its sphere." *J. McIntyre Machinery, Ltd. v. Nicastro*, 564 U.S. 873, 879 (2011) (plurality opinion). In both contexts, the minimum-contacts requirement ensures "fair warning that [a person's] activity may subject [him] to the jurisdiction of a foreign sovereign." *Quill*, 504 U.S. at 312 (citing *Shaffer*, 433 U.S. at 218 (Stevens, J., concurring)).

Thus, the "minimum connection" necessary for a State directly to demand money from a person under threat of criminal penalty does not meaningfully differ from the "minimum contacts" necessary for the State to require the person to defend against that demand. Indeed, this Court has used the formulations interchangeably. *E.g, South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080, 2091 (2018) (describing an earlier tax decision as holding that the taxpayer "lacked the requisite minimum contacts with the State required by the . . . Due Process Clause"). And this Court has routinely applied minimum-contacts concepts when addressing state power to tax. *E.g.*,

Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009) ("[A] nondomiciliary jurisdiction may constitutionally tax property . . . when the taxpayer avails itself of the substantial privilege of carrying on business in that jurisdiction.") (internal citation and quotation marks omitted).[5]

Second, Petitioner incorrectly contends that *Hanson* does not apply because it concerned jurisdiction over the trustee, rather than over the trust. Pet. Br. 24. This Court long ago dismissed as an "ancient form without substantial modern justification" the "fiction that assertion of jurisdiction over property is anything but an assertion of jurisdiction over the owner of the property." *Shaffer*, 433 U.S. at 212. In both this case and *Hanson*, the person over whom the State asserted jurisdiction is the trustee. That was so in *Hanson* because the trustee owned the assets in dispute. It is so here because the trustee owns the income the State seeks to tax.

That the trustee is the relevant party for jurisdictional purposes is also a consequence of the State's own law. North Carolina imposes an income tax on individuals and then separately, in the statute at issue, requires the trustee to pay tax on trust income. N.C. Gen. Stat. § 105-160.2 (2017) ("The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provi-

[5] The State itself relies on adjudicative jurisdiction cases when it deems them helpful. Pet. Br. 45 (invoking the "modern analysis under the Due Process Clause" and citing *International Shoe*), 26 n.11 (relying on *Burger King*), 28 (relying on adjudicative jurisdiction cases to urge rejection of *Safe Deposit*).

sions of this Part."); N.C. Dep't of Rev., Form D-407A (2018) (directing that "the fiduciary must file" the return reflecting trust income).

In reality and under the law, there is thus no difference between asserting jurisdiction over the trustee as legal owner of the trust property and asserting jurisdiction over the "trust abstraction."[6] Relying on such a distinction represents the height of the "kind of formalism" that the State purports to disavow. Pet. Br. 25.

Hanson therefore controls here. That decision is a pillar of modern due process jurisprudence, its reasoning often recited and its result consistently reaffirmed.[7] Unless this Court repudiates both, North Carolina cannot prevail in this case.

---

[6] Nor does the name of the party in the case caption make any difference. "[L]egal proceedings involving such traditional trusts are effectively brought by or against their trustees[.]" *Raymond Loubier Irrevocable Tr. v. Loubier*, 858 F.3d 719, 722 (2d Cir. 2017); *see also Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S Ct. 1012, 1016 (2016) ("Traditionally . . . legal proceedings involving a trust were brought by or against the trustees in their own name[,]" and the trustee is also the relevant party "if the trust, as an entity, [is] sued.").

[7] Since deciding *Hanson*, this Court has invoked it as a key authority in nearly every subsequent due process decision. *See, e.g.*, *Bristol-Myers Squibb Co. v. Superior Ct.*, 137 S. Ct. 1773, 1780 (2017); *Walden*, 571 U.S. at 284–85, 288; *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915, 924 (2011); *Nicastro*, 564 U.S. at 877, 880–82; *Asahi Metal Industry Co., Ltd. v. Superior Ct.*, 480 U.S. 102, 109–10 (1987); *Burger King*, 471 U.S. at 474; *Ins. Corp. of Ir., Ltd. v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 713–14 (1982); *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 294–98 (1980);
(continued)

II. DUE PROCESS PRINCIPLES COMPEL THE DECISION BELOW AND REFUTE THE STATE'S JURISDICTIONAL THEORIES

The holdings of *Safe Deposit* and *Hanson* align with the core set of principles this Court has prescribed for evaluating the outer constitutional limits of state jurisdiction. The State agrees that the outcome here should turn on "'the traditional notions of fair play and substantial justice' that shape modern analysis under the Due Process Clause." Pet. Br. 45 (quoting *International Shoe*). But aside from invoking "[f]reeform notions of fundamental fairness divorced from traditional practice," *Nicastro*, 564 U.S. at 880, the State does not attempt—and even urges this Court to avoid—application of the concrete principles that define the modern due process framework. Pet. Br. 21 n.9. Those tenets defeat the State's jurisdictional theories.

A. The State Cannot Show the Minimum Connection or Rational Relationship Necessary to Assert Jurisdiction

For the State to satisfy the Due Process Clause, it must establish that there exist minimum contacts, a "minimum connection, between a state and the person, property or transaction it seeks to tax, and that the income attributed to the State for tax purposes [is] rationally related to [fiscal] values connected with the taxing State." *Quill*, 504 U.S. at

---

Kulko v. Superior Ct., 436 U.S. 84, 92–101 (1978); *Shaffer*, 433 U.S. at 215–16.

306 (internal quotation marks and citations omitted).[8]

The North Carolina tax fails this standard. The State's attempt to assert jurisdiction over the trustee based on nothing more than the forum residence of a contingent beneficiary conflicts with settled law that directs the focus on the trustee's own conduct. And the State cannot tax the worldwide income of the trust on the mere speculation that a forum resident may someday receive it.

1. Jurisdiction depends on the contacts of the taxpayer with the State and cannot rest solely on the taxpayer's relationship with a forum resident

"The inquiry whether a forum State may assert . . . jurisdiction over a nonresident [taxpayer] focuses on the relationship" between the taxpayer and the State. *Walden*, 571 U.S. at 283–84 (quoting *Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770, 775 (1984)) (internal quotation marks omitted). The State cannot establish jurisdiction by pointing to the forum contacts of other parties; "[r]ather, it is the [taxpayer's own] conduct that must form the necessary connection with the forum State that is the basis for its jurisdiction over him." *Id.* at 285.

The necessary relationship "must arise out of contacts that the [nonresident] *himself* creates with

[8] The State mischaracterizes the constitutional test. It asserts that "the Trust has the burden of establishing two elements": that the State "lacks a minimum connection," and that the amount taxed is "not rationally related" to the taxing State. Pet. Br. 15. As the party asserting jurisdiction, the State must satisfy both parts of the *Quill* standard.

the forum State." *Id.* at 284 (citing *Burger King*, 471 U.S. at 475) (internal quotation marks omitted). On that basis, this Court has "consistently rejected attempts to satisfy the . . . minimum contacts inquiry by demonstrating contacts between [third parties] and the forum State." *Id.* at 284. The "unilateral activity of another party or a third person is not an appropriate consideration when determining whether a [nonresident] has sufficient contacts with a forum State to justify an assertion of jurisdiction." *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 417 (1984).

Nor can jurisdiction be based solely on "the [taxpayer's] contacts with persons who reside" in the forum State. *Walden*, 571 U.S. at 285. The taxpayer's "relationship with a . . . third party, standing alone, is an insufficient basis for jurisdiction." *Bristol-Myers*, 137 S. Ct. at 1781 (quoting *Walden*, 571 U.S. at 286).

The irreducible due process requirement remains the one *Hanson* established in the trust context: "[I]t is essential in each case that there be some act by which the [taxpayer] purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." 357 U.S. at 253; *see Goodyear*, 564 U.S. at 924; *Burger King*, 471 U.S. at 474 ("[T]he constitutional touchstone remains whether the [individual] purposefully established 'minimum contacts' in the forum State.").

2. There are no minimum contacts between the trustee and North Carolina

These enduring principles control this case. The State sought to tax the trustee on income of trust

property he owns and controls. It designated him as the person required to pay the tax. *See supra* p. 9. The jurisdictional inquiry therefore focuses on whether the trustee *himself* has minimum contacts with North Carolina.

The trustee has no such minimum contacts here. He did not engage in any conduct "purposefully avail[ing] [him]self of the privilege of conducting activities within the forum state." *Hanson*, 357 U.S. at 253. The State does not even attempt to argue otherwise. Instead, the State cites a single fact as grounds for jurisdiction: that a contingent beneficiary happened to move to North Carolina. Pet. Rep. in Supp. of Cert. 6–7 (asserting that this case presents only the question whether jurisdiction is proper based "solely on the presence of an in-state beneficiary").

Under this Court's decisions, the question presented thus answers itself. "If the question is whether an individual's [relationship] with an out-of-state party *alone* can automatically establish sufficient minimum contacts in the other party's home forum, we believe the answer clearly is that it cannot." *Burger King*, 471 U.S. at 478. A different person "cannot be the only link between the [taxpayer] and the forum." *Walden*, 571 U.S. at 285.

"In short, when viewed through the proper lens—whether the [taxpayer's] actions connect him to the forum—[the trustee] formed no jurisdictionally relevant contacts with" North Carolina. *Walden*, 571 U.S. at 289. Because the trustee lacks "the 'minimal contacts' with that State that are a prerequisite to its exercise of power over him," *Hanson*, 357 U.S. at 251, North Carolina's "unacceptably grasping" attempt at

jurisdiction violates the Due Process Clause. *Daimler AG v. Bauman*, 571 U.S. 117, 138 (2014).

3. There is no rational relationship between the taxed income and North Carolina's fiscal values

The North Carolina tax also fails the *Quill* requirement that the "income attributed to the State for tax purposes" must be "rationally related to [fiscal] values connected with the taxing State." 504 U.S. at 306.

The State taxed the worldwide income of the trust property through the trustee. None of that income was earned in the State, and no one in North Carolina received or enjoyed it during the relevant tax years. The State did not give the trustee "anything for which it could ask return," nor did the taxed income "bear[] fiscal relation to protection, opportunities, and benefits given by the state." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). The sole basis for the State's attribution of every penny of income to North Carolina was the possibility that the contingent beneficiary might someday receive it in North Carolina. That speculative basis does not satisfy *Quill* or due process.

B. The Contacts of Any "Trust Constituent" Are Not Attributable to Everyone Else in the Trust Relationship

The State's principal theory for jurisdiction is that the forum contacts of a beneficiary are attributable to the trustee. According to the State, the contacts of any person in the trust relationship are effectively the contacts of "the trust," and those contacts therefore bind the other "trust constituents" for

jurisdictional purposes. Thus, in the State's view, any State that has contacts with any "trust constituent" may assert jurisdiction over all other people associated with the trust.

That contention is incorrect. It conflicts with basic features of trust law and the actual relationship between trustee and beneficiary, it conflicts with the way in which this Court has approached questions of jurisdiction in the trust context, and it conflicts with North Carolina's own law.

1. The beneficiary and trustee are not agents, and the beneficiary does not represent the trust property

The State's argument misconceives the distinct roles that trustees and beneficiaries occupy in a traditional trust. Those distinct roles preclude the State's effort to treat the beneficiary and trustee as one for jurisdictional purposes on the ground that both are "trust constituents."

The trustee, not the beneficiary, represents the trust property and bears its rights and obligations. He can bind the trust property and is liable for all obligations incurred during the administration of the trust, including third-party claims against the trust assets. Austin W. Scott, William F. Fratcher & Mark L. Ascher, Scott & Ascher on Trusts ("Scott & Ascher on Trusts") §§ 26.1, 26.4 (5th ed. 2007); *Greenough*, 331 U.S. at 494 n.19 ("As a trustee holds the estate . . . he is personally bound by the contracts he makes as trustee, even when designating himself as such."). For procedural purposes, the trustee's domicile is dispositive, *see Americold*, 136 S Ct. at 1016, and "legal proceedings involving such tradi-

tional trusts are effectively brought by or against their trustees[.]" *Loubier*, 858 F.3d at 722.

Consistent with this principle, the trustee is liable for taxes assessed on the trust and for failure to file returns or pay taxes. Unif. Tr. Code § 816 (2000); George Gleason Bogert et al., *The Law of Trusts and Trustees* § 265 (2018) ("The liability of the Trustee for failure to file a tax return or to make estimated tax payments is the same as that of an individual.")

But this relationship between the trustee and the trust property does not apply to beneficiaries. The trustee does not represent the beneficiary: the trustee is not the beneficiary's agent and has no power to subject the beneficiary to third party claims. Scott & Ascher on Trusts §27.1; *see also* Restatement (Third) of Trusts § 103 (Am. Law Inst. 2003). This is true even when the trustee enters into a contract in the proper performance of his duties and purports to bind the beneficiaries personally. Scott & Ascher on Trusts §27.1 (The trustee "has no authority to act on behalf of the beneficiaries personally and is not subject to their control.")

Similarly, the beneficiary cannot bind trust property that does not legally belong to her. Where, as here, the trust instrument conveys to the trustee absolute discretion over the disposition of the trust property, a transferee or creditor of a beneficiary cannot compel the trustee to make distributions. Restatement (Third) of Trusts § 60 (Am. Law Inst. 2003). The beneficiary's inability to bind the trustee is reinforced by the inclusion of a spendthrift provision like the one in the trust agreement here, prohibiting the beneficiary from assigning or otherwise attaching the trust assets. Art. 12, App.

70 (prohibiting "attachment, execution, garnishment, sequestration or other seizure under any legal, equitable or other process.")

As a result, the State's assertion that a beneficiary "is a trust's most important constituent" means nothing in this context. Pet. Br. 29. Each of the "trust constituents" serves a distinct role; the trust cannot exist until the settlor expresses his intent to create it, and the trust cannot operate without a trustee to administer it.[9] The relevant question, however, is not the "importance" of the "constituent," but instead whether the practical nature of the relationships justifies the State's assertion of power over one person based on the actions of another. Under basic principles of trust law, the beneficiary's role does not support attribution of her actions to the trustee.

2. This Court's decisions in the trust context focus on the contacts of the person over whom the State asserts jurisdiction

This Court does not amalgamate the contacts of all "trust constituents" when evaluating jurisdiction over a person who is part of a trust relationship. Instead, as discussed above, *supra* § II(A), this Court

---

[9] The beneficiary need not be ascertainable, or indeed in existence, at the time the trust is created. N.C. Gen. Stat. § 36C-4-409(1) (trust "without a definite or definitely ascertainable beneficiary" is valid); Scott & Ascher on Trusts §12.1. "Thus, for example, a trust can be created for the benefit of a child not born or conceived at the time of the creation of the trust, or for the benefit of a definite class of persons although the identity of the individuals comprising its membership is not ascertained or ascertainable at the time of the trust's creation." Restatement (Third) of Trusts, § 2 (Am. Law Inst. 2003).

has consistently focused on the particular person over whom the State seeks jurisdiction and decided whether that person's conduct gives rise to the necessary minimum connection. That is as true in the trust context as it is in due process jurisprudence generally.

Hanson exemplifies the proper analysis. There, the Court focused on the nonresident trustee and concluded that the trustee's own contacts did not support jurisdiction. The Court rejected an effort to attribute to the trustee the conduct of other parties in the trust relationship, emphasizing that "[t]he unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State." 357 U.S. at 253. The State's basic theory in this case—treating the "trust constituents" as if they were interchangeable agents of a single trust entity—is the opposite of *Hanson*'s reasoning.

The State incorrectly invokes two cases to support its theory. First, the State contends that *Greenough* "treated a trust and its constituents as inextricably intertwined," Pet. Br. 26, such that "a trust constituent's residency in a state connects the trust to the state." *Id.* at 30.

That is a misreading of *Greenough.* The issue in *Greenough* was not whether jurisdiction was proper because *any* "trust constituent" resided in the State. Rather, the question was whether jurisdiction was proper specifically because the resident was a *trustee*. The Court upheld jurisdiction because of the unique features of the trustee's role as "the owner of the intangibles." 331 U.S. at 493; *see id.* ("This close relationship between the intangibles and the *owner*

furnishes an adequate basis for the tax *on the owner* by the state of his residence . . . . The state of the *owner's* residence supplies the *owner* with the benefits and protection inherent in the existence of an organized government.") (emphases added).

Because the beneficiary is not the owner of the trust property, the reasoning of *Greenough* does not "appl[y] equally to this case." Pet. Br. 30. As discussed above, *supra* pp. 21–22, the Court in *Greenough* distinguished *Safe Deposit* on exactly that basis. *Greenough*, 331 U.S. at 496 (noting that *Safe Deposit* "held invalid a state's tax on a trust's intangibles" because the property was "actually in the hands of the nonresident trustee and not subject to the control" of the resident beneficiary).

Second, the State contends that *Stone v. White*, 301 U.S. 532 (1937), rejected the "separateness theory" under which the contacts of people in the trust relationship are evaluated individually. *Stone* did not involve jurisdiction and did not change this Court's understanding of trust law. That case addressed a trust that gave the beneficiary an absolute right to the income "at such times and in such amounts as she should deem best." *Id.* at 533. In that context, the Court upheld imposition on the trustees of a tax that the beneficiary should have paid because it was on income that had been distributed to her. Given the beneficiary's actual ownership of the trust income and absolute right to demand it, the Court reasoned that it need not "shut its eyes to the fact that in the realm of reality it was the beneficiary's money which paid the tax." *Id.* at

535. Nothing in *Stone* affects the jurisdictional principles relevant here.[10]

3. North Carolina law treats beneficiary and trustee as separate and distinct entities

Not only are trustees and beneficiaries treated as separate and distinct under settled trust law and this Court's precedents, but they are also treated as independent actors by North Carolina itself.

Consistent with trust law generally, North Carolina statutes carefully assign the trustee and beneficiary distinct roles. In addition to authority conferred by the terms of the trust, the trustee possesses "[a]ll powers over the trust property that an unmarried competent owner has over individually owned property," as well as any "other powers appropriate to achieve the proper investment, management, administration or distribution of the trust property." N.C. Gen. Stat. § 36C-8-815 (2017). The trustee is empowered to "enforce claims of the trust and to defend claims against the trust." N.C. Gen. Stat. § 36C-8-811 (2018). North Carolina law further permits the trustee, among other things, to invest trust property, borrow money, abandon or

[10] The State also incorrectly describes *Americold*, asserting that "[b]ecause of the abstract nature of a trust," the Court held that a trust's citizenship is determined by its membership. Pet. Br. 23 n.10. The entity in *Americold* "call[ed] itself a trust," but the Court concluded that the entity actually had "little in common with [a] traditional" trust. 136 S. Ct. at 1016. "For a traditional trust" like the one here, the Court confirmed, the trustee's "citizenship is all that matters for diversity purposes." *Id.*; *see also Navarro Sav. Ass'n v. Lee*, 446 U.S. 458, 462 (1980) ("[T]rustees are real parties in interest for procedural purposes").

relinquish rights, change the character of the trust property, and, with respect to securities, "exercise the rights of an absolute owner." N.C. Gen. Stat. § 36C-8-816 (2018).

The beneficiary has no comparable rights or powers. In fact, the trustee need not even "inform[] any beneficiary in advance of transactions relating to trust property." N.C. Gen. Stat. § 36C-8-813(b)(1) (2018). The beneficiary of a discretionary trust like the one here cannot encumber or transfer her interest in the trust, and a "creditor or assignee of a beneficiary may not reach a discretionary trust interest or a distribution by the trustee before its receipt by the beneficiary." N.C. Gen. Stat. § 36C-5-504(b) (2018). The discretionary beneficiary's only concrete right is to sue for abuse of discretion in complying with a standard for distribution. N.C. Gen. Stat. § 36C-5-504(e) (2018).[11]

---

[11] North Carolina follows the majority rule that its courts are the appropriate forum only for "a trust having its principal place of administration in this State." N.C. Gen. Stat. § 36C-2-202 (2018). *See also* Restatement (Second) of Conflict of Laws § 267 (Am. Law Inst. 1971); Scott & Ascher on Trusts, § 45.2.2.6. Indeed, North Carolina law specifically prohibits the State's courts from adjudicating disputes involving out-of-state trusts absent extraordinary circumstances. *See* N.C. Gen. Stat. § 36C-2-203(2) (2018) ("The clerk of court shall not, over the objection of a party, entertain proceedings under this section involving a trust having its principal place of administration in another state except" when, among other things, "the interest of justice otherwise would be seriously impaired."). Thus, unlike in *Greenough*, the tax cannot be justified by the benefit the State provides the trustee in the form of access to its courts. North Carolina courts would be presumptively closed to disputes between the trustee and fiduciary over this trust. *Cf. Greenough*, 331 U.S. at 495 ("There may be matters of trust *(continued)*

The State's tax system reinforces that separation between beneficiary and trustee. North Carolina law imposes a tax on beneficiaries as individual taxpayers for the income actually distributed to them. It separately imposes on trustees a tax for the income of the trust property they represent. N.C. Gen. Stat. § 105-160.2 (2017) ("The fiduciary responsible for administering the estate or trust shall pay the tax" on trust income); *see Sabine v. Gill*, 51 S.E.2d 1, 4–5 (N.C. 1948) (concluding that, as a result of North Carolina tax statutes, "the distance here between the trustees and the beneficiary seems to be too great for the judiciary to close the gap by making them to all intents and purposes one," and that "[t]he trusteeship is far from a mere agency which might lend itself to the concept of constructive holding" for the beneficiary).

What the State calls the "separateness theory" is, therefore, the result of its own laws.[12]

---

administration which can be litigated only in the courts of the state that is the seat of the trust.").

[12] North Carolina's statutes reflect "the tendency of modern law to treat trusts as distinct legal entities" akin to corporations. Restatement (Third) of Trusts § 2 (Am. Law. Inst. 2003), comment i; *see id.* at comment a (describing as "outmoded" the "concept that a trust is not an entity"); N.C. Gen. Stat. § 36C-1-103(12) (2018) (defining "person" to include a trust); N.C. Gen. Stat. § 58-1-5(9) (2018) (defining a trust as a "person" for insurance purposes).

This Court could thus affirm on the alternative ground that the State, having decided to treat trusts as corporate-like entities that are separate and distinct from trust beneficiaries, cannot then deny that separate status for jurisdictional purposes by arguing that the trust and its beneficiaries are effectively one and the same.

C. The State Cannot Assert Jurisdiction over the Trustee on the Basis of Public Services Provided to a Beneficiary

The State next contends that it may tax the trustee in exchange for the public services it provided to the resident beneficiary. Pet. Br. 30–36. That argument fails for three basic reasons.

First, it suffers from the same flaw as the State's principal theory, "improperly attribut[ing] [another person's] forum connections to the [taxpayer] and mak[ing] those connections decisive in the jurisdictional analysis." *Walden*, 571 U.S. at 289 (internal citation and quotation marks omitted). The State focuses on benefits provided to the beneficiary, but the State taxed the trustee, so the relevant question is what benefits the *trustee* received. The State posits indirect ways in which North Carolina helped the trustee because of his relationship with the beneficiary. But "financial benefits accruing . . . from a collateral relationship to the forum State will not support jurisdiction if they do not stem from a constitutionally cognizable contact with the State." *World-Wide Volkswagen*, 444 U.S. at 299. On that basis, the Court rejected in *Kulko* exactly the argument the State is now advancing. There, the Court addressed the contention that California's jurisdiction over a Florida parent was proper because of public benefits California had provided his minor child:

> The court below stated that the presence in California of appellant's daughter gave appellant the benefit of California's police and fire protection, its school system, its hospital services, its

> recreational facilities, its libraries and museums . . . . But, in the circumstances presented here, these services provided by the State were essentially benefits to the child, not the father, and in any event were not benefits that appellant purposefully sought for himself.

436 U.S. at 94 n.7 (internal quotation marks omitted). That reasoning is even more compelling in this case. *Kulko* involved a parent with mandatory support obligations to the resident, whereas the trustee here had no legal obligation to provide anything to the beneficiary during the relevant period. And in *Kulko*, the parent sent the resident to the forum State to live. The trustee here, in contrast, had no control over the beneficiary's choice of residence.

Second, the State's public-benefits argument rests on premises that are incorrect, factually and legally. The State claims unfairness in the beneficiary consuming state resources without paying for them. But the beneficiary did pay North Carolina tax on all income that she and her family had actually received in exchange for the "benefits and protections that come with residency in North Carolina." Pet. Br. 34. The beneficiary had not received, had no right to receive, and did not own or control any of the income on trust property during the tax years. Whether to distribute that income was left to "the Trustee's absolute discretion." Art. 1 § 1.1(a), App. 46. Indeed, the beneficiary may not ever have received any trust assets. *See supra* pp. 3–5. There is thus no basis for treating the income as if it were hers. *Cf. Sabine*, 51 S.E.2d at 5 (rejecting beneficiary's claimed deduction

for taxes paid by the trustee because, under North Carolina statutes, the property belonged to the trustee "and [became] hers only by distribution").

The State also misstates the record in arguing that the protections North Carolina provided the beneficiary "replaced services that the Trust otherwise would have had to buy" for her. Pet. Br. 34–35. In fact, the trustee was not required to provide any income or principal to the beneficiary during the years at issue. While the trust agreement highlighted certain life events as guidance to the trustee, Art. 1 § 1.4(c), App. 51, the decision whether to distribute income and principal remained the trustee's alone. *Id.* at 46–47. That decision could be challenged only if it were "arbitrary or the result of bad faith." *Supra* p. 5.

Third, there are no discernable limits to the theory that a State may premise jurisdiction over a trustee on public services to a beneficiary. That theory would not be limited to the beneficiary's residence. It would also permit taxation by any State that, because the beneficiary spent a meaningful amount of time there, could claim to have "give[n] the beneficiary the interim protection of its laws" and provided her valuable services. Pet. Br. 33 (internal quotation marks omitted); *cf. Walden*, 571 U.S. at 290 (rejecting respondent's theory as overbroad because it would support jurisdiction not only in the forum State but also "wherever else [a third party] might have traveled").

Nor would the State's theory be confined to the trust context. According to that theory, when a State provides benefits and protections to a person while property she may someday receive generates income

elsewhere, "it is only fair" to permit the State to "demand a return" by taxing the current property owner for that income. Pet. Br. 17. This reasoning would apply to a parent who resides in New York and executes a will that contemplates the eventual distribution of all his assets to his only child, who resides in North Carolina. The State could equally contend in those circumstances that "North Carolina offered [the child] wide-ranging protections and services" while "income accumulated for [her] benefit," Pet. Br. 17, and on that basis impose a tax directly on the New York parent's income. Even the State would presumably not endorse that unfair result.

D. A Fiduciary Relationship with a Forum Resident Does Not Constitute Purposeful Availment by the Trustee

The State argues that the fiduciary nature of the trust relationship necessarily creates constitutional jurisdiction over the trustee wherever a beneficiary decides to live. Pet. Br. 26 & n.11. This Court has twice rejected that contention, and this case demonstrates why it should do so again.

In *Shaffer v. Heitner*, the Court considered whether Delaware could exercise jurisdiction over nonresident corporate officers of a Delaware corporation. Both the dissent and the appellee contended that the officers' decision to accept their positions and thereby to assume fiduciary obligations to a Delaware resident provided sufficient "contacts, ties, or relations" with that State to support jurisdiction. *Id.* at 213–14 (internal quotation marks omitted). The dissent argued that the officers "voluntarily associated themselves with the State[,]

. . . invoking the benefits and protection of its laws, by entering into a long-term and fragile relationship with one of its" residents. *Id.* at 227–28 (Brennan, J., dissenting) (internal citation and quotation marks omitted). The Court disagreed, holding that the acceptance of fiduciary obligations to a forum resident does not constitute "purposeful[] avail[ment] of the privilege of conducting activities within the forum State." *Id.* at 216 (internal citation and quotation marks omitted).

Hanson, of course, stands for the same proposition in the trust context. The Court refused to uphold jurisdiction over a nonresident trustee despite the trustee's fiduciary obligations to the resident beneficiaries. There, too, the Court rejected the argument that jurisdiction was proper because the trustee had availed itself of the forum by "maintain[ing] business relations" with the settlor and beneficiary, *id.* at 259 (Black, J., dissenting), or because the "community of interest" between the trust constituents was "so close" as to deem them "in privity," *id.* at 263 (Douglas, J., dissenting).

The State attempts to analogize this case to *Burger King*, but that comparison is inapt. Pet. Br. 26 & n.11. The Court upheld jurisdiction there because the franchisee had "deliberately reached out . . . and negotiated with a Florida corporation," entered into a commercial contract governed by Florida law, and accepted the "exacting regulation" of his business by the Florida corporation. 471 U.S. at 479–80 (internal quotation marks omitted).

No such circumstances are present here. The trustee did not reach into North Carolina to initiate a relationship, he has no contractual relationship

with the beneficiary, the trust is not governed by North Carolina law, the trustee is not subject to control or regulation by any North Carolina party, and he owed the North Carolina beneficiary nothing other than the good-faith exercise of his absolute discretion. The beneficiary's decision to reside in North Carolina "was completely adventitious as far as [the trustee] was concerned." *Rush v. Savchuk*, 444 U.S. 320, 328–29 (1980). "He had no control over that decision," and he did not by accepting the settlor's appointment subject himself to jurisdiction "in any state to which a potential [beneficiary] might decide to move." *Id.* at 329.

This case illustrates the error in the State's argument. For the first 15 years of the trust's existence, the beneficiary did not know the trust existed, and she never met the initial trustee. *See supra* p. 7. Even after the beneficiary eventually learned of the trust, she interacted "very infrequently" with the trustee and met with him only twice, both times in New York. App. 106–07, 126. That is not the kind of relationship that, by its nature, is necessarily so "intensive" and "inextricably intertwined" that jurisdiction over the trustee must follow the beneficiary. Pet. Br. 26 & n.11.

III. NORTH CAROLINA DOES NOT ACQUIRE JURISDICTION BECAUSE IT DISAGREES WITH THE TAX POLICY OF OTHER STATES

The State attempts to justify its jurisdictional overreach by advancing a series of policy arguments centered on the concern that the decision below opened a "judicially created tax shelter." Those arguments are incorrect and vastly overstated; the States have ample means of taxing trust income.

The State's real complaint is not that States lack constitutional power to tax, but rather that some of the States that possess power to tax have chosen not to use it. That disagreement does not give North Carolina license to extend its jurisdiction beyond constitutional boundaries.

A. States Have Ample Means of Taxing Trust Income Undisturbed by the Decision Below

The premise of North Carolina's policy argument is that the decision below "lays waste to the states' taxing authority" because it deprives States of the ability to tax trust income. Pet. Br. 2. As the Brief for the American College of Trust and Estates Counsel ("ACTEC Br.") demonstrates, that is simply not the case. States tax trust income in many different ways that the decision below does not disrupt. *See* ACTEC Br. 12–19 (describing the numerous ways in which States tax trusts).

The various approaches the States have employed largely align with the same considerations of actual ownership, control, and receipt underlying this Court's decisions. Thus, States tax the income of a grantor trust—one where the settlor retains control or ownership of the property—to the resident settlor.[13] When the beneficiary actually receives distributions, the State of the beneficiary's residence

---

[13] Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 20.09 (2019). For the federal rule, *see* 26 U.S.C.A. § 676 (a) (1986) ("The grantor shall be treated as the owner of any portion of a trust . . . where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.")

collects taxes.[14] States also tax trust income to the extent it is sourced to property or activity occurring within that State.[15]

This case concerns accumulated trust income that the trustee does not distribute in a particular year. States may and do tax such income in several ways. North Carolina incorrectly asserts that the decision below means that "the only state that can tax trust income is the state where a trustee lives." Pet. Br. 17. To be sure, a State with a resident trustee may tax undistributed income each year it is generated.[16] So, too, may a State in which a trust is administered.[17] But the State where the beneficiary resides may also collect taxes on accumulated income that was not distributed in a given year in one of two ways. If the beneficiary has an absolute right to the income, the beneficiary's State of residence may tax her for it regardless whether the income was distributed.[18] If, as here, the beneficiary's interest is instead contingent, the State of the beneficiary's residence may, pursuant to a "throwback" tax regime, collect tax on accumulated income from

---

[14] *See Lawrence*, 286 U.S. at 280–81 (noting the established principle that the State of residence may tax an individual on all actual income from whatever source derived).

[15] *See, e.g.*, Me. Stat. tit. 36, §§ 5163, 5175-A (2017); Mich. Comp. Laws § 206.110 (2018); R.I. Gen. Laws §§ 44-30-16, 44-30-35 (2018); *see also* ACTEC Br. 5 n.12.

[16] *See, e.g.*, Ariz. Rev. Stat. Ann. §§ 43-1301(1)(b)(5) (2019); Ark. Code Ann. § 26-51-203 (2019); Cal. Rev. & Tax. Code § 17742 (2019).

[17] *See, e.g.*, Colo. Rev. Stat. § 39-22-103(10) (2018); S.C. Code Ann. § 12-6-30(5) (2018). *See also* ACTEC Br. 10–11.

[18] *See* 26 U.S.C.A. §§ 671, 678(a) (1954).

distributions made in future years. In States with such a throwback tax, income that was not taxed in the year it was generated is taxed to the resident beneficiary if and when she actually receives it—not, as with North Carolina's tax, to the nonresident trustee based on speculation that the resident beneficiary someday *might* receive it.[19] *See* ACTEC Br. 15–19 (explaining the operation of the "throw-back" tax).

Thus, the ruling below rejected a single, specific tactic that only North Carolina and two other States have even attempted: taxing a trustee with which the State has no connection, on income that has not been distributed, solely on the possibility that at some later point the income might be distributed to a resident contingent beneficiary.[20] The North

---

[19] *See, e.g.*, 61 Pa. Code § 105.5(c) (2019); Cal. Rev. & Tax Code § 17745(b) (2019); N.Y. Tax Law § 612(b)(40) (2019).

[20] Only Tennessee and Georgia also have statutes taxing nonresident trustees for undistributed income solely on the ground that a contingent beneficiary resides in the State. Tenn. Code § 67-2-110(a) (2018); Ga. Code Ann. § 48-7-22(a)(1)(C) (2017). Tennessee, however, has voted to eliminate the income tax entirely as of January 1, 2021. *See* H.R. 534, 110th Gen. Assemb., Reg. Sess. (Tenn. 2017) (enacted). Practitioners disagree about whether Georgia law actually requires such a tax on nonresident trustees. *See* ACTEC Br. 11 n.11 (citing Ga. Comp. R. & Regs. 560-7-8- 35(1)(d)).

California imposes such a tax only if the resident beneficiary actually receives, or has a noncontingent right to receive, the income in a particular year. Cal. Rev. & Tax Code § 17742(a) (2019); Franchise Tax Board, TAM 2006-2002, p. 2 ("A resident beneficiary whose interest in a trust is subject to the sole and absolute discretion of the trustee holds [only] a contingent interest in the trust."), *available at*

(continued)

Carolina courts correctly concluded that this method did not respect constitutional limits on jurisdiction.

B. Differences in Tax Policy Are a Consequence of Federalism and Do Not Expand North Carolina's Jurisdiction

The myriad approaches to trust taxation reflect the different choices of voters in the various States. North Carolina's disagreement with those choices does not permit it to assert jurisdiction over persons with whom it lacks the requisite minimum contacts.

There is no dispute that the income of this trust was within the taxing power of multiple States. Whether and how the income was actually taxed turned on the tax laws of the particular States with jurisdiction—laws that reflect those States' considered policy choices. In light of those choices, North Carolina and its State *amici* cannot attribute the results to the judiciary. Connecticut joins the State *amici* despite the fact that, as the State of the trustee's residence, it could have taxed the very income at issue in this case but chose not to. The State of Washington joins, expressing "grave concern" about the revenue impacts of the decision below, despite the fact that it imposes no income tax at all on anyone. Brief for Minnesota *et al.*, at 1.

---

https://www.ftb.ca.gov/law/Technical_Advice_Memorandums/2006/20060002.pdf.

The remaining statutes that North Carolina cites (Pet. Br. 6 n.1) require further connections with the taxing State and therefore do not implicate the question presented here: whether a State may tax a nonresident trustee based solely on the fact of a resident contingent beneficiary.

North Carolina itself has decided not to tax trust income on the ground that a trustee or other fiduciary, as opposed to a beneficiary, resides in the State. Nor does North Carolina tax on the ground that the trust is administered there. That choice, which aligns with the State's concerted efforts to court a thriving banking industry,[21] is within the State's "sovereign right to formulate tax policy," *id.* at 9, reflecting a judgment to forgo certain tax revenue in favor of other objectives.

But differences among state tax laws, and concomitant respect for the limits of state power, do not create and have never been considered a "judicially created tax shelter." Instead, they are critical features of federalism. Observing the constitutional boundaries of state jurisdiction furthers the States' prerogative to make individualized choices without interference from other States that lack a legitimate interest. *See Bristol-Myers*, 137 S. Ct. at 1780–81 ("The sovereignty of each State . . . implie[s] a limitation on the sovereignty of all its sister States."). Indeed, one of the key functions of the minimum-contacts principle is to ensure that States "do not reach out beyond the limits imposed on them by their status as coequal sovereigns in a federal system." *World-Wide Volkswagen*, 444 U.S. at 292.

---

[21] *See Key Industries in North Carolina – Business & Financial Services*, North Carolina Dep't of Commerce (touting the State's "low tax burdens" as a prime reason "financial institutions flock to North Carolina"; citing as a "competitive advantage" that "NC is ranked No. 1 for lowest state and local tax burden in the United States") (last visited March 14, 2019), https://www.nccommerce.com/business/key-industries-north-carolina/business-financial-services.

The decision below does not "end the states' ability to adopt tax approaches" to address the concerns that North Carolina perceives. Pet. Br. 42. The States can and frequently do reconsider the decisions they have made in this context.[22]

North Carolina's true complaint is thus not about the lack of state power to tax, but instead about the decision of certain States not to exercise that power. This Court has refused to base jurisdiction on these sorts of differences among laws in non-forum States. *E.g.*, *Keeton*, 465 U.S. at 779 ("Whether Ohio's limitations period is six months or six years does not alter the jurisdictional calculus in New Hampshire"; that other States would apply different rules "has nothing to do with the contacts" that matter for jurisdictional purposes). North Carolina's policy disagreements with other States are similarly irrelevant to its constitutional jurisdiction. *See Greenough*, 331 U.S. at 490 ("Neither the expediency of the levy nor its economic effect on the economy of the taxing state is for our consideration.").[23]

---

[22] Tennessee, for example, voted in 2017 to eliminate the income tax. *See supra* n.20. In 2010, Washington voters considered but defeated a ballot initiative imposing an income tax. *See* Sec'y of State, State of Wash., Initiative Measure No. 1098 (filed Apr. 27, 2010), *available at* https://www.sos.wa.gov/elections/initiatives/text/i1098.pdf. In 2006, the Florida legislature repealed an intangible personal property tax. H.B. 209, 2006 Leg., Reg. Sess. (Fla. 2006) (enacted). In 2002, Ohio adopted an income tax on trustees. H.R. 675, 124th Gen. Assemb., Reg. Sess. (Ohio 2002) (enacted).

[23] Equally misplaced is the State's concern that the decision below will motivate behavior intended to minimize state tax burdens. Only North Carolina and two other States currently impose the tax at issue, so its invalidation will have little

(continued)

C. *Wayfair* Is Not Relevant

North Carolina repeatedly invokes *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018), but that case is not relevant here. *Wayfair*, a Commerce Clause decision, endorsed the minimum-contacts framework that both parties agree governs this case. *Wayfair* rejected a physical-presence rule that played no part in the decisions below because *Quill* long ago rejected that requirement in the due process context.

The Court overruled previous cases in *Wayfair* based on intervening "dramatic technological and social changes" reflected in e-commerce. *Id.* at 2095 (internal quotation marks omitted). Technological changes have not had the same impact on trust administration. At least since *Greenough*, this Court has recognized that trustees are not stationary or affixed to one State. 331 U.S. at 493 ("The trustee of today moves freely from state to state. The settlor's residence may be one state, the seat of a trust another state and the trustee or trustees may live in still another jurisdiction or may constantly change their residence."); *see Hanson*, 357 U.S. at 250–51

---

practical effect. In any event, taxpayer decisions based on the differential impact among state laws are a consequence of federalism. That individuals routinely consider how they would fare under various State tax regimes has no relevance to North Carolina's jurisdiction, nor is it a "fairness" argument in the State's favor. "Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant." *Comm'r v. Newman*, 159 F.2d 848, 850–851 (2d Cir. 1947) (Learned Hand, J., dissenting).

(rejecting jurisdiction over the trustee even while recognizing that "technological progress has increased the flow of commerce between States").

To the extent *Wayfair* has any application, it confirms the decision below. In *Wayfair*, South Dakota argued that a nonresident taxpayer's own forum-directed conduct created a sufficient nexus for the State to collect sales tax from resident customers. Here, in contrast, North Carolina seeks to assert jurisdiction over one party based entirely on the forum contacts of someone else. Thus, if there is any analogy to be drawn to *Wayfair*, it demonstrates the error of North Carolina's position, which is the equivalent of contending that the respondent in *Wayfair* could be taxed by every State in which any one of its beneficial shareholders resided, based solely on the fact of their residence. That argument fails under the most basic principles of due process.

CONCLUSION

Respondent respectfully submits that the judgment of the court below should be affirmed.

Respectfully submitted,

DAVID A. O'NEIL
Counsel of Record
ANNA A. MOODY
LAURA E. O'NEILL
DEBEVOISE & PLIMPTON LLP
801 Pennsylvania Ave. N.W.
Washington, D.C.
(202) 383-8000
daoneil@debevoise.com

THOMAS DEAN MYRICK
MOORE & VAN ALLEN PLLC
100 North Tryon Street
Charlotte, N.C. 28202
704-331-1126
tommyrick@mvalaw.com

Counsel for Respondent

March 18, 2019

No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

ON WRIT OF CERTIORARI TO THE SUPREME
COURT OF NORTH CAROLINA

BRIEF OF *AMICUS CURIAE* THE NEW YORK STATE BAR ASSOCIATION IN SUPPORT OF RESPONDENT

MICHAEL MILLER
President
ROBERT M. HARPER*
ANGELO M. GRASSO
JEFFERY H. SHEETZ
LOIS BLADYKAS
NEW YORK STATE BAR ASSOCIATION
One Elk Street
Albany, New York 12207
(518) 463-3200
rharper@farrellfritz.com

Counsel for Amicus Curiae

* *Counsel of Record*

287465

COUNSEL PRESS

(800) 274-3321 • (800) 359-6859

TABLE OF CONTENTS

Page

TABLE OF CONTENTS. i

TABLE OF AUTHORITIES iii

INTEREST OF *AMICUS CURIAE* 1

SUMMARY OF ARGUMENT. .2

ARGUMENT. 3

I. A Trust Is Separate and Distinct from Its Beneficiaries, and Should Be Treated as Such for Purposes of State Income Taxation of Undistributed Trust Income. 3

II. Due Process Does Not Permit a State to Tax Undistributed Trust Income Based Solely on the Residence of a Discretionary Trust Beneficiary in the State. 8

A. A Discretionary Trust Beneficiary's Residence In a State Does Not Justify That State's Taxation of Undistributed Trust Income That Is Earned In Another State. 10

B. The Analysis of the Court Below Is Neither Formalistic Nor Rigid and Comports With the Due Process Clause 16

Table of Contents

Page

C. The Court Below Did Not Create A Tax Shelter 18

III. North Carolina's Tax Violates the Commerce Clause 21

A. The Four Factors For the Dormant Commerce Clause Analysis Cannot Be Met 21

B. In the Alternative, the Matter Should be Remanded for Commerce Clause Consideration 26

CONCLUSION 27

TABLE OF CITED AUTHORITIES

Page

Cases

Abell v. Tait,
30 F.2d 54 (4th Cir. 1929), *cert. denied*,
279 U.S. 849 (1929) 4

Allied-Signal, Inc. v. Dir., Div. of Taxation,
504 U.S. 768 (1992). 13, 16

Andrews v. Commonwealth of Pennsylvania,
196 A.3d 1090 (Pa. Commw. Ct. 2018) 22

Blue v. Dep't of Treasury,
462 N.W.2d 762 (Mich. Ct. App. 1990) 13

Brooke v. City of Norfolk,
277 U.S. 27 (1928). 10

Brown v. Spohr,
73 N.E. 14 (N.Y. 1904) 4

Chase Manhattan Bank v. Gavin,
733 A.2d 782 (Conn. 1999). 14-15

Complete Auto Transit, Inc. v. Brady,
430 U.S. 274 (1977). . . . . *passim*

Comptroller of Maryland Treasury v. Wynne,
135 S. Ct. 1787 (2015). 23, 24, 26

Page

Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 26

District of Columbia v. Chase Manhattan Bank, 689 A.2d 539 (D.C. 1997) 14, 15

F.W. Woolworth Co. v. New Mexico, 458 U.S. 354 (1982) 8

Fielding v. Comm'r of Revenue, 916 N.W.2d 323 (Minn. 2018), *petition for cert. pending*, No. 18-664 (filed Nov. 15, 2018) 9-10

Greenough v. Tax Assessors of City of Newport, 331 U.S. 486 (1947) 14, 18

Hans Rees' Sons v. North Carolina, 283 U.S. 123 (1931) 26

Hanson v. Denckla, 357 U.S. 235 (1958) 11

In re Harmon, 900 N.Y.S.2d 761 (N.Y. App. Div. 2010) 6

In re Swift, 727 S.W.2d 880 (Mo. 1987) 17

J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938) 24, 25

Page

Kimberly Rice Kaestner Family Trust v. North Carolina Dep't of Revenue, 12-CVS-8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018). 12, 21, 22

Lineback by Hutchens v. Stout, 339 S.E.2d 103 (N.C. Ct. App. 1986) 6

Linn v. Ill. Dep't of Revenue, 2 N.E.3d 1203 (Ill. App. Ct. 2013) 9

Linser v. Office of Attorney Gen., 672 N.W.2d 643 (N.D. 2003) .12

McCulloch v. Franchise Tax Bd., 390 P.2d 412 (Cal. 1964). 15

Mercantile-Safe Deposit & Tr. Co. v. Murphy, 242 N.Y.S.2d 26 (N.Y. App. Div. 1963), *aff'd*, 203 N.E.2d 490 (N.Y. 1964). .11

Merchants' Loan & Tr. Co. v. Smietanka, 255 U.S. 509 (1921). 4

Miller Brothers Co. v. Maryland, 347 U.S. 340 (1954). 8, 22

Page

Noel v. Liberty Bank of Ark.,
No. 3:10-CV-00107, 2012 WL 13027498
(E.D. Ark. Nov. 27, 2012). 5

Oklahoma Tax Com'n v. Jefferson Lines, Inc.,
514 U.S. 175 (1995) 23, 25

Oklahoma Tax Comm'n v. Chicksaw Nation,
515 U.S. 450 (1995). 9

Pike v. Bruce Church, Inc.,
397 U.S. 137 (1970). 26

Potter v. Taxation Div. Dir.,
5 N.J. Tax. 399 (N.J. Tax Ct. 1983) 12

Quill Corp. v. North Dakota,
504 U.S. 298 (1992), *overruled in part by South Dakota v. Wayfair, Inc.*,
138 S. Ct. 2080 (2018). 8, 9, 11, 16

Residuary Tr. A v. Dir., Div. of Taxation,
27 N.J. Tax 68 (N.J. Tax Ct. 2013), *aff'd*,
28 N.J. Tax 541 (N.J. App. Div. 2015) 9

Safe Deposit & Tr. Co. v. Virginia,
280 U.S. 83 (1929). 10, 14

South Dakota v. Wayfair,
138 S. Ct. 2080 (2018). . . . . *passim*

Page

Stephens v. Tipton,
268 P. 1014 (Or. 1928) 4

United States v. Montgomery Cnty., Alabama,
845 F. Supp. 820 (M.D. Ala. 1993) 10

Western R.R. Co. v. Nolan,
48 N.Y. 513 (N.Y. 1872). 5

Westfall v. Dir. of Revenue,
812 S.W.2d 513 (Mo. 1991) 17

Statutes and Other Authorities

U.S. Const. amend. XIV, § 1. . . . . .2, 8

Ark. Code Ann. § 26-51-203(a)(1). 19

Cal. Rev. & Tax Code § 17742(a) .18

Cal. Rev. & Tax Code § 17745(b) .19

Ga. St. § 48-7-22(a)(1)(c) 18

Mich. Comp. Laws § 206.110 19

N.C. Gen. St. § 105-160.2 18

N.Y. E.P.T.L. § 7-1.4. 4

Page

N.Y. Tax Law § 612(b)(40). 19

Restatement (Second) of Trusts § 2 3

Restatement (Second) of Trusts § 59, cmt. b 4

Restatement (Second) of Trusts § 128, cmt. d. 12

Tenn. Code Ann. § 67-2-110(a) 18

Wis. Stat. § 700.16 5

George T. Bogert, *Trusts* § 1 (6th ed. 1987). 4, 5, 6

Kevin R. Ghassomian, *Eliminate State Tax On Trust Income: A Comprehensive Update on Planning with Incomplete Gift Non-Grantor Trusts*, 39 ACTEC L.J. 317 (Winter 2013) 18

Richard W. Nenno, *Minimizing or Eliminating State Income Taxes on Trusts*, Koren Estate, Tax, and Personal Financial Planning Update (August 2018 ed.). 23

Tenn. Dep't of Rev., *2018 Guidance for Tennessee's Hall Income Tax Return* (July 12, 2017). 18

INTEREST OF *AMICUS CURIAE*

The New York State Bar Association ("NYSBA") is the largest voluntary state bar association in the United States, with more than 72,000 members.[1] NYSBA's members live and practice in every town, city and county in the State of New York, and its membership also includes non-resident lawyers around the nation and throughout the world.

NYSBA has 26 sections dedicated to discrete areas of the law, including the Trusts and Estates Law Section, which consists of more than 3,000 members. With the assistance of its sections, as well as more than 60 committees, NYSBA drafts and supports legislation, sponsors conferences, seminars and institutes, and makes policy recommendations to bodies including the United States Congress, the New York State Legislature, and the New York State Office of Court Administration.

NYSBA previously has submitted *amicus curiae* briefs to the Supreme Court of the United States. NYSBA respectfully submits this brief in support of respondent, the Kimberley Rice Kaestner 1992 Family Trust ("Respondent"), and to assist the Court concerning the practical and policy implications of this case for the

1. NYSBA respectfully submits this brief, pursuant to the blanket-consent letters that the parties filed with the Court. Pursuant to Rule 37.6 of the Court's Rules, *amicus* affirms that no counsel for a party authored this brief, in whole or in part; that no such counsel or party has made a monetary contribution intended to fund the preparation or submission of this brief; and that no person other than *amicus* and its counsel made such a monetary contribution.

trusts and estates bar, as well as the grantors, trustees, and beneficiaries of trusts.

SUMMARY OF ARGUMENT

NYSBA respectfully submits this *amicus curiae* brief in support of Respondent. The court below correctly found that an out-of-state trust that did no business in North Carolina, had no assets in North Carolina, and distributed no income to anyone in North Carolina had no connection or substantial nexus with that state, which unconstitutionally taxed Respondent on its undistributed income. This accords with generally accepted trusts and estates law, which draws a distinction between a trust's trustee and its beneficiaries, and does not treat a trust as a vehicle to serve at the beneficiaries' behest.

With that in mind, NYSBA respectfully submits that North Carolina's argument that a beneficiary is "the central figure" in a trust is a mischaracterization of well-settled trusts and estates law. Pet. Br. at 2. Contrary to North Carolina's contention, the central figure in a trust is the trustee, who is the taxpayer, the fiduciary, and the owner of legal title in the trust's property. This distinction is all the more apparent here, where the trustee has absolute discretion to make (or not make) distributions, and the beneficiaries' rights are contingent upon that absolute discretion.

Given the nature and purpose of trusts, North Carolina's tax impermissibly violates the Due Process Clause of the Fourteenth Amendment to the United States Constitution, as well as the Commerce Clause contained in the Constitution, by taxing trustees who

have no relationship with North Carolina. The tax violates the Due Process Clause because it does not require that a trustee have the requisite "minimum connection" with the state, nor does it require the existence of a rational relationship between North Carolina and the income it seeks to tax. As to the Commerce Clause, the tax fails the four-part test set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), as there is no nexus between Respondent and North Carolina, and the tax is neither internally consistent nor externally consistent. Hence, the decision below should be affirmed.

ARGUMENT

I. A Trust Is Separate and Distinct from Its Beneficiaries, and Should Be Treated as Such for Purposes of State Income Taxation of Undistributed Trust Income.

To justify the state income tax that it assessed against Respondent, North Carolina effectively argues that no legal distinction exists between a trust and its discretionary beneficiaries. North Carolina's contention flatly contradicts the governing trusts and estates law, which this Court should apply in rejecting North Carolina's position.

A trust "is a fiduciary relationship with respect to property, subjecting [the person] by whom the title to property is held, to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it." Restatement (Second) of Trusts § 2. The trust relationship has three essential requirements: (1) "an expression

of intent that property be held, at least in part, for the benefit of one other than the settlor;" (2) "at least one beneficiary for whom the property is to be administered by the trustee;" and (3) "an interest in property which is in existence or is ascertainable and is to be held for the benefit of the beneficiary." George T. Bogert, *Trusts* § 1 (6th ed. 1987) ("Bogert on Trusts"); *Brown v. Spohr*, 73 N.E. 14 (N.Y. 1904).

A trust may be created for any lawful purpose, N.Y. E.P.T.L. § 7-1.4, but the most common reason for establishing a trust is to separate the control of trust assets from its beneficiaries. Restatement (Second) of Trusts § 59, cmt. b. As a result, legal title to trust property vests in the trustee, not in a beneficiary. *Stephens v. Tipton*, 268 P. 1014, 1015 (Or. 1928). The bifurcation of legal and beneficial title to trust assets is fundamental to the very existence of a trust; for if legal and beneficial title are not separated (such that legal and beneficial title to trust property rest in the same individual or entity), no trust arises. *Id.*

Beneficiaries are not "owners" of trust assets in the common sense of the word. On the contrary, because a trustee is a fiduciary, and fiduciaries and beneficiaries are separate entities, *Abell v. Tait,* 30 F.2d 54, 55 (4th Cir. 1929) (citing, *e.g.*, *Merchants' Loan & Tr. Co. v. Smietanka*, 255 U.S. 509 (1921)), *cert. denied,* 279 U.S. 849 (1929), a trust beneficiary's interest in trust assets is "non-possessory." Bogert on Trusts, § 38.

A trustee has legal ownership of trust assets, at least until trust distributions are made. The trustee's legal ownership of trust assets typically carries with it the

power to sell trust assets, to invest trust property, and to collect the income earned on trust property. Bogert on Trusts, § 88. A beneficiary has no such powers. In fact, a beneficiary's rights with respect to trust property are derivative, not direct, and are subject to the possessory rights that a trustee has as to trust assets. *Western R.R. Co. v. Nolan*, 48 N.Y. 513, 518-19 (N.Y. 1872). For example, in order to assert a cause of action on behalf of a trust, the trustee, not a beneficiary, must commence an action, even though that action ultimately may inure to the beneficiary's benefit. *Noel v. Liberty Bank of Ark.*, No. 3:10-CV-00107, 2012 WL 13027498, at *8 (E.D. Ark. Nov. 27, 2012).

Given the foregoing, and the nature of the trustee-beneficiary relationship, it logically follows that a beneficiary's right to distribution of trust assets is subject to limitations. It is governed by the terms of the trust instrument, pursuant to which the trust is created. Bogert on Trusts, § 38. As memorialized in the trust instrument, the settlor's intentions are entitled to great latitude in fixing beneficiaries' interests in a trust, and not all trust beneficiaries are created equal. The trust instrument may direct that a beneficiary's equitable interest in trust assets is subject to a definite period of trust administration, or that the trust's administration shall continue indefinitely. *Id.*; Wis. Stat. § 700.16. Likewise, the trust instrument may provide that a trust beneficiary's interest is contingent or vested; is in trust income or principal; is subject to a condition precedent or subsequent; or is possessory or non-possessory. Bogert on Trusts, § 38.

A settlor may direct that a trustee make certain distributions to specific beneficiaries (whose rights

are "mandatory"), or may "authorize the trustee to do or refrain from doing a certain act, or use his [or her] judgment as to when or how a power should be used." Bogert on Trusts, § 89. Put another way, a settlor may vest the trustee with partial or absolute discretion to make trust distributions. *Id.* In general, a trustee's exercise of discretion in making trust distributions (or refraining from doing so) will only be disturbed, by courts or otherwise, upon a showing that the trustee did not act in good faith. *Id.*; *In re Harmon*, 900 N.Y.S.2d 761, 764 (N.Y. App. Div. 2010). The trustee's exercise of discretion in distributing trust assets is entitled to tremendous deference, regardless of the wishes of trust beneficiaries (and, oftentimes, much to beneficiaries' chagrin). *Id.*

Further demonstrating the dichotomy that exists between trusts and their beneficiaries is the fact that courts typically will not require trustees to exercise their discretion to make trust distributions in a manner that would allow for beneficiaries' creditors and assignees to gain access to trust assets. *Lineback by Hutchens v. Stout*, 339 S.E.2d 103, 106 (N.C. Ct. App. 1986). Indeed, courts have explained that, under a "discretionary trust, the trustee may withhold the trust income and principal altogether from the beneficiary and the beneficiary, as well as the creditors and assignees of the beneficiary, cannot compel the trustee to pay over any part of the trust funds." *Id.*

In order to justify the unconstitutional state income tax that it seeks to levy against Respondent, North Carolina argues that a beneficiary is "the central figure in a trust." Pet. Br. at 2. North Carolina's contention overlooks well-settled trust law, which establishes that

three figures are essential to a trust: the settlor, the trustee, and the beneficiaries. The trust's beneficiaries are not, as North Carolina argues, more important to the trustee-beneficiary relationship than the trustee.

In fact, for the purpose of determining the legal ownership of assets that are held in trust, the beneficiaries are less important to the trust relationship than the trustee is. During the relevant tax years, the beneficiaries' ability to receive income distributions was subject to the trustee's absolute discretion. Joint Appendix ["App."] 45-47. As he was permitted to do under the terms of Respondent trust, the trustee did not exercise his discretion to distribute income to the beneficiaries during the 2005, 2006, 2007, or 2008 tax years. *Id.* at 12.

Legal title to trust assets, including its income, remained with the trustee, rather than the trust's beneficiaries. Because legal title to the trust's income remained with the trustee, and the beneficiaries had neither access to, nor control over the income, the trust and its beneficiaries are separate and distinct from each other, and should be treated as such for purposes of state income taxation of undistributed trust income.

Accordingly, it strains credulity to dispute that the trust was separate and distinct from its beneficiaries, and North Carolina's contentions to the contrary are devoid of merit.

II. Due Process Does Not Permit a State to Tax Undistributed Trust Income Based Solely on the Residence of a Discretionary Trust Beneficiary in the State.

The Question Presented addresses the extent to which the Due Process Clause permits North Carolina to tax undistributed income earned by a trust that is administered, and maintains all of its assets, books, and records, outside of North Carolina, based solely upon the North Carolina residence of discretionary trust beneficiaries to whom no trust distributions were made during the relevant tax years. As the Due Process Clause does not permit such state income taxation, the Court should affirm the decision of the court below.

Under the Due Process Clause, "[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law[.]" U.S. Const. amend. XIV, § 1. The Court has interpreted the Due Process Clause to limit states' authority to tax, requiring a state to satisfy two jurisdictional prerequisites in order to impose tax on a prospective taxpayer. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992), *overruled in part by South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018). First, a state must show a "definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax". *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). Second, the state must establish the existence of a rational relationship between income that the state seeks to tax and "values connected with the taxing [s]tate." *Quill*, 504 U.S. at 306; *F.W. Woolworth Co. v. New Mexico*, 458 U.S. 354, 365 (1982). Absent those two jurisdictional prerequisites, a state cannot tax a

prospective taxpayer in a manner that passes Due Process Clause-based muster.

Although a state may, at times, tax a prospective taxpayer that does not have a physical presence within the state's borders in a constitutionally-permissible manner, the state's authority to do so is subject to limitations. *Oklahoma Tax Comm'n v. Chicksaw Nation*, 515 U.S. 450, 463 n.11 (1995). One such limitation is the requirement that the prospective taxpayer "purposefully avail . . . itself of the benefits of an economic market in the forum [s]tate." *Quill*, 504 U.S. at 307. The underlying rationale is that a prospective taxpayer's purposeful availment puts the prospective taxpayer on notice that its "activity may subject [it] to the jurisdiction of a" state in which it does not have a physical presence. *Id.* at 308. The foregoing principles apply regardless of whether (a) the prospective taxpayer is an individual, a business entity, or a trust, or (b) the tax concerns income or sales tax.

In order for a state to tax income earned by a trust in a manner that comports with the Due Process Clause, the state must establish that the trust has a "definite link" and "minimum connection" to the state, and that a rational relationship exists between the trust income that the state seeks to tax and the values that the state provides. *Linn v. Ill. Dep't of Revenue*, 2 N.E.3d 1203, 1208 (Ill. App. Ct. 2013); *Residuary Tr. A v. Dir., Div. of Taxation*, 27 N.J. Tax 68, 72-76 (N.J. Tax Ct. 2013), *aff'd*, 28 N.J. Tax 541 (N.J. App. Div. 2015) (affirming on the basis of statutory construction, rather than the Due Process Clause). Failing such a showing, the Due Process Clause will bar state income taxation of a trust. *Linn*, 2 N.E.3d at 1208; *Fielding v. Comm'r of Revenue*, 916

N.W.2d 323, 329 (Minn. 2018), *petition for cert. pending*, No. 18-664 (filed Nov. 15, 2018).

A. A Discretionary Trust Beneficiary's Residence In a State Does Not Justify That State's Taxation of Undistributed Trust Income That Is Earned In Another State.

A state's taxation of undistributed income earned by a trust that is administered in another state, based solely on the presence of a trust beneficiary within the taxing state, is hardly a novel concept. *Brooke v. City of Norfolk*, 277 U.S. 27, 28-29 (1928). In fact, for the past 80 years, this Court has rejected states' efforts to tax undistributed trust income earned in another state where the taxing state's sole connection to the trust is the residence of a trust beneficiary in that state. *Id.*; *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83, 92 (1929). The Court has reasoned that a trust and its beneficiaries, though related, are not one and the same. *Safe Deposit*, 280 U.S. at 92 (explaining that, where the trustee of a trust owned legal title to trust securities in Maryland, and none of the trust beneficiaries located in Virginia had a "present right to their enjoyment or power to remove them," the "securities did not and could not follow any person domiciled in Virginia"); *cf. United States v. One Parcel of Prop. Located at Route 27, Box 411 (Patterson Road), Montgomery Cnty., Alabama*, 845 F. Supp. 820, 823-24 (M.D. Ala. 1993) (in rejecting the federal government's argument that a trust beneficiary's knowledge should be imputed to the trust's trustee in a forfeiture proceeding concerning the beneficiary, the court noted that a trustee's ownership of trust property "is independent of the beneficiary," and oftentimes requires the trustee to protect "the beneficiary from his or her own improvidence or incapacity").

Relying upon this Court's well-reasoned precedent, other courts (including state courts) have held that, under the Due Process Clause, the presence of a trust beneficiary in a particular state, without more, is insufficient to establish minimum contacts to justify the state's taxation of undistributed trust income that is earned in another state. *Mercantile-Safe Deposit & Tr. Co. v. Murphy*, 242 N.Y.S.2d 26, 28 (N.Y. App. Div. 1963) ("We find no merit . . . in their thesis that since the resident beneficiaries of the trust could be taxed on income distributed the nonresident trustee can be taxed on income accumulated."), *aff'd*, 203 N.E.2d 490, 491 (N.Y. 1964). For example, in *Mercantile-Safe Deposit & Trust Co. v. Murphy*, New York sought to tax the undistributed income earned by a trust administered in Maryland, by a corporate trustee based in Maryland, solely because a trust beneficiary resided in New York. *Id.* Citing to *Safe Deposit*, New York's Appellate Division and Court of Appeals rejected the state's argument, and held that regardless of the beneficiary's residence in New York, the tax violated the Due Process Clause. *Id.*[2]

A similar result is warranted when a state's only connection to a trust is a discretionary trust beneficiary's

2. The holding the New York courts reached in *Mercantile-Safe Deposit & Trust Co.* is consistent with the one that this Court articulated in *Hanson v. Denckla*. In *Hanson*, this Court found that the presence of trust beneficiaries in Florida did not confer on that state jurisdiction over the trustee of a trust who had no other Florida connections. *Hanson v. Denckla*, 357 U.S. 235, 254 (1958). While North Carolina argues that *Hanson* has no application here because personal jurisdiction in litigation and tax jurisdiction are distinct concepts, this Court has recognized that adjudicative jurisdiction and tax jurisdiction are comparable with each other. *Quill*, 504 U.S. at 307-08.

residence within the state. Under such circumstances, insufficient contacts exist between the state and the trust to justify the state's taxation of the trust's undistributed income. *Potter v. Taxation Div. Dir.*, 5 N.J. Tax. 399, 405 (N.J. Tax Ct. 1983). This is because the discretionary trust beneficiary has "no right to the undistributed trust income." *Id.* Absent an exercise of discretion by the trustee, the discretionary trust beneficiary cannot access such undistributed trust income, direct that it be paid to (or for the benefit of) the beneficiary, or otherwise exercise control over it. Restatement (Second) of Trusts § 128, cmt. d.; *but cf. Linser v. Office of Attorney Gen.*, 672 N.W.2d 643, 646 (N.D. 2003) (explaining that a discretionary beneficiary's interests in a trust are too remote to warrant treating the trust's undistributed assets as belonging to the beneficiary).

Recognizing that the presence of discretionary trust beneficiaries within North Carolina was the only connection that the trust had to that state, the court below correctly concluded that the trust lacked sufficient minimum contacts with North Carolina to justify its tax on all of the income the trust earned during the 2005 to 2008 tax years. *Kimberly Rice Kaestner 1992 Family Tr. v. North Carolina*, 814 S.E.2d 43, 51 (N.C. 2018). The trustee resided in Connecticut. App. 40-41. The trustee maintained the trust's books and records in New York. *Id.* at 41. All of the trust's assets were in Massachusetts. *Id.* The trustee did not make distributions to any beneficiaries that were located in North Carolina, earn income within that state, or otherwise transact business in North Carolina. *Id.* at 41-42.

Simply put, since neither the trust nor the trustee engaged in any affairs in North Carolina, it cannot be said that Respondent purposefully availed itself of any benefits associated with North Carolina. What is more, because the trust's discretionary beneficiaries did not have a right to access or control the trust's assets or income, and those beneficiaries did not receive any trust distributions during the relevant tax years, the mere presence of Respondent's discretionary beneficiaries in North Carolina during those years is insufficient to establish the requisite minimum contacts to justify that state's tax on Respondent's undistributed trust income during the relevant tax years.

Putting aside, for argument's sake only, that the mere presence of a discretionary beneficiary of a trust in a particular state is insufficient to establish minimum contacts to justify that state's taxation of undistributed trust income that is earned outside of the state, such undistributed trust income also bears no relationship, rational or otherwise, to the values that the state in which the discretionary trust beneficiary resides provides to the trust. *Blue v. Dep't of Treasury*, 462 N.W.2d 762, 764 (Mich. Ct. App. 1990). Since none of the trustee, the trust's assets or the trust's income is located within North Carolina, the state provides "no ongoing protection or benefit to the trust." *Id.* The state is essentially a stranger to the trust, regardless of the state's relationship to a discretionary trust beneficiary. *Cf. Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992) (noting that, to satisfy the Due Process Clause, "there must be a connection to the activity itself, rather than a connection only to the actor the [s]tate seeks to tax"). Consequently, the Due Process Clause does not permit North Carolina to tax the trust on undistributed income that the trust earned outside of North Carolina's borders.

North Carolina's reliance upon *Greenough v. Tax Assessors of City of Newport* for the proposition that "a trust constituent's residency in a state connects the trust to the state" is misplaced. Pet. Br. at 30. Although *Greenough* established that a state could constitutionally tax income earned by a trust based upon a trustee's presence within that state, *Greenough* does not support North Carolina's argument that a beneficiary's presence within the state provides the same jurisdictional basis. *Greenough v. Tax Assessors of City of Newport*, 331 U.S. 486, 493-96 (1947).

North Carolina's claim that *Greenough* is at odds with *Safe Deposit* is incorrect. First, it is worthy of note that the Court cited to *Safe Deposit* in *Greenough*, recognizing that the two cases involved different jurisdictional issues. *Greenough*, 331 U.S. at 496-97. On the one hand, the Court answered the jurisdictional question in *Safe Deposit* – whether the presence of trust beneficiaries in Virginia permitted that state to tax the trust's assets, even though the trustee, and the trust's assets, were located in Maryland – in the negative. *Safe Deposit*, 280 U.S. at 89-94. On the other hand, however, the Court answered the jurisdictional question in *Greenough* – whether the presence of a trust's trustee in Rhode Island authorized that state to tax the trust's intangible assets – affirmatively. *Greenough*, 331 U.S. at 488-98. Collectively, they provide that the presence within a state of a trust's trustee, but not a trust's beneficiary, is sufficient to establish minimum contacts with the state. Hence, *Safe Deposit* and *Greenough* are consistent with each other.

Finally, Petitioner's reference to *District of Columbia v. Chase Manhattan Bank*, *Chase Manhattan Bank*

v. Gavin, and *McCulloch v. Franchise Tax Board* is misplaced. All but one of the trusts in question in *District of Columbia* and *Gavin* were testamentary trusts, which were created pursuant to decrees that issued from courts in the jurisdictions that imposed tax. *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539, 545 (D.C. 1997); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 795-99 (Conn. 1999). Although *Gavin* also concerned an inter vivos trust, the beneficiary thereof – whose presence in Connecticut was found to justify that state's taxation of the trust's undistributed income – had more significant vested rights in the *Gavin* inter vivos trust (including the right to receive the trust's corpus at age forty-five, and to direct how the trust's corpus would be distributed, if she died before attaining forty-five years of age) than Respondent's discretionary beneficiaries did in the trust established for their benefit. *Gavin*, 733 A.2d at 802. In *McCulloch*, California taxed the California-resident beneficiary of a Missouri testamentary trust for income earned during the last five years of the trust's administration, at a point when the trust already had terminated and its assets had been distributed to the beneficiary, which is readily-distinguishable from the present matter (in which Respondent's assets remained in trust during, and after, the relevant tax years). *McCulloch v. Franchise Tax Bd.*, 390 P.2d 412, 414-21 (Cal. 1964).

In light of the foregoing, the Due Process Clause does not permit a state to tax the undistributed income that a trust earns in another state, based solely upon the presence of a discretionary trust beneficiary within the taxing state. The court below correctly concluded as much in ruling for Respondent.

B. The Analysis of the Court Below Is Neither Formalistic Nor Rigid and Comports With the Due Process Clause.

Since deciding *International Shoe Co. v. Washington*, the Court has eschewed formalistic Due Process Clause tests that "focused on a [party's] 'presence' within a [s]tate in favor of a more flexible inquiry into whether [the party's] contacts with [a state] made it reasonable, in the context of our federal system of Government," to be taxed by the state. *Quill*, 504 U.S. at 307. Regardless of that flexibility, however, the Court has declined to abandon "the requirement that, in the case of a tax on activity, there must be a connection to the activity itself . . . " *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992). The Court has recognized that the Due Process Clause requires a connection to the activity that is taxed, not merely "to the actor [that] the [s]tate seeks to tax." *Id.*

North Carolina and certain *amici* assert that the North Carolina Supreme Court's holding was overly formalistic and rigid, in a manner that contravenes this Court's Due Process Clause precedents. Pet. Br. at 21-22; Br. for Minnesota and Nineteen Other States and the District of Columbia as Amicus Curiae Supporting Petitioner (hereinafter, the "States Amicus Br.") at 3-6. However, that argument fails because the income tax that North Carolina seeks to impose upon the trust's undistributed income bears no connection to activities that took place, or income earned, within North Carolina's borders. In effect, North Carolina impermissibly seeks to tax the trust based upon a connection not to the trust or the trustee, but rather to its beneficiaries, whose rights to access trust assets during the relevant tax years were subject to the trustee's absolute discretion. App. 42.

Minnesota, nineteen other states, and the District of Columbia advocate for the Court to adopt the Missouri Supreme Court's six-pronged test for determining whether a state can tax income earned by a trust. States Amicus Br. at 4. The six factors enumerated by the Missouri Supreme Court are: (1) "the domicile of the settlor"; (2) "the state in which the trust is created"; (3) "the location of the trust property"; (4) "the domicile of the beneficiaries"; (5) "the domicile of the trustees"; and (6) "the location of the administration of the trust." *Westfall v. Dir. of Revenue*, 812 S.W.2d 513, 514 (Mo. 1991). Under that test, when only one or two of the six factors are satisfied, the Due Process Clause cannot be met. *In re Swift*, 727 S.W.2d 880, 882 (Mo. 1987) (finding that Missouri could not impose income tax against a trust, even though the trust's settlor was domiciled in that state, and the trust was created there).

The test for which *amicus* advocates would not justify reversal here. Without more, the mere presence of a discretionary trust beneficiary in a particular state is insufficient to satisfy the Due Process Clause's requirement that a state have minimum contacts with a trust before taxing the trust's undistributed income. The presence of a trust beneficiary in a state is neither the dispositive factor that North Carolina claims it to be, nor one that warrants reversal here.

Contrary to the claims of North Carolina and certain *amici*, the North Carolina Supreme Court did not apply an antiquated, formalistic, or rigid Due Process Clause test in this matter. On the contrary, the court below properly recognized that North Carolina's efforts to tax undistributed trust income based solely upon the presence of discretionary trust beneficiaries within its borders

did not satisfy the Due Process Clause's requirement for minimum contacts.

C. The Court Below Did Not Create A Tax Shelter.

The states have adopted divergent approaches for taxing trust income. Seven states (Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming) do not tax trust income at all. Kevin R. Ghassomian, *Eliminate State Tax On Trust Income: A Comprehensive Update on Planning with Incomplete Gift Non-Grantor Trusts*, 39 ACTEC L.J. 317, 322 (Winter 2013). Although the remaining forty-three states and the District of Columbia do tax trust income, those jurisdictions apply different criteria in taxing income accumulated by trusts.

Only four states (California, Georgia, North Carolina, and Tennessee) tax income earned by trusts based upon the residence of a trust beneficiary within their borders. Cal. Rev. & Tax Code § 17742(a); Ga. St. § 48-7-22(a)(1)(c); N.C. Gen. St. § 105-160.2.; Tenn. Code Ann. § 67-2-110(a). Among the states in that small minority, Tennessee has repealed its state income tax, which will be fully phased out effective January 1, 2021. Tenn. Dep't of Rev., *2018 Guidance for Tennessee's Hall Income Tax Return* (July 12, 2017).

While the states are free to enact tax legislation of their choosing, that power is subject to limitations. *Greenough*, 331 U.S. at 493-95 ("But our question here is whether or not a provision of the Constitution forbids the tax. Neither the expediency of the levy nor its economic effect on the economy of the taxing state is for our consideration."). At the very least, the states must

comport with the Due Process Clause in enacting taxation legislation, which North Carolina failed to do here.

The Due Process Clause provides states with a wide array of options that do not raise constitutional concerns. Those options include: (1) taxing trust income that is derived from property and activity that takes place within a state; and (2) imposing tax on undistributed trust income earned by a trustee who is located in a state. Mich. Comp. Laws § 206.110; Ark. Code Ann. § 26-51-203(a)(1).

Yet another constitutionally-permissible option is available to states. States may tax accumulated trust income at the time that it is distributed to beneficiaries who are located within their borders, regardless of where the income is earned. N.Y. Tax Law § 612(b)(40); Cal. Rev. & Tax Code § 17745(b). When doing so, states receive the benefit of taxing resident trust beneficiaries, who receive trust distributions, for the accumulated income that the trusts earn during the years before distributions occur. Regardless of the contacts (or lack thereof) that the states have to trusts that are administered outside of their borders, states possess the minimum required contacts with trust beneficiaries who reside in the states and can tax such trust beneficiaries on accumulated trust income that is distributed to them without violating the Due Process Clause.

In light of the alternatives that are available to the states, it strains credulity to suggest that the analysis of the court below creates a tax shelter. Instead, as the North Carolina Supreme Court correctly recognized, a state can tax trust income, so long as the state satisfies the Due Process Clause's minimum contacts-based test,

which can be met by establishing that the trust's income arose from property or activities that occurred within the state, the trust's trustee was located in the state, or the trust's income was distributed to trust beneficiaries who resided within the state. Absent such a minimal showing, a state's taxation of trust income violates the Due Process Clause.

The Court's Commerce Clause-based analysis in *South Dakota v. Wayfair, Inc.* does not compel a contrary result. In *Wayfair*, the Court rejected the efforts of businesses that maintained no physical presence in particular states, but sold their goods and services to consumers located in those states via the internet, to avoid paying any sales tax to those states. In stark contrast to *Wayfair*, none of the parties to this proceeding argues that undistributed trust income is absolutely exempt from state income taxation in the absence of a physical presence of a trust within a state.

Rather, to the extent that a state's only connection with an out-of-state trust is a discretionary beneficiary's residence within the state, the state must await the beneficiary's receipt of trust distributions in order to tax trust income. Such a result fairly balances the state's interest in maximizing its tax revenues and the Due Process Clause's minimum-contacts analysis, by which all states are bound.

In light of the foregoing, North Carolina's tax on Respondent during the 2005 to 2008 tax years, which was predicated upon the residence of Respondent's discretionary trust beneficiaries in that state, violates the Due Process Clause. The Court should, therefore, affirm the North Carolina Supreme Court's decision.

III. North Carolina's Tax Violates the Commerce Clause.

Although the Question Presented concerns whether North Carolina's tax violates the Due Process Clause, Respondent argued below that the tax also violates the Commerce Clause. *Kimberly Rice Kaestner Family Trust v. North Carolina Dep't of Revenue*, 12-CVS-8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018). While the North Carolina Business Court ruled that the law violated both the Due Process Clause and the Commerce Clause, North Carolina's Court of Appeals and Supreme Court only ruled that the statute violated the Due Process Clause. *Id.*, 814 S.E.2d at 47. Should the Court consider North Carolina's tax vis-à-vis the Commerce Clause, it should find that it is unconstitutional, or in the alternative, remand the matter.

A. The Four Factors For the Dormant Commerce Clause Analysis Cannot Be Met.

A state tax will survive scrutiny under the Dormant Commerce Clause so long as it: "(1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides." *South Dakota v. Wayfair*, 138 S. Ct. 2080, 2091 (2018) (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)).[3] An analysis of the tax under the

3. In finding that the tax ran afoul of the Commerce Clause, the North Carolina Business Court held that the tax did not satisfy the first or fourth prong, and did not address the other two prongs.

Complete Auto Transit test shows that North Carolina's tax does not fulfill any of these requirements, much less all of them.

The substantial nexus requirement commands that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). For example, in the wake of *Wayfair*, Pennsylvania's intermediate appellate court rejected a Commerce Clause challenge to a Pennsylvania personal income tax upon non-resident taxpayers because the underlying entity derived its income from real property owned in Pennsylvania, which created a substantial nexus with the state. *Andrews v. Commonwealth of Pennsylvania*, 196 A.3d 1090, 1098 (Pa. Commw. Ct. 2018).

The operative activity – Respondent accumulating undistributed income – and the taxpayer (the trustee) did not create a nexus with North Carolina, much less a substantial nexus. The trustee did not live or work in North Carolina, none of the income was earned in North Carolina, and the trust did not own any assets in North Carolina. Nor was a cent distributed from the trust to anyone in North Carolina. The presence of discretionary beneficiaries in the State of North Carolina was incidental to the taxpayer's activities.

Kimberly Rice Kaestner Family Trust, 2015 WL 1880607, at *9. Specifically, the Business Court held that the discretionary beneficiaries' presence in North Carolina was "some contact" but hardly a "substantial nexus." Likewise, it found the taxpayer (the trustee) had no presence within the state.

Wayfair does not change this analysis. *Wayfair* dispensed with the physical presence requirement, dubbing it "artificial, anachronistic . . . unsound and incorrect." *Wayfair*, 138 S. Ct. at 2099. But this does not alter the outcome, as the state still must show that the tax is applied to an activity with a substantial nexus with the taxing state and that the taxpayer availed itself of the "substantial privilege" of conducting business in the jurisdiction. *Wayfair*, 138 S. Ct. at 2099. This is not the case here, as North Carolina's tax is designed to capture all income earned by a trustee, regardless of whether the trustee used or profited from any of North Carolina's services.[4]

Nor is the tax fairly apportioned. This prong of the *Complete Auto Transit* test serves to "ensure that each [s]tate taxes only its fair share of an interstate transaction." *Oklahoma Tax Com'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184 (1995). Doing so requires analyzing whether the tax is both internally consistent and externally consistent. Internal consistency is achieved "when the imposition of a tax identical to the one in question by every other [s]tate would add no burden to interstate commerce that intrastate commerce would not also bear." *Jefferson Lines, Inc.*, 514 U.S. at 185. This Court described utility of this test three years ago in *Comptroller of Maryland Treasury v. Wynne*:

---

4. For this reason, tax practitioners and commentators have speculated that *Wayfair* would have a minimal impact on state taxation of trusts. Richard W. Nenno, *Minimizing or Eliminating State Income Taxes on Trusts*, Koren Estate, Tax, and Personal Financial Planning Update (August 2018 ed.).

> By hypothetically assuming that every State has the same tax structure, the internal consistency test allows courts to isolate the effect of a defendant [s]tate's tax scheme. This is a virtue of the test because it allows courts to distinguish between (1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other [s]tates, and (2) tax schemes that create disparate incentives to engage in interstate commerce (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes. The first category of taxes is typically unconstitutional; the second is not.

Comptroller of Maryland Treasury v. Wynne, 135 S. Ct. 1787, 1802 (2015) (internal citations omitted).

If imposed nationwide, the North Carolina tax would discriminate against interstate commerce, as it would create double taxation upon any trust where the trustee resided in a state that taxed trust income, and a trust beneficiary, intentionally or not, resided in a different state.[5] In some instances, this would be unavoidable. As an illustration, consider a testamentary trust where the trustee had absolute discretion over distributing trust income, and a minor beneficiary resided in another state, and since she was a minor, could not relocate. Under the North Carolina law, the trustee would be subjected to

5. Subjecting interstate commerce "to the risk of a double tax burden to which intrastate commerce is not exposed" is forbidden by the Commerce Clause. *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938).

double taxation, and would be without recourse, as neither the trustee nor the beneficiary could relocate.[6]

This scheme would also create a sea change in trusts and estates practice for inter vivos trusts, as every time a beneficiary relocated to another state, grantors and trustees would be compelled to create a new trust (or decant a trust into a new trust) to avoid double taxation. Arguably, a trustee would be breaching its fiduciary duty if the trustee did not create a new trust (or decant).

The tax also fails to be externally consistent, which seeks "to discover whether a [s]tate's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing [s]tate." *Jefferson Lines, Inc.*, 514 U.S. at 185. As none of Respondent's activity occurred within North Carolina, the tax reaches beyond its permissible scope.[7] Additionally, as noted above, a blanket application of North Carolina's law exposes the taxpayer (the trustee) to multiple taxation if the trustee is also paying income tax to the state in which she resides.[8]

---

6. This is why the tax also fails the third prong of *Wayfair* and *Complete Auto Transit*, as it is plainly discriminates against interstate commerce; here, there are a trustee and a trust beneficiary in different states.

7. Similarly, the tax fails the fourth prong of *Wayfair* and *Complete Auto Transit*, which requires that the tax bear some relation to the services provided by North Carolina. The services that North Carolina and its *amici* claim the state is providing (such as public education) are to the beneficiary, not the taxpayer.

8. "The threat of real multiple taxation . . . may indicate a state's impermissible overreaching." *Jefferson Lines*, 514 U.S. at 185; *see also J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938).

B. In the Alternative, the Matter Should be Remanded for Commerce Clause Consideration.

In the event the Court reverses on Due Process grounds and does not hold that North Carolina's tax is unconstitutional under the Dormant Commerce Clause, it should remand for further proceedings to develop a record concerning whether the tax violates the Commerce Clause. For example, a tax will not be externally consistent when the taxpayer demonstrates "by clear and cogent evidence that the income attributed to the [s]tate is in fact out of all appropriate proportions to the business transacted in that [s]tate."[9] *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983) (citing *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931)). The parties should be permitted to develop a record to ascertain whether this was the case.

Additional findings of fact would also be necessary to ascertain if North Carolina's tax poses an undue burden and violates the balancing test set forth *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). Indeed, this Court noted in *Wayfair* that *Pike* is one of several other aspects of Commerce Clause jurisprudence that can be used to ascertain a statute's constitutionality. *Wayfair*, 138 S. Ct. at 2098-99. The same is true as to whether North Carolina's tax impermissibly results in out-of-state taxpayers being subjected to double-taxation, whereas a domestic trust would not be. *See Wynne*, 135 S. Ct. at 1822.

---

9. *Container Corp.* concerned an apportionment formula between two states. While this is not the case here, the overarching principle applies.

CONCLUSION

For the foregoing reasons, NYSBA respectfully submits that the decision below should be affirmed.

Respectfully submitted,

MICHAEL MILLER
President
ROBERT M. HARPER*
ANGELO M. GRASSO
JEFFERY H. SHEETZ
LOIS BLADYKAS
NEW YORK STATE BAR ASSOCIATION
One Elk Street
Albany, New York 12207
(518) 463-3200
rharper@farrellfritz.com

Counsel for Amicus Curiae

* *Counsel of Record*

No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

PETITIONER'S REPLY BRIEF

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
RYAN Y. PARK
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

TABLE OF CONTENTS

TABLE OF CONTENTS i

TABLE OF AUTHORITIES iii

INTRODUCTION 1

ARGUMENT 4

I. The premises of the Trust's arguments are false 4

A. A trustee is not the true owner of a beneficiary's trust income 4

B. North Carolina taxed the Trust, not the trustee 8

II. The Trust misunderstands this Court's decisions on due process and taxation 12

A. The Trust's reliance on *Pennoyer*-era cases is mistaken 12

B. The Court's decisions in *Hanson* and *Shaffer* do not control 16

1. *Hanson* is inapposite here 16

2. *Shaffer* does not help the Trust here 17

III. The Trust's remaining arguments fail 19

A. The Trust's new arguments do not succeed 19

1. Tax jurisdiction does not depend on whether trust income is distributed....19

2. The Trust's "no purposeful availment" argument is mistaken........................21

3. The Trust's "absolute discretion" argument is contrary to trust law......23

B. The Trust has not justified its proposed tax shelter 25

CONCLUSION...28

TABLE OF AUTHORITIES

Cases

Am. Oil Co. v. Neill, 380 U.S. 451 (1965).....................4

Americold Realty Tr. v. Conagra Foods, Inc., 136 S. Ct. 1012 (2016)....................................... 1, 8, 9, 26

Blair v. Comm'r, 300 U.S. 5 (1937).........................7, 13

BNSF Ry. Co. v. Tyrrell, 137 S. Ct. 1549 (2017).........12

Brooke v. City of Norfolk, 277 U.S. 27 (1928).....*passim*

Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985)...18

Commonwealth v. Stewart, 12 A.2d 444 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941)...........*passim*

Container Corp. v. Franchise Tax Bd., 463 U.S. 159 (1983)...15

Curry v. McCanless, 307 U.S. 357 (1939)...................14

Daimler AG v. Bauman, 571 U.S. 117 (2014)............12

Greenough v. Tax Assessors, 331 U.S. 486 (1947)...*passim*

Hanson v. Denckla, 357 U.S. 235 (1958)..............16, 17

In re Andrew C., 2017 WL 6821717 (N.Y. Sur. Ct. 2017)...24, 25

Kulko v. Superior Court, 436 U.S. 84 (1978).............18

Lawrence v. State Tax Comm'n, 286 U.S. 276 (1932)...15

MeadWestvaco Corp. v. Ill. Dep't of Revenue, 553 U.S. 16 (2008)...1, 9

Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425 (1980) 15

New York ex rel. Cohn v. Graves, 300 U.S. 308 (1937) 15

People v. Mishkin, 521 N.Y.S.2d 296 (App. Div. 1987) 5, 7

Phillips Petroleum, Inc. v. Shutts, 472 U.S. 797 (1985) 17

Quill Corp. v. North Dakota, 504 U.S. 298 (1992) 1, 3, 12, 22, 26

Robertson v. Bullions, 11 N.Y. 243 (1854) 7

Safe Deposit & Trust Co. v. Virginia, 280 U.S. 83 (1929) 12, 13, 14, 15, 16

Scripto, Inc. v. Carson, 362 U.S. 207 (1960) 18

Shaffer v. Heitner, 433 U.S. 186 (1977) 16, 17, 18

South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018) 23, 25, 26, 27

Stone v. White, 301 U.S. 532 (1937) 4, 5, 13, 16, 21

Tyndall v. Tyndall, 119 S.E. 354 (N.C. 1923) 5, 7

Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940) 4

Statutes

N.C. Gen. Stat. § 105-160.2 .... 9, 10, 17, 22

Unif. Trust Code § 816 10

Rules

S. Ct. R. 15.2 9

Other Authorities

Myron Kove, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* 10

John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165 (1997)...5, 7

Richard W. Nenno, *Bases of State Income Taxation of Nongrantor Trusts* 27

INTRODUCTION

Quill's minimum-connection analysis centers on fundamental fairness. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992). As the Department's opening brief showed, this fairness-based analysis supports the tax at issue here.

Because a trust is just a relationship between multiple people, a trust has no jurisdictional contacts of its own. *Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016). Instead, its contacts are those of the people in the trust relationship. *See Greenough v. Tax Assessors*, 331 U.S. 486, 495 (1947).

Of the people in the trust relationship, the beneficiary—the trust's central figure—has the most important jurisdictional contacts. Pet'r's Br. 29–33. After all, serving the beneficiary's interests is a trust's reason for being. *Id.* at 29–30. When a state provides benefits and protections to a trust beneficiary, the state benefits her trust. *Id.* at 30–36.

In light of this reality, the tax here is fundamentally fair: North Carolina has given the Kaestner Trust something for which the state can ask for taxes in return. *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24–25 (2008) (applying this standard).

The Trust's response does not meaningfully rebut this analysis. Instead, the Trust repeatedly relies on two false premises to argue that trustees' contacts alone count for due-process purposes.

First, the Trust relies on the premise that a trustee is the true owner of trust income. That argument conflicts with core principles of trust law. Trust law makes beneficiaries, not trustees, the true owners of trust assets. Because of a beneficiary's ownership interest, her jurisdictional contacts count at least as much as a trustee's contacts do.

Second, the Trust relies on the premise that when North Carolina taxes trust income, the state is taxing the trustee, not the trust. This argument contradicts the arguments that the Trust made in its brief in opposition to certiorari.

In any event, the Trust's new argument is mistaken. The operative statute taxes trusts, not trustees. Further, taxes on trust income economically affect beneficiaries, not trustees.

Once these linchpins of the Trust's response are removed, little remains.

The Trust's doctrinal arguments misunderstand this Court's decisions on due process and trust taxation. The Trust relies on *Pennoyer*-era cases, as well as cases that did not involve taxes on a trust. The Trust is mistaken when it argues that "those precedents control here." Resp't's Br. 12.

Nor has the Trust explained away the massive tax shelter that its proposed rule would create. To the contrary, the Trust's brief heightens those concerns. The Trust proposes a rule that would invalidate statutes in a majority of the states.

Nothing in the Due Process Clause requires such a result. Under *Quill*'s fairness-based analysis, due process does not bar states from taxing a resident beneficiary's trust income.

ARGUMENT

I. The premises of the Trust's arguments are false.

A. A trustee is not the true owner of a beneficiary's trust income.

The Department's opening brief showed that, out of the people in the trust relationship, the beneficiary has the most important jurisdictional contacts. Pet'r's Br. 29–33. In response, the Trust tries to diminish the beneficiary's status. It claims that "there is no basis to treat [trust] income as if" it belongs to the beneficiary. Resp't's Br. 14; *see id.* at 40. The Trust goes on to argue that the trustee is the "owner of the trust property," so only his contacts should count. *Id.* at 27.

The Trust's argument contradicts modern due-process analysis, as well as fundamental principles of trust law.

In a due-process challenge to a tax, "this Court concerns itself with the practical operation of the tax, that is, substance rather than form." *Am. Oil Co. v. Neill*, 380 U.S. 451, 455 (1965) (citing *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 443–44 (1940)).

When a state taxes trust income, that tax does not burden a trustee economically. Instead, "only [the beneficiary] is ultimately burdened." *Stone v. White*, 301 U.S. 532, 538 (1937). In *Stone*, the Court recognized that "in the realm of reality it was the beneficiary's

money which paid the tax." *Id.* at 535. The Court declined to "shut its eyes to [that] fact." *Ibid.*[1]

The reality that *Stone* acknowledged is a bedrock principle of trust law: Beneficiaries—not trustees—are the true owners of their trust assets. John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 181 (1997); *see, e.g.*, *People v. Mishkin*, 521 N.Y.S.2d 296, 296 (App. Div. 1987) (referring to beneficiaries as "the true owner[s]" of trust assets); *Tyndall v. Tyndall*, 119 S.E. 354, 356 (N.C. 1923) (referring to a beneficiary as "the real owner" of trust assets).

The facts here underscore this principle of trust law:

- As Ms. Kaestner herself testified, the Trust here existed for one purpose: "to give me money." App. 82.
- During all of the tax years at issue, Ms. Kaestner and her children were the only people eligible to receive distributions. App. 46–47 (art. 1.2(a)–(b)).

---

[1] The Trust tries to distinguish *Stone* by noting that the beneficiary in that case had a right to income for life. Resp't's Br. 40–41. But nothing in *Stone* suggests that the Court's rationale turned on any feature of the trust instrument in that case. Indeed, the Court implied the opposite: It noted that "*whenever* the trustee brings suit" on behalf of a trust, that lawsuit "is for the benefit and in the equitable interest of the [beneficiary]." *Stone*, 301 U.S. at 536 (emphasis added).

- The trust instrument required that Ms. Kaestner personally receive all of the trust assets in 2009, when she turned 40. App. 47 (art. 1.2(c)(1)); App. 83. The only reason why Ms. Kaestner did not receive those assets in 2009 was that the trustee decanted the trust assets into another trust—an event that occurred only after the trustee consulted with Ms. Kaestner. App. 97; Pet'r's Br. 9–10.

- A few years after the decanting, Ms. Kaestner did receive trust assets. N.C. R. 214–15.[2]

[2] Despite these facts, the Trust refers repeatedly to Ms. Kaestner as a "contingent" beneficiary, without ever defining that label or stating any reason why the label might matter for due-process purposes. *E.g.*, Resp't's Br. i (Question Presented). For at least three reasons, the label does not help the Trust.

First, what matters for due process is not how an interest is labeled, but whether a resident beneficiary is eligible to receive distributions at the time of the tax. *See infra* pp. 19–21, 23–25. Here, during all of the tax years at issue, the only beneficiaries eligible to receive distributions were Ms. Kaestner and her children, who were North Carolinians during these years. App. 46–47 (art. 1.2(a)–(b)).

Second, the Trust's label contradicts the Trust's own complaint. The complaint describes Ms. Kaestner and her children as the Trust's "current beneficiaries." App. 11. It contrasts them with the Trust's "contingent remainder beneficiaries," who live outside of North Carolina. App. 11.

Third, Ms. Kaestner's interest was not "contingent" in any meaningful sense. She was required to receive all the trust assets in June 2009, just six months after the tax years at issue. App. 47 (art. 1.2(c)(1)).

Trust law describes this type of interest in trust assets as a beneficiary's equitable interest. *Commonwealth v. Stewart*, 12 A.2d 444, 447 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941); *Blair v. Comm'r*, 300 U.S. 5, 14 (1937). Her equitable interest is "an *actual property interest* in the subject-matter of the trust." *Stewart*, 12 A.2d at 446–47 (emphasis added); *accord Blair*, 300 U.S. at 14; Trust Profs.' Br. 9–12.

The trustee's interest in trust assets, by contrast, is "merely nominal." Langbein, *supra*, at 181. The trustee has no interest in trust property "other than as the depositary of the legal title." *Robertson v. Bullions*, 11 N.Y. 243, 270 (1854); *Tyndall*, 119 S.E. at 356 (same).

Thus, in every meaningful sense, a beneficiary, not a trustee, is the true owner of the assets in a trust.

A hypothetical illustrates this point. Suppose that a trustee used some of the trust income to buy himself a car, then defended his action on the theory that he was the true owner of the trust assets. No court would accept that defense. *See*, *e.g.*, *Mishkin*, 521 N.Y.S.2d at 296 (rejecting trustee's "contention that he had a right of ownership equal to that of the . . . beneficiaries").

In sum, a key premise of the Trust's argument that only the trustee's contacts should count—the premise that the trustee is the real owner of trust property—is false.

B. North Carolina taxed the Trust, not the trustee.

The Trust's response also depends on a second false premise: that "[t]he State sought to tax the trustee," not the Trust. Resp't's Br. 33. Relying on that premise, the Trust argues that the Court should "focu[s] on whether the trustee *himself* has minimum contacts with North Carolina." *Id.* at 34.

That argument clashes with what the Trust argued in all of the North Carolina courts and in its brief in opposition to certiorari.

- For example, in the state supreme court, the Trust argued that "it is the entity the state seeks to tax—*here the Trust*—that must have the connection with the forum state." Resp't's N.C. S. Ct. Br. 27 (emphasis added).

- Likewise, at the petition stage in this Court, the Trust framed this case as one in which "the State sought to tax the . . . income of a trust." Resp't's Cert. Opp. i (Question Presented). It went on to argue that "[t]he Kaestner Trust has no connection to North Carolina." *Id.* at 8.

The Trust is now retreating from its insistence on trust-level contacts—and for good reason. As the Department has argued throughout this case, a trust is merely a fiduciary relationship between people, not "a distinct legal entity." *Americold*, 136 S. Ct. at

1016.[3] Therefore, a trust cannot make entity-level connections between "itself" and a state. Pet'r's Br. 16.

To try to save the state-court judgment on alternative grounds, the Trust now argues that "[t]he State sought to tax the trustee." Resp't's Br. 34. It goes on to argue that the real question here is "whether the trustee *himself* has minimum contacts with North Carolina." *Ibid*.[4]

That new argument fails for multiple reasons.

First, the argument was not preserved in—and, indeed, contradicts—the Trust's brief in opposition to certiorari. Under these circumstances, this Court "typically will not address a question . . . even if the answer would afford an alternative ground for affirmance." *MeadWestvaco*, 553 U.S. at 31; *see* S. Ct. R. 15.2.

Second, the Trust's new argument fails on the merits. North Carolina is not imposing an income tax on Mr. Bernstein personally; it is taxing "the taxable income of the . . . trust." N.C. Gen. Stat. § 105-160.2

---

[3] The Court in *Americold* noted that "when a trustee files a lawsuit or is sued *in her own name*, her citizenship is all that matters for diversity purposes." 136 S. Ct. at 1016 (emphasis added). Here, however, only the Trust is the plaintiff. The trustee is not a party.

[4] A number of amici apply this same mistaken premise. *See, e.g.*, Prof. Brilmayer Br. 11, 17–21; Chamber of Commerce Br. 3, 15–17.

(2017). That is why the Trust—and not Mr. Bernstein—is the plaintiff in this lawsuit.

In the decision under review, the state supreme court agreed that the statute taxes trusts, not trustees. Pet. App. 4a. The court described the trustee as the person who "physically" sends in the tax payment on behalf of the trust. Pet. App. 12a (citing N.C. Gen. Stat. § 105-160.2).

Despite all this, the Trust claims that "the trustee is liable for taxes assessed on the trust." Resp't's Br. 37. It cites a treatise for that proposition. *See* Myron Kove, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 265, at 130 (rev. 3d ed. 2012) [hereinafter Bogert]. That section of the treatise, however, says the opposite: "[T]he trustee is *not* personally liable for income taxes assessed on the trust's taxable income." *Ibid.* (emphasis added).

Citing the same section, the Trust also claims that "the trustee is liable . . . for failure to file returns or pay taxes." Resp't's Br. 37 (citing Bogert, *supra*, § 265). Again, however, that section says the opposite: Unpaid trust taxes are "collectible from the trust estate . . . but *not* from the personal estate of the trustee." Bogert, *supra*, § 265, at 128 (emphasis added).[5]

---

[5] The Trust also cites the Uniform Trust Code. Resp't's Br. 37 (citing Unif. Trust Code § 816 (Unif. Law Comm'n 2000)). But the cited code section states only that a trustee is authorized to remit taxes on the trust's behalf, not that the trustee pays those taxes with his own money. Unif. Trust Code § 816.

As these points show, North Carolina did not tax the trustee here. That false premise undermines the Trust's argument that a due-process analysis should be limited to the trustee's contacts alone.

* * *

In sum, the two major premises of the Trust's arguments are false. The failure of those premises shows why a trustee's contacts are not the only contacts that count for due-process purposes. Instead, as shown above and in the Department's opening brief, the beneficiary—the trust's central figure—has the most important jurisdictional contacts. Pet'r's Br. 29–33; *supra* pp. 4–7.

II. The Trust misunderstands this Court's decisions on due process and taxation.

A. The Trust's reliance on *Pennoyer*-era cases is mistaken.

The Trust begins its doctrinal arguments by emphasizing two of this Court's *Pennoyer*-era decisions: *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929), and *Brooke v. City of Norfolk*, 277 U.S. 27 (1928). For several reasons, those cases do not carry the day here.

First, those cases applied a physical-presence test that is inconsistent with modern due-process analysis.

Safe Deposit demanded that the trust assets at issue be "actual[ly] presen[t]" in the taxing state. 280 U.S. at 92. The majority opinion uses the word "situs" ten times. *Id.* at 91–94.

Brooke, too, relies on presence-based reasoning. The *Brooke* Court found it pivotal that "the property held in trust has remained in Maryland and no part of it is or ever has been in Virginia." 277 U.S. at 28.

These presence-focused cases have been "superseded by developments in the law of due process." *Quill*, 504 U.S. at 308. Twice within the last five years, the Court has cautioned that *Pennoyer*-era precedents "should not attract heavy reliance today." *Daimler AG v. Bauman*, 571 U.S. 117, 138 n.18 (2014); *accord BNSF Ry. Co. v. Tyrrell*, 137 S. Ct. 1549, 1557–58 (2017).

The Trust tries to shore up *Safe Deposit* and *Brooke* by arguing that they reflect a "practical realit[y]" that the trustee is the one true owner of a beneficiary's trust income. Resp't's Br. 18. That explanation, however, overlooks the actual reasoning in *Safe Deposit* and *Brooke*—reasoning that focuses on physical presence, not economic reality. *See supra* p. 12.

More importantly, the Trust's view of practical reality is the opposite of the actual reality that this Court recognized in *Stone*: the reality that trust money is "the beneficiary's money." 301 U.S. at 535; *see supra* pp. 4–7.

In sum, the Trust's argument contradicts first principles of trust law, as well as this Court's later decisions in *Stewart*, *Blair*, and, most notably, *Stone*.[6]

The Trust's reliance on *Safe Deposit* and *Brooke* is misplaced for a second reason as well: Even aside from their *Pennoyer*-era reasoning, these cases have been separately undercut by later decisions.

Safe Deposit relies heavily on the idea that the Due Process Clause bars taxation by more than one

---

[6] The Trust also tries to refigure *Greenough* as a case that calls a trustee the one true owner of trust assets. Resp't's Br. 21–22. *Greenough* does not endorse the Trust's view. The *Greenough* Court explicitly based its holding on the benefits and protections that the taxing state provided to the trust. The Court expressly "restrict[ed its] discussion and determination" to rejecting the argument that Rhode Island offered no "protection of or benefit to the trust fund." *Greenough*, 331 U.S. at 490.

state. That doctrine was overruled in *Curry v. McCanless*, 307 U.S. 357, 363 (1939).

The Trust's only answer to *Curry* is to point out that the Court's analysis of double taxation started to shift even earlier. Resp't's Br. 19 n.3. But that point only highlights that *Safe Deposit* was infirm before *Curry* dealt the fatal blow.[7]

Brooke, another *Pennoyer*-era decision, suffered a similar fate. There, the Court held that the Due Process Clause bars a state from taxing beneficiaries on trust property that is not physically present in that state. 277 U.S. at 29. Thirteen years later, however, the Court reversed course.

In *Stewart*, the Court affirmed a state supreme court's decision that the Due Process Clause *allows* a state to tax beneficiaries on trust property that is not physically present there. 12 A.2d at 446–47, *aff'd mem.*, 312 U.S. 649. Over the dissent of Justice McReynolds, the author of the majority opinion in *Safe Deposit*, the Court held that Pennsylvania could tax a resident beneficiary on her equitable interest in a trust—the same property interest that makes Ms.

[7] Although the Trust admits that *Safe Deposit*'s double-taxation reasoning is no longer good law, the Trust still complains that the tax here could produce double taxation. Resp't's Br. 19 n.3. The Trust, however, does not claim that any actual double taxation happened here. During the tax years at issue, the Trust paid virtually no trust-income tax in any state except North Carolina. Pet'r's Br. 43–45.

Kaestner the true owner of her trust income here. *See supra* pp. 4–7.

The Trust does not address *Stewart* at all.

Finally, *Safe Deposit* and *Brooke* are distinguishable because they both involved property taxes. *Safe Deposit*, 280 U.S. at 90; *Brooke*, 277 U.S. at 28. This case, in contrast, involves income taxes.

For due-process purposes, the Court has long distinguished property taxes from income taxes. *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 314 (1937); *accord Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 187–88 (1983); *Greenough*, 331 U.S. at 491–92.

Property taxes and income taxes are "predicated upon different governmental benefits." *Graves*, 300 U.S. at 314. Property taxes are constitutional because a state protects property itself. *Container Corp.*, 463 U.S. at 188. Income taxes, in contrast, are "founded upon the [state's] protection afforded to the recipient of the income." *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932).

Because of this difference, the Court has cautioned that the "single situs" reasoning that often applies to property taxation should "carry little force in the case of income taxation." *Container Corp.*, 463 U.S. at 188 (quoting *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 445 (1980)). Under this principle, the single-situs reasoning in *Safe Deposit* and *Brooke* carries little force here. Tax Profs.' Br. 16–18.

In sum, *Safe Deposit* and *Brooke* offer no guidance on the question presented.

B. The Court's decisions in *Hanson* and *Shaffer* do not control.

1. *Hanson* is inapposite here.

The Trust argues that *Hanson v. Denckla*, 357 U.S. 235 (1958), controls this case. Resp't's Br. 23–30. That argument fails for at least three reasons.

First, *Hanson* is distinguishable because it involved jurisdiction over a trustee, not a trust. 357 U.S. at 254–55. The issue in *Hanson* was whether a Delaware trustee could be haled into a Florida court in a will contest. *Ibid.*

Here, the Department is not seeking to hale the trustee, Mr. Bernstein, across state lines. Instead, North Carolina taxed a resident beneficiary's *trust* on income that was generated exclusively for her benefit. For this reason, *Hanson* is inapposite.

Second, *Hanson* is distinguishable because the state imposition there was felt only by a nonresident of the forum state: the Delaware trustee. *Ibid.*

Here, in contrast, the imposition is ultimately felt by an *in-state* resident. As shown above, "only [the beneficiary] is ultimately burdened" by trust taxes. *Stone*, 301 U.S. at 538; *see supra* pp. 4–7. In economic terms, the taxes here affected only Ms. Kaestner, a North Carolinian.

Third, *Hanson* is distinguishable because the imposition there involved the burdens of being sued. *See Phillips Petroleum, Inc. v. Shutts*, 472 U.S. 797, 808 (1985) (describing these burdens). This case, in contrast, involves a tax—a purely economic imposition.[8] This imposition is limited, moreover, to "the amount of the taxable income . . . that is for the benefit of a resident of [North Carolina]." N.C. Gen. Stat. § 105-160.2.

For these reasons, the Trust's reliance on *Hanson* is misplaced.

2. *Shaffer* does not help the Trust here.

The Trust also relies on *Shaffer v. Heitner*, 433 U.S. 186 (1977). Resp't's Br. 47–49. The Trust argues that *Shaffer* stands for the broad proposition that "the acceptance of fiduciary obligations to a forum resident" does not support jurisdiction. *Id*. at 48.

The Court in *Shaffer* specifically noted, however, that the case did not involve a fiduciary-duty theory of jurisdiction. The Court stressed that the relevant statute based jurisdiction "not on [the defendants'] status as corporate fiduciaries, but rather on the presence of their property in the State." 433 U.S. at 214. It was that quasi-in-rem theory, not a theory based

---

8 The Trust and its amici are right that this Court's decisions on adjudicative jurisdiction have helped shape tax jurisdiction. *Hanson*, however, illustrates a key difference between these two doctrines—the nature of the imposition involved.

on fiduciary relationships, that the *Shaffer* Court rejected.

Moreover, the Trust's broad reading of *Shaffer* cannot be squared with *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 473 (1985), which held that an extensive contractual relationship can justify jurisdiction over a person. Nor can it be squared with *Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960), which based jurisdiction on a relationship with in-state independent contractors.

Here, a trust's relationship with its beneficiary is at least as close as the relationships in *Burger King* and *Scripto*.[9] Indeed, a trust exists to serve its beneficiary; it cannot exist without her. Pet'r's Br. 29–30.

For these reasons, the Trust's arguments based on *Shaffer* are mistaken.

* * *

In sum, the Court's due-process decisions do not support the Trust's effort to narrow the scope of trust taxation.

---

[9] The Trust's reliance on *Kulko v. Superior Court*, 436 U.S. 84 (1978), fares no better. There, the defendant father's only relevant contact with California was that he allowed his daughter to live there with her mother. *Id.* at 92–93. The Court rejected this strained theory of a contact because it would "discourag[e] parents from entering into reasonable visitation agreements." *Id.* at 93. That concern has no relevance here.

III. The Trust's remaining arguments fail.

A. The Trust's new arguments do not succeed.

1. Tax jurisdiction does not depend on whether trust income is distributed.

The Trust argues that the fact that Ms. Kaestner did not receive distributions during the years at issue is constitutionally pivotal. *E.g.*, Resp't's Br. 8, 17. The Trust bases this argument on *Brooke v. City of Norfolk*, 277 U.S. 27 (1928). Resp't's Br. 16–17, 20–23.

Here, again, the Trust does not mention this Court's affirmance in *Commonwealth v. Stewart*, 12 A.2d 444 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941).

Stewart held that due process allowed a state to tax a resident beneficiary on *undistributed* trust assets. *Id.* at 447. *Stewart* cited two reasons why distributions are not constitutionally pivotal.

First, even though a trustee formally holds undistributed trust assets, a beneficiary's equitable interest in those assets provides the connection that justifies tax jurisdiction. *Id.* at 450. Ms. Kaestner holds this same equitable interest here. *See supra* pp. 4–7.

Second, when a trust accumulates trust assets, a trust beneficiary's home state "affords her the personal security that enables her to enjoy those resources." *Stewart*, 12 A.2d at 451. The Court expanded this principle in *Greenough*, 331 U.S. at 495. There, the Court held that it does not matter whether a trust constituent actually uses the state's benefits and

protections; all that matters is that she has the *opportunity* to do so. *Ibid.*

Here, during all of the tax years at issue, Ms. Kaestner and her children lived in North Carolina, enjoying taxpayer-funded benefits and protections. Pet'r's Br. 30–36. Whether the Trust made distributions or not, the state's protection of the Kaestners benefited the Trust. *Id.* at 33–36.

For example, North Carolina's regulation of banking gave the Trust the opportunity to make secure distributions and loans to Ms. Kaestner. *Id.* at 36. The Trust used that opportunity: It made a loan to Ms. Kaestner just a month after the tax period here. Pet. App. 3a. A few years later, it distributed trust assets to her. N.C. R. 214–15.

Finally, the Trust's "no distributions" argument overlooks the context in which the Trust was accumulating income.

A trust accumulates income for one purpose: eventually distributing that income to the beneficiary. *See supra* pp. 4–7. Here, Ms. Kaestner eventually received assets from the Trust. N.C. R. 214–15. If she had wanted to receive the trust assets sooner, in June 2009, she would have received them then. Those assets were decanted into a new trust only after consultation with Ms. Kaestner. App. 97; Pet'r's Br. 9–10.

In addition, a trust's accumulation of income has immediate benefits for the beneficiary. As noted above, trusts can make low-interest-rate loans to

beneficiaries, allowing them to enjoy the trust's accumulated income without paying any personal income tax. Tax Profs.' Br. 20–21. That is exactly what happened here. Pet. App. 3a; App. 99–100, 113.

Because of these realities, the Trust is wrong to treat income distributions as constitutionally pivotal.

2. The Trust's "no purposeful availment" argument is mistaken.

The Trust argues that jurisdiction is lacking because Mr. Bernstein did not purposefully avail himself of the taxing state. Resp't's Br. 12–15, 34, 47–49.

That argument fails because North Carolina did not tax Mr. Bernstein; it taxed the Trust. *See supra* pp. 8–11. The economic effect of the tax was felt only by Ms. Kaestner, a North Carolinian. *See Stone*, 301 U.S. at 538; *supra* pp. 4–7.

Moreover, the Trust's argument assumes that the only purposeful availment that counts for the Trust is the trustee's purposeful availment. Instead, just as the contacts that count for due-process purposes are those of the trust constituents, a trust's purposeful availment takes place through a trust constituent—the grantor, the trustee, or the beneficiary. *See Greenough*, 331 U.S. at 495; Pet'r's Br. 25–28.

Under that principle, the Trust purposefully availed itself of North Carolina. The Trust's central constituent, Ms. Kaestner, was a North Carolina

resident throughout the tax years at issue. As a resident, Ms. Kaestner enjoyed extensive benefits and protections from the state. Pet'r's Br. 30–36. Those state benefits and protections benefited the Trust in multiple ways—most notably, by helping the Trust conserve its income. *Id.* at 33–36. The Trust leaves that argument unanswered.

Indeed, North Carolina protected Ms. Kaestner throughout the life of the Trust. When the Kaestner Trust was created, Ms. Kaestner had been living in North Carolina for years.[10] Pet. App. 2a–3a.

By that time, moreover, North Carolina's trust-tax statute had been on the books for more than 75 years. The statute explicitly taxes trust income "that is for the benefit of a resident of [North Carolina]." N.C. Gen. Stat. § 105-160.2. This statutory language gave the Trust and its constituents fair warning that the Trust would be taxed in North Carolina. *See Quill*, 504 U.S. at 312 ("We have . . . often identified 'notice' or 'fair

---

[10] The Trust was split off from the Rice Family Trust in 2002 and formally established as a separate trust in 2006. Pet'r's Br. 7–8; Pet. App. 3a. Ms. Kaestner moved to North Carolina in 1997. Pet. App. 2a–3a.

Thus, Professor Brilmayer's arguments about the Trust apply a mistaken factual assumption: that Ms. Kaestner moved to North Carolina "well after the Trust was established." Prof. Brilmayer Br. 2; *see id.* at i, 3–4, 15 n.5, 17, 24–27.

The source of this mistaken assumption may be the Trust's inaccurate statement that Ms. Kaestner moved to North Carolina "five years after the trust's creation." Resp't's Br. 7. In actuality, the Kaestner Trust was created years after Ms. Kaestner moved to North Carolina.

warning' as the analytic touchstone of due process nexus analysis.").

Finally, even if one accepted the Trust's theory that Mr. Bernstein's purposeful availment is the only purposeful availment that matters, this case would still show purposeful availment. Resp't's Br. 34. When all of a trust's beneficiaries live in a given state, a trustee's fiduciary duty requires him to direct all of his efforts toward residents of that state. Tax Profs.' Br. 9.

For these reasons, the Trust's "no purposeful availment" argument fails.

3. The Trust's "absolute discretion" argument is contrary to trust law.

The Trust argues that the Trust lacked a minimum connection to North Carolina because the trustee had "absolute discretion" to treat Ms. Kaestner as he saw fit. Resp't's Br. 14, 45, 49. That argument exaggerates the trustee's discretion and its relevance here.

First, the Trust's "absolute discretion" argument misses the point. What matters for due-process purposes is whether a resident beneficiary is *eligible* to receive distributions at the time of the tax. *See supra* pp. 19–21. When a beneficiary is eligible for distributions, state services to the beneficiary benefit the trust. Pet'r's Br. 33–36. These state services help a trust conserve its income and garner investment returns. *Id.* at 31–32. Here, throughout the tax years

at issue, Ms. Kaestner and her children were the only people eligible for distributions from the Trust. *See* App. 46–47 (art. 1.2(a)–(b)).

In any event, the term "absolute discretion" in a trust instrument is not taken literally. Trust Profs.' Br. 13 n.5 (summarizing authorities). Instead, a trustee's fiduciary duty to trust beneficiaries limits his discretion. *Ibid*.

Even when a trust instrument gives trustees "sole and absolute discretion" to make distributions, it is "unacceptable for trustees to simply sit back and do nothing until a request is made." *In re Andrew C.*, 2017 WL 6821717, at *1 (N.Y. Sur. Ct. 2017).[11] Instead, trust law gives trustees "an affirmative duty to inquire with diligence into the quality of [a beneficiary's] life and to apply trust income towards significantly improving it."[12] *Ibid.*

Thus, if North Carolina had not protected Ms. Kaestner during the years at issue, Mr. Bernstein's fiduciary duties would have called for him to make distributions to meet her needs. If he refused those distributions on the ground that his "absolute discretion" did not require them, Ms. Kaestner would

---

[11] Here, the trust instrument states that New York law governs its interpretation. App. 69 (art. 10).

[12] The trust instrument here reinforced these duties. It "direct[ed]" the trustee to consider the trust "a family asset, and to be liberal in the exercise of the discretion conferred upon [him] and to use income and principal . . . to meet the needs of the beneficiaries." App. 51 (art. 1.4(c)).

have had a claim for breach of fiduciary duty. *See*, *e.g.*, *ibid.*

As these points show, the Trust's assertion that Mr. Bernstein "had no legal obligation to provide anything to [Ms. Kaestner] during the relevant period," Resp't's Br. 45, is irrelevant to a due-process analysis and contrary to trust law.

B. The Trust has not justified its proposed tax shelter.

The Trust's arguments here, if successful, would open up a massive tax shelter—an outcome that this Court recently rejected. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2094 (2018).

Under the Trust's proposed rule, to avoid state income taxes nationwide, all one would need to do is select a trustee in a state with no trust-income tax.[13]

The Trust responds with two alleged justifications for this tax shelter. Both fail.

First, the Trust argues that the Department is questioning other states' taxing choices. Not so. It is simply asking the Court to honor North Carolina's *own* taxing choices. The Department is also showing why

[13] To try to make this tax shelter seem smaller, the Trust suggests that states might enact a "throwback" rule. Resp't's Br. 51–52. A throwback rule, however, would still allow beneficiaries like Ms. Kaestner to avoid state taxes on all of their trust income. All the beneficiaries would need to do is move to a strategically chosen state before taking a distribution. Pet'r's Br. 40.

North Carolina's tax is fundamentally fair—the central focus of the "minimum connection" test. *See Quill*, 504 U.S. at 306.[14]

The Department is also pointing out the practical consequences of the Trust's proposed rule: "significant revenue losses to the States." *Wayfair*, 138 S. Ct. at 2092. Avoiding those consequences would protect the same interest that the Trust claims to support: "the sovereign right of each state to set its tax policy." Resp't's Br. 15.[15]

The Trust also argues that a decision in its favor would not significantly disrupt states' taxing choices. The Trust is grossly mistaken. Its arguments, if accepted, would invalidate trust-tax statutes in a majority of the states.

---

[14] One of the no-trust-tax states, South Dakota, explicitly argues that the trust-tax statutes in the majority of its sister states should fall so that South Dakota can maintain its "comparative economic advantage" and attract "the trust industry." S.D. Br. 1, 3; *see id.* at 7–8. Crediting arguments like those would create a race to the bottom in trust taxation—an effect that would insulate wide swaths of trust income from state taxes. Pet'r's Br. 39–43; Tax Profs.' Br. 18–25.

[15] The Trust and its amici suggest that the Department's arguments would allow corporations to be haled into court in states where their shareholders live. Resp't's Br. 56–57; Chamber Br. 1. Those concerns are unfounded.

The Department's argument applies only to trusts—unique arrangements that lack any entity status. Pet'r's Br. 22–25. The argument does not extend to legal entities, like corporations, that are capable of making entity-level contacts. *See Americold*, 136 S. Ct. at 1016.

The Trust is asking this Court to constitutionalize the following rule: Only the state where a trustee lives and the state where a trust is administered have the right to tax undistributed non-source income in a non-grantor trust. *Id.* at 50–51. That rule would not treat a beneficiary's residency or a grantor's residency as a proper jurisdictional connection. *See ibid.*

A majority of states tax trust income on the basis of beneficiary residency, grantor residency, or a set of factors that includes at least one of those connections. Tax Profs.' Br. 18–20; Twenty-one States' Br. 9–12. Thus, if the Court accepted the Trust's proposed rule, that ruling would strike down trust-tax statutes in a majority of states.[16]

In sum, the rule that the Trust seeks here would construct a tax shelter of multi-billion-dollar proportions. Pet'r's Br. 39–43 (describing these concerns further); Tax Profs.' Br. 18–25 (amplifying these concerns).

This Court has not hesitated to reject such a result. *See Wayfair*, 138 S. Ct. at 2100. This case calls for the same outcome.

[16] Tax Profs.' Br. 19. Indeed, thirty-three states use beneficiaries' residency or grantors' residency as a criterion for taxing trusts. *See* Richard W. Nenno, *Bases of State Income Taxation of Nongrantor Trusts* (Feb. 28, 2019), https://perma.cc/88UZ-Q7ML.

CONCLUSION

The state supreme court's decision should be reversed.

Respectfully submitted,

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
RYAN Y. PARK
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

April 5, 2019

The Anatomy of a Trust Contest

Hon. Vincent W. Versaci
Schenectady County Surrogate's Court, Albany

Gary B. Freidman, Esq.
Greenfield Stein & Senior, LLP, NYC

Frank T. Santoro, Esq.
Farrell Fritz, P.C., Uniondale

NEW YORK STATE BAR ASSOCIATION
TRUSTS AND ESTATES LAW SECTION
<u>SPRING MEETING – NAPLES, FLORIDA - MAY 17-18, 2019</u>

Trust Litigation in the 21st Century

Presented by: Hon. Vincent W. Versaci, Frank T. Santoro and Gary B. Freidman

---

On March 28, 2016, Sammy Settlor, then age 85, was discharged from the Standish Sanitarium, a psychiatric hospital, after suffering from severe depression and anxiety. His physician, Dr. Hugo Z. Hackenbush of the Standish Sanitarium (a for profit institution owned by Dr. Hackenbush), has prescribed a high dose regimen of anti-depressants and mood stabilizing medications – some of the side effects of which are intermittent memory loss, hallucinations and delusions, and impaired vision.

On April 1, 2016, Sammy, who resided in Columbia County, New York (but maintained a pied-a-terre in Manhattan) executed a Will and revocable trust ("Trust") prepared by Louis Litt, whom Sammy met at one of Louis' many catered breakfast seminars on avoiding probate. Sammy named as his trustees both Louis Litt -- whose offices were in Manhattan and Copake, NY, but who is now retired and a resident of Naples, Florida -- and an old girlfriend, Jessica Pearson, who resided in New York County, but who moved a few months later to an apartment at the Ritz Carlton in Naples, Florida. Sammy's 2016 Will pours his entire probate estate into his Trust and contains a direction that his Will be probated in the Surrogate's Court, New York County. His prior Will, executed in 2010, left a $2 Million bequest to his alma mater, the School of Hard Knocks.

On April 2, 2016, the day after the Will and Trust were executed, Sammy funded the Trust with $10 Million in marketable securities maintained at an account at First Jersey Securities, headquartered in Hoboken, NJ, his 500-acre horse farm in Columbia County, valued at $5 Million, and a $500 saving account at a Citibank branch on East 42nd Street in Manhattan, New York. All decisions concerning Trust investments and administration are made in Naples

The Sammy Settlor Revocable Trust gives $500,000 to Louis Litt, $500,000 to the Standish Sanitarium, Inc. $1 Million to each of Sammy's 2 children from his first marriage, $4 Million to each of his two children from his second marriage and his horse farm to Jessica Pearson. The Trust residuary is bequeathed to the New York Bar Foundation. The Trust contains a detailed <u>in terrorem</u> clause which provides that any person who directly or indirectly challenges the Trust, Sammy's Will, his nomination of fiduciaries or any actions of his fiduciaries will be deemed to pre-decease Sammy without issue.

Sammy died on May 1, 2019 while feeding the pigeons at City Hall Park and it is not clear whether his probate estate contains any assets other than a few hundred dollars in a bank account in New York County.

His grieving third wife of 10 months, Donna Paulsen, and his 2 children from his first marriage Mike Ross and Rachel Zane, have made an appointment to see you on your return to your office in Manhattan from Naples, Florida. Rachel is named as Sammy's executor.

NEW YORK STATE BAR ASSOCIATION
TRUSTS AND ESTATES LAW SECTION
SPRING MEETING – NAPLES, FLORIDA - MAY 17-18, 2019

Trust Litigation in the 21st Century

Presented by: Hon. Vincent W. Versaci, Frank T. Santoro and Gary B. Freidman

1. Challenging Trusts

a. Differences between will and trust contests

i. There are numerous procedural, substantive, and practical differences between probate contest and trust contests in New York. SCPA 1404 and New York's rich common law provides a well-worn path for litigating the issue of the validity of a will. Not so with trust contests. However, the law continues to evolve as the courts have confronted trust contests more frequently and statutes have been amended to address issues raised repeatedly in trust contests. The contours of a trust contest have become more defined (Colleen F. Carew and Gary B. Freidman, *Trust Contests - - The Developing Law*, NYLJ, 4/18/07 at 3, col. 1 [APPENDIX 1]; John J. Barnosky, *The Incredible Revocable Living Trust*, Journal of the Suffolk Academy of Law, Volume 10 [1995] [APPENDIX 2]).

b. Choice of Forum

i. Supreme Court versus Surrogate's Court

1. The Supreme Court and the Surrogate's Court have concurrent jurisdiction over lifetime trusts. CPLR Article 77 authorizes a special proceeding for the determination of matters relating to express trusts (*see Chiantella v Vishnick*, 84 AD3d 797 [2d Dept 2011]). SCPA 207 and SCPA 1501 address Surrogate's Court jurisdiction over lifetime trusts and the applicability of the SCPA to lifetime trusts (Frank T. Santoro, *CPLR Article 77 and Trust Litigation in Supreme Court*, NY St BA T&E Newsletter [Fall 2016] [APPENDIX 3]).

2. The nature of the proceeding will likely affect choice of forum.

a. Challenge the validity of a trust and/or trust amendment? (CPLR Article 77; SCPA 202, 207).

b. Seek remedies related to trust administration, conduct of fiduciary? The SCPA contains numerous provisions that provide beneficiaries and interested parties with avenues to seek remedies and relief. For example, SCPA 2102 [1] provides a person with an interest in a estate, such as a trust beneficiary with the right to compel disclosure of information (*see In re Kassover*, NYLJ, 2/11/91, at 28 [Sur Ct, Nassau County] [miscellaneous proceeding by contingent remainderperson seeking information concerning a

testamentary trust was permitted after written demand made upon fiduciary and denied]).

c. The trust instrument may even direct the forum for any dispute or it may contain an arbitration clause, and public policy favoring arbitration is strong (*see Matter of Ismailoff*, 2007 NY Slip Op 50211[U] [Sur Ct, Nassau County, 2007])

c. Jurisdictional Issues

i. Subject matter jurisdiction

1. The Surrogate's Court has jurisdiction over “the estate of any lifetime trust which has assets in the state, or of which the grantor was a domiciliary of the state at the time of the commencement of a proceeding concerning the trust, or of which a trustee then acting resides in the state or, if other than a natural person, has its principal office in the state.” (SCPA 207). Venue would be proper in the county where the assets of the trust are located, where the grantor was domiciled at the time of the commencement of the proceeding, or where the trustee then serving resides or has its principal place of business.

2. Surrogate’s Court has limited by expansive jurisdiction (*see Matter of Mastroianni*, Sur Ct, Schenectady County, August 6, 2012, Versaci, J., File No. 2008-90 [APPENDIX 4]). The Supreme Court is New York’s Court of general jurisdiction - - it could probate a will - - but it will not.

ii. Personal jurisdiction

1. SCPA 309 governs the exercise of personal jurisdiction over persons required to be given notice and opportunity to be heard.

2. An express trust proceeding under Article 77 is a special proceeding governed by CPLR Article 4, and CPLR 403 [c] requires service in the same manner as a summons in an action, to wit, pursuant to CPLR Article 3.

iii. Forum *non conveniens*

1. Under N.Y. Const. art. VI, § 19 [a] and CPLR 325, the Supreme Court may, and quite often does, transfer trusts and estates related disputes to the Surrogate’s Court. Where there are existing proceedings pending pertaining to an estate or a trust in the Surrogate’s Court, the Supreme Court will generally refrain from exercising its concurrent jurisdiction where all the relief requested may be obtained in the Surrogate’s Court and where the Surrogate’s Court has already acted (*In re Tabler's Will*, 55 AD2d 207 [3d Dept 1976]). Commencing a proceeding

in Supreme Court may result in an unnecessary battle over the forum, delay the proceedings, and add to the expense of inevitable litigation.

d. Statute of Limitations

i. Revocable versus Irrevocable?

1. Revocable trusts are the functional equivalents of wills (*see Matter of Tisdale*, 171 Misc 2d 716, 718 [Sur Ct, NY County 1997). They are "ambulatory during the settlor's lifetime, speak at death to determine the disposition of the settlor's property, may be amended or revoked In order for a trust to be revocable, the instrument must state that the trust is revocable; otherwise, the trust will be deemed irrevocable (*see* EPTL § 7-1.16). A revocable trust may set the standard of "competence" that is required on the grantor's part in order for the grantor to amend or revoke the trust instrument (*see Manning v Glens Falls Nat. Bk. & Tr.*, 265 AD2d 743, 743-45 [3d Dept 1999] [finding that the grantor lacked the requisite "competence" to remove the trustee under the terms of the trust instrument]). While a grantor certainly can amend or revoke a revocable trust during his or her lifetime, the grantor's distributees or the fiduciary of the grantor's estate can only commence a proceeding to invalidate a revocable trust after the grantor's death (*see Matter of Heumann*, NYLJ, 11/2/06, at 21, col. 3 [Sur Ct, Westchester County]). Surrogate's Courts have held that the statute of limitations on claim to invalidate a revocable trust accrues at the grantor's death, rather than the trust's creation (*see Matter of Dalton*, NYLJ, 2/2/09, at 47, col. 4 [Sur Ct, Suffolk County]). A six-year statute of limitations begins to run against a distributee or person adversely affected by a revocable trust at the grantor's death (*see Matter of Davidson,* 177 Misc 2d 928, 930 [Sur Ct, NY County 1998]; *see also Matter of Kosmo Family Trust*, NYLJ, 12/17/18, at 33 [Sur Ct, Albany County] *citing Tilimbo v Posimato*, 2008 NY Slip Op 51366[U] [Sur Ct, Bronx County 2008] [APPENDIX 5]).

2. An irrevocable trust can only be amended or revoked upon the written consent of the grantor and all parties having a beneficial interest in the trust (*see* EPTL § 7-1.19). For a challenges to an irrevocable trust created by the decedent and for the recovery of assets funded therein, the statute will run from the date of the creation of the trust and will be governed by applicable theory (*see Cheliotis v Stratakis*, 2008 NY Slip Op 33503[U] [Sur Ct, Nassau County] [applying a six-year statute of limitations on a claim to set aside the creation of an irrevocable trust into which decedent's real property was funded on the grounds of fraud]; *see also Estate of Napoli*, 2017 NYLJ Lexis 2960 [Sur Ct, Kings County]).

e. Standing to challenge a trust or trust amendment

i. Those persons who may commence a proceeding to set aside a trust are a distributee, an executor, and an administrator to whom limited letters issued pursuant to SCPA 702 [9] (*see Davidson*; *see also Matter of Kosmo Family Trust*, NYLJ, 12/17/18, at 33 [Sur Ct, Albany County]).

f. Necessary parties to the proceeding

i. Where the relief sought is to set aside the trust, the necessary parties are the same as those required to be served with citation in a will contest. Any person who may be adversely affected by the relief sought is a necessary party (*see Matter of Ricardino*, NYLJ, 2/5/98, at 30, col. 5 [Sur Ct, Nassau County]). The Attorney General should not be forgotten - - and often is by those who are commencing a proceeding where they are most comfortable (in Supreme Court) pertaining to an *inter vivos* trust.

g. Discovery issues

i. SCPA 1404 and CPLR Article 31

1. SCPA 1404 permits a potential objectant to a will the right to inquire into the circumstances surrounding the preparation and execution of the propounded instrument in order to determine whether to file objections. The ostensible reason for this "one-way street" is to afford a potential objectant an opportunity to assess the facts surrounding the preparation and execution of the will, which he or she has no first-hand knowledge of, and has no other means of obtaining such information. In a contested trust proceeding no such analogy exists. There are no attesting witnesses who may provide opinion evidence of capacity and the absence of undue influence. The person seeking to set aside the trust must commence the proceeding and proceed with discovery under Article 31 of the CPLR.

ii. Evidentiary/discovery Issues

1. Attorney-client privilege:

a. A 2016 amendment of CPLR 4503 [b] created another exception to the attorney-client privilege in the case of revocable trusts. The purpose of the attorney-client privilege is to promote the use of legal representation by assuring clients that they may freely confide in their counsel without concern that such confidences may be divulged to outsiders (*see Matter of Colby,* 187 Misc 2d 695 [Sur Ct, NY County 2001]). Naturally, because the privilege shields evidence from disclosure, it obstructs the fact-finding process. CPLR 4503 [b] contemplates the fact that revocable trusts serve as the equivalent of wills. The exception only applies after the death of the

grantor, in recognition of the fact that a party, other than the grantor, has no standing to challenge a revocable trust during the grantor's lifetime (*see* N.Y.S. Assembly Memorandum in Support of Legislation, *citing Matter of Davidson,* 177 Misc 2d 928, 930 [Sur Ct, NY County 1998]).

b. While the statute addresses revocable trusts in the 2016 amendment, justification exists for an exception to privilege and waiver by an interested party where an irrevocable trust is in issue. In *Matter of Leddy* (2014 NYLJ LEXIS 4921 [Sur Ct, Nassau County] [APPENDIX 6]), where a revocable trust was in issue, the court held that the "[i]n a dispute between parties as to an interest in property which they claim through the same decedent, attorney-client privilege does not apply (*id., citing* RESTATEMENT [THIRD] OF THE LAW GOVERNING LAWYERS § 81 [2000] *and Matter of Levinsky*, 23 AD2d 25 [2d Dept 1965, *appeal denied* 16 NY2d 484 [1965] *and* 1 MCCORMICK ON EVIDENCE § 94 [7th ed.]; *see also Matter of Bronner*, 7 Misc 3d 1023[A] [Sur Ct, Nassau County 2005] [holding that "objectant may waive attorney-client privilege on behalf of the decedent in a probate contest in the interests of the estate in the truth finding process"]).

2. Physician-patient privilege

a. CPLR 4504 [c] – "A physician or nurse shall be required to disclose any information as to the mental or physical condition of a deceased patient privileged under subdivision (a), except information which would tend to disgrace the memory of the decedent, either in the absence of an objection by a party to the litigation or when the privilege has been waived:

i. by the personal representative, or the surviving spouse, or the next of kin of the decedent; or

ii. in any litigation where the interests of the personal representative are deemed by the trial judge to be adverse to those of the estate of the decedent, by any party in interest; or

iii. if the validity of the will of the decedent is in question, by the executor named in the will, or the surviving spouse or any heir-at-law or any of the next [of] kin or any other party in interest" (*see* CPLR 4504 [c]).

b. To obtain the grantor's medical records – which may reveal information concerning the grantor's mental and physical capabilities at the time of the trust's creation or amendment – it generally will be necessary to obtain signed HIPAA-complaint authorizations from the fiduciary of the grantor's estate.

c. If the fiduciary has not been appointed or refuses to cooperate, it may be possible to obtain a "so ordered" subpoena for the court having jurisdiction over the trust contest. To do so, the party seeking a "so ordered" subpoena will have to file the document with the court, together with an affirmation explaining why the subpoena is needed, on notice to the other parties who have appeared in the proceeding.

d. Arguably, CPLR 4504, which provides an exception to physician patient privilege does not apply in a proceeding to set aside a trust.

3. *In terrorem* provisions

a. The use of *in terrorem* clauses has been recognized in trust contests. While the statutory safe harbor provisions (EPTL § 3-3.5) are limited to wills, some authorities suggest that a proceeding to rescind or invalidate a trust in whole or in part may not trigger an *in terrorem* clause (*see Oakes v Muka*, 31 AD2d 834 [3d Dept 2006]; *Matter of Shamash*, NYLJ, 6/16/09, at 38, col. 2 [Sur Ct, NY County]).

h. <u>How to Prove Your Case</u>

i. Grounds to challenge a trust

1. Due execution

a. EPTL § 7-1.17 provides the requirements for the creation of a lifetime trust. Per statute:

> (a) Every lifetime trust shall be in writing and shall be executed and acknowledged by the person establishing such trust and, unless such person is the sole trustee, by at least one trustee thereof, in the manner required by the laws of this state for the recording of a conveyance of real property or, in lieu thereof, executed in the presence of two witnesses who shall affix their signatures to the trust instrument.

> (b) Any amendment or revocation authorized by the trust shall be in writing and executed by the person authorized to amend or revoke the trust, and except as otherwise provided in the governing instrument, shall be acknowledged or witnessed in the manner required by paragraph (a) of this section, and shall take effect as of the date of such execution. Written notice of such amendment or revocation shall be delivered to at least one other trustee within a reasonable time if the person executing such amendment or revocation is not the sole trustee, but failure to give such notice shall not affect the validity of the amendment or revocation or the date upon which same shall take effect. No trustee shall be liable for any act reasonably taken in reliance on an existing trust instrument prior to actual receipt of notice of amendment or revocation thereof.

2. Capacity – Revocable Trust or Irrevocable Trust

a. For an irrevocable trust, the relevant inquiry is whether the party was capable of making “a rational judgment concerning the particular transaction” - - in other words, contractual capacity. Contractual capacity is lacking where the party is “wholly and absolutely incompetent to comprehend and understand the nature of the transaction” (*Matter of ACN*, 133 Misc 2d 1043 [Sur Ct, NY County 1986]).

b. In *Matter of ACN*, the parties disagreed on the standard of capacity to be applied in addressing whether an irrevocable trust was created by the grantor with the requisite capacity. “A will, by nature, is a unilateral disposition of property whose effect depends upon the happening of an event *in futuro*. A contract is a bilateral transaction in which an exchange of benefits, either present or deferred, is exchanged.” The court determined that the standard for contractual capacity would apply, as the irrevocable trust was created by way of a bilateral transaction between the creator of the trust.

c. Courts have applied the contractual capacity standard to revocable trusts as well (*Matter of DelGatto*, 98 AD3d 975 [2d Dept 2012]). However, authority exists suggesting that the lower, testamentary capacity standard, should apply to revocable trusts

(*see Matter of Williams,* 2018 NY Slip Op 32497 [U] [Sur Ct, NY County]; *Matter of Aronoff*, 171 Misc 2d 172, 177 n 6 [Sur Ct, NY County 1996]).

3. Undue influence

a. In *Matter of Williams* (2018 NY Slip Op 32497 [U] [Sur Ct, NY County] [APPENDIX 7]), Surrogate Anderson recently summarized undue influence in a trust contest citing the leading cases on the claim, and stating:

> [W]here an instrument is proved to be the product of "a moral coercion, . . . restraining independent action and destroy[ing] free agency, . . . which, by importunity[,] . . . constrained [the purported creator to execute the instrument] . . . against [her] free will and desire," it must be invalidated *(Children's Aid Society v Loveridge,* 70 NY 387, 394 [1877]).
>
> As is often noted, undue influence can seldom be demonstrated by direct proof, since such an influence rarely occurs in plain view *(Rollwagen v Rollwagen,* 63 NY 504, 519 [1876]), instead taking the form of a "subtle but pervasive" *(Matter of Neary,* 44 AD3d 949, 951 [2d Dept 2007]) manipulation of another that is aimed at displacing the other's volition with one's own. Proof of undue influence must establish more than a motive to achieve such effect on another and an opportunity to do so: it must establish also that such effect was actually achieved *(Matter of Fiumara,* 47 NY2d 845 [1979]).

b. As in will contests, the burden of proof in trust contests generally lies with the party asserting undue influence (*see Matter of Walther,* 6 NY2d 49 [1959]. However, where there is a confidential relationship between the beneficiary and the grantor, an inference of undue influence arises which. In the absence of an explanation, the beneficiary has the burden of proving by clear and convincing evidence that the transaction was fair and free from undue influence (*see Matter of DelGatto*, 98 AD3d 975 [2d Dept 2012]; *Oakes v. Muka*, 69 AD3d 1139 [3d Dept 2010]; *Matter of Engstrom*, 47 Misc 3d 1212[A] [Sur Ct, Suffolk County 2014][APPENDIX 8]; *Matter of Graeve*, Sur Ct, Schenectady County, September 5, 2012, Versaci, J., File No. 2010-126/B [APPENDIX 9]).

4. Other grounds for a challenge

a. Invalid *ab initio*: There are four elements to a valid trust, it must have: 1) a designated beneficiary; 2) a designated trustee; 3) a fund or identifiable property; and 4) actual delivery of the fund to the trustee (*see Matter of Fontanella*, 33 AD2d 29 [3d Dept 1969]). As with wills, courts favor the enforcement of trusts and may cure certain defects, such as appointing a trustee where the grantor failed to do so (*Matter of Gold*, NYLJ, 10/16/02, at 20, col. 2 [Sur Ct, Kings County]), but a failure to fund the trust has been held to be fatal (*Matter of Hird*, NYLJ, 10/2/03, at 29, col. 1 [Sur Ct, Suffolk County]).

b. Ineffective pour over: Under EPTL § 3-3.7, a testator can pour his estate over into a lifetime trust so long as he has, before or contemporaneously with his will, executed the trust with the formalities required by EPTL § 7-1.17. In *Matter of D'Elia*, 40 Misc 3d 355 [Sur Ct, Nassau County 2013), the decedent left his residuary estate to a revocable trust. However, the decedent did not execute the trust until a week after the will was made and the disposition failed.

c. Duress – In a will contest, and in a trust contest the objectant must bear the burden of proof on the issue of duress (see *Matter of Osgood*, NYLJ, 2/11/91, at 22, col. 6 [Sur Ct, Nassau County]), by a preponderance of the evidence (*see* 3 Warren's Heaton on Surrogate's Court Practice § 42.04). "A donative transfer is procured by duress if the wrongdoer threatened to perform or did perform a wrongful act that coerced the donor into making a donative transfer that the donor would not otherwise have made" (see *Matter of Rosasco*, 31 Misc 3d 1214[A] [Sur Ct, NY County 2011]). In this regard, "[a]n act is wrongful if it is criminal or one that the wrongdoer had no right to do" (*id.)*.

d. Fraud – As in a will contest, the burden is on the person challenging the trust to prove fraud (*see* Warren's Heaton, *supra* § 42.04). The objectant must carry this burden by clear and convincing evidence (see *Matter of Klingman*, 60 AD2d 949 [2d Dept 2009]), as conclusory allegations and speculation will not suffice (*see Matter of Dietrich*, 271 AD2d 894 [3d Dept 2000]). In the context of a probate contest, which serves as an apt analog for a trust contest, fraud arises when someone "knowingly [makes] a false statement to the testator which cause[s] [the testator] to execute a will that dispose[s] of his property in a manner differently than [the testator] would have in the absence of that statement" (*see Matter of Evanchuk*, 145 AD2d 559 [2d Dept 1988]).

i. <u>Trying the case</u>

i. Before the Judge or a jury

1. SCPA 502 unequivocally provides a party to a contested proceeding over the validity of a revocable lifetime trust the right to a trial by jury.

2. Prior to the amendment of SCPA 502, the courts were not in accord on whether a jury was available in challenges to revocable trusts. Some courts held that there was no right to a jury in challenges to revocable trusts (*see Matter of Aronoff*, 171 Misc 2d 172 [Sur Ct, NY County 1996]; *Matter of Stralem*, NYLJ, 7/14/1997, at 37 [Sur Ct, Nassau County 1997]), while others held to the contrary on similar facts (*see Matter of Tisdale*, 17 Misc 2d 716 [Sur Ct, NY County 1997]; *Matter of Richman*, NYLJ, 4/26/2000, at 27 [Sur Ct, Queens County]). The same reasoning could be employed in addressing many cases involving irrevocable trusts and a question remains as to whether and to what extent the right to a jury exists in a case challenging an irrevocable trust.

3. Where the right to a jury in a revocable trust proceeding exists, a party seeking to avail themselves of the right to a jury must comply with SCPA 502, which requires that the party seeking a jury file a demand. The demand must be filed either with the petition or six days after the service of objections. A party who fails to make a timely demand is deemed to have waived his or her right to a jury. As with a will contest, a party should not rely upon a demand made by another party because that demand may be withdrawn at any time. Under CPLR 4102 [e], the Surrogate's Court has discretion to relieve a party from the failure to timely make a jury demand (*see* CPLR 4102 [e] ["The court may relieve a party from the effect of failing to comply with this section if no undue prejudice to the rights of another party would result."]). Why go there.

4. In Supreme Court practice, the jury demand is made at the time of the filing of the Note of Issue and Certificate of Readiness (CPLR 4102).

ii. Motions in Limine

1. A motion in limine is made prior to trial to address evidentiary issues in aid of preventing a mistrial through disclosure of prejudicial and even inadmissible materials. The motion is

addressed to the inherent powers of the court to set guidelines for permissible conduct at the trial. *Matter of Kochovos*, NYLJ, 3/28/88, at 16, col, 3 [Sur Ct, Bronx County 1988]).

iii. Burdens of proof

1. Unlike a probate contest, the party seeking to set aside a trust bears the burden of proof on all issues. Notwithstanding certain parallels to wills (i.e., the existence of statutory requirements to execute a trust) the trustee does not have any burden after the decedent's death to establish the validity of the trust. Nor does the trustee have a duty to demonstrate that the grantor was competent when the trust was executed (*Matter of DelGatto*, 98 AD3d 975 [2d Dept 2012]; *Matter of Arnoff*, 171 Misc 2d 172, 653 NYS2d 844 [Sur Ct, NY County 1996]; *Vultaggio v Vultaggio*, 2015 NY Slip Op 32456[U] [Sur Ct, Nassau County]).

iv. CPLR 4519

1. Under CPLR 4519, a person interested in the event who may be otherwise barred from testifying in a will contest may not be so barred in the contested trust proceeding, if the witness's interest differs under the two instruments. The key whenever ascertaining whether a witness may testify is to determine whether the person seeking to testify has a direct economic interest in the outcome.

2. The statute does not apply to any pre-trial disclosure (CPLR Article 31) or in pre-trial discovery proceedings such as depositions. At the trial on the merits, the Dead Man's Statute precludes the respondent-witness's testimony (*Rosenberg v Grace*, 158 Misc2d 32[Sup Ct, NY County 1993] *Mesbahi v Blood*, Sup Ct, Schenectady County, May 21, 2018, Versaci, J., Index No. 2017-0953 [APPENDIX 10])

3. Summary Judgment? CPLR 4519 may be asserted or waived only at the time of trial and does not bar consideration of interested testimony on a summary judgment motion because the privilege may be waived at trial (*Phillips v Joseph Kantor & Co.,* 31 NY2d 307 [1972]). Thus, evidence which would may be excluded at trial, may be considered in denying a motion for summary judgment. However, evidence that would be precluded by CPLR 4519 cannot, in and of itself, overcome a prima facie case for summary judgment.

v. Hearsay

1. Defined

a. Hearsay is an out of court statement of a declarant offered in evidence to prove the truth of the matter asserted in the statement.

b. The declarant of the statement is a person who is not a witness at the proceeding, or if the declarant is a witness, the witness uttered the statement when the witness was not testifying in the proceeding.

c. A statement of the declarant may be written or oral, or non-verbal, provided the verbal or non-verbal conduct is intended as an assertion.

2. Can we hear from the creator of the trust?

a. A statement which is not offered for its truth is not barred by the hearsay rule.

b. An out-of-court statement by a declarant describing the declarant's state of mind at the time the statement was made, such as intent, plan, motive, design, or mental condition and feeling, but not including a statement of memory or belief to prove the fact remembered or believed, is admissible, even though the declarant is available as a witness.

An out-of-court statement by a declarant describing the declarant's physical condition at the time the statement is made is admissible provided the declarant is unavailable at the time of the proceeding.

vi. Using Experts

1. As an analog, in as will contest, a properly qualified expert witness may opine as to decedent's testamentary capacity. CPLR 4515 provides that the expert "may express an opinion and reasons without first specifying the data upon which it is based. Upon cross-examination, he may be required to specify the data and other criteria supporting the opinion." Additionally, the questions calling for the expert's opinion need not be in hypothetical form.

2. Weight of the evidence will depend. The testimony of an expert physician, who only reviewed the medical records, did

not see or examine the testator is the "weakest and most unreliable" evidence (*Matter of Vukich*, 53 AD2d 1029 [4th Dept 1976], *affd* 43 NY2d 668).

3. CPLR 3101 [d] provides that upon demand a party must identify expert for trial and set forth the substance of the opinion to be rendered. Failure to comply with this section could result preclusion (Colleen F. Carew and Gary B. Freidman, *Expert Disclosure in Surrogate's Court*, NYLJ, 2/18/11 at 3, col 1; Charles F. Gibbs and Gary B. Freidman, *Expert Disclosure in Surrogate's Court*, *Part II,* NYLJ, 9/29/11 at 3, col. 1 [APPENDIX 11])

j. Who pays for the cost of a challenge?

i. Matter of Hyde

1. In *Matter of Hyde* (15 NY3d 179 [2010] [APPENDIX 12]), the Court of Appeals held that SCPA 2110 gives the Surrogate's Court the discretion to determine the allocation of attorney's fees paid from the trust or estate. The court is authorized to direct the source of payment either from the estate generally, or from the funds in the hands of the fiduciary belonging to the legatee.

2. Other Trust Litigation

a. SCPA 2102 relief

i. SCPA 2102 [1] authorizes an interested party to commence a proceeding to compel a trustee to "supply information concerning the assets or affairs of an estate relevant to the interest of the petitioner when the fiduciary has failed after request made upon him in writing therefor" (*see* SCPA 2102 [1]). For example, in *Matter of Preston*, NYLJ, 11/15/12, at 27, col. 2 (Sur Ct, NY County), petitioner petitioned to compel the trustees of a lifetime trust to deliver a copy of the trust instrument and to provide financial information for the trust. The court granted the petition, to the extent that it directed that the trustees provide a copy of the trust. However, the court denied the petition, to the extent that the petitioner requested financial information for the trust. The petitioner would have to establish her interest in the trust's assets before the trustees would be required to provide financial information

b. Reformation Proceedings

i. Appropriate where there is a mistake or change in the law

1. Reformation of a trust involves the Court changing the language of the trust by the addition or deletion of words (*Matter of Stahle*, NYLJ, Jan. 23, 2001, at p. 32, col. 6 [Sur Ct, Onondaga County]). Unlike construction, which is necessitated when the

grantor's/testator's intent is questionable and needs to be ascertained, reformation can be appropriate only when such intent is determinable but the terms of the instrument do not comport with such intent due to, *e.g.,* a mistake or change in the law (*Matter of* Meyer, NYLJ, 2/26/02 at 8, col. 5 [Sur Ct, NY County] [allowing reformation due to drafting error]).

a. Are the floodgates going to open? *(see Matter of Sukenik*, 2016 NY Slip Op 31217[U] [Sur Ct, NY County]; *Matter of Sukenik,* 162 AD3d 564 [1st Dept 2018] [APPENDIX 13]).

c. Construction Proceedings

i. SCPA 1420

1. Construction of an irrevocable trust (which could be contained either in a will, or in a free-standing lifetime trust) occurs when a court ascertains the testator's/grantor's intent as expressed in the words of the instrument. Section 1420 of the Surrogate's Court Procedure Act allows a court to construe a will in one of three procedural contexts: (1) an independent construction proceeding, (2) an accounting proceeding, and (3) a probate proceeding *(see* Margaret Valentine Turano and Hon. C. Raymond Radigan, New York Estate Administration § 3.11 [LexisNexis 2019 ed.]).

2. A court will construe when certain language of the trust is ambiguous, making it impossible to carry out the grantor's intent. The goal of every construction is "to ascertain [the] decedent's [or grantor's] intent in order that it may be effectuated" (*Matter of Richard*, NYLJ, 7/7/03, at 20, col. 1 [Sur Ct, NY County]). "That intent is to be ascertained 'not from a single word or phrase but from a sympathetic reading of the will [or trust] as an entirety and in view of all the facts and circumstances under which the provisions of the will [or trust] were framed'" (*Matter of Bieley*, 91 NY2d 520, 525 [1998] [citations and quotations omitted]). When the grantor's/testator's intent as expressed in the entire instrument is clear and unambiguous, courts will not look further than the instrument itself to ascertain the meaning of that part of the instrument that is ambiguous *(In re Manufacturers & Traders Trust,* 42 AD3d 936 [4th Dept 2007]). "The prime consideration [in all construction proceedings] is the intention of the testator as expressed in the will. All rules of interpretation are subordinated to the requirement that the actual purpose of the testator be sought and effectuated as far as is

consonant with principles of law and public policy" (*Matter of Fabbri,* 2 NY2d 236 [1957]).

3. Extrinsic evidence of the grantor's/testator's intent is admissible to clarify an ambiguity in a trust's language for which the intent of the grantor cannot be gleaned from the four corners of the trust. However, "if the terms of the will [or trust] are clear and unambiguous, extrinsic evidence will not be admitted to contradict those terms" *In re* Cole, 18 Misc.3d 1105[A], N.Y. Slip. Op. 52417[U] [Sur Ct, Nassau County 2007]).

d. Revoking trusts

i. Revocable trusts

1. The instrument must state that the trust is revocable; otherwise, the trust will be deemed irrevocable (*see* EPTL § 7-1.16).

ii. Irrevocable trusts

1. An irrevocable trust can only be amended or revoked upon the written consent of the grantor and all parties having a beneficial interest in the trust (*see* EPTL § 7-1.9).

2. A minor with a beneficial interest cannot consent to such an amendment or revocation, but some courts have dispensed with the need for a minor's consent when the proposed amendment benefits the minor (*see Matter of Johnson*, NYLJ, 6/3/11, at 30, col. 1 [Sur Ct, NY County]).

3. If the trust agreement contains any other conditions to revocation, those must be satisfied. Revocation, amendment, or modification can only be accomplished by complying with any requirements set forth in the trust agreement to effect a revocation, and (2) complying with the statutory requirements of EPTL § 7-1.9, which permits revocation of an express trust by the grantor thereof only upon the consent of all persons who hold a beneficial interest in the trust (*see Matter of Dodge's Trust*, 25 NY2d 273, 285 [1969]; *Elser v Meyer*, 29 AD3d 580 [2d Dept 2006]; *Matter of Mordecai's Trust,* 24 Misc 2d 668 [Sup Ct NY County 1960]; *Matter of French-American Aid for File Children, Inc.*, 151 AD3d 662 [1st Dept 2017]; *Matter of French-American Aid for File Children, Inc.*, NYLJ, 4/20/16, at 24, col. 6 [Sur Ct, NY County] [APPENDIX 14]).

e. Challenging decanting

i. Under EPTL § 10-6.6, a trustee may exercise the "power to invade the principal of an irrevocable trust by paying over some or all of the principal to a separate trust" (*see* Joseph T. La Ferlita, *New York's Newly-Amended Decanting Statute*, N.Y.S.B.A. Trusts and Estates Section Newsletter 10 [Winter 2011]; Steven H. Holinstat, Henry J. Leibowitz and Daniel W. Hatten, *Who Can Recant a Decant? Who Is the 'Creator' of a Decanted Trust*, NYLJ, 8/29/16 [APPENDIX 15]), subject to the certain limitations. Statutory formalities must be adhered to – notice provisions and statutory time frames are critical. At this juncture the courts have yet to confront procedural and substantive challenges to statutory decanting.

3. Challenging a Trust Within an Article 81 Proceeding

a. Mental Hygiene Law § 81.29

i. Authorizes court to modify, amend, or revoke, *inter alia*, any previously executed contract, conveyance, or disposition during lifetime or to take effect upon death, made by the incapacitated person prior to the appointment of the guardian while the person was incapacitated. Except, the statute forbids courts from invalidating a will or codicil of a living person. Article 81 proceedings have, consequently, changed the face of estate plans of living persons.

4. Challenging a Trust Within a Divorce Proceeding

a. Domestic Relations Law § 236 [B] [5] [d] [12]

i. In determining the equitable distribution of marital property, the court may consider "any transfer or encumbrance made in contemplation of a matrimonial action without fair consideration" (*see Ferraro v Ferraro*, 157 AD2d 596 [2d Dept 1999]). Funds placed in a trust (revocable or irrevocable) are not beyond the reach of the in matrimonial actions. New York courts routinely subject trust assets to equitable distributions in matrimonial actions (*see Pena v Alves*, 50 AD3d 336 [1st Dept 2008]; *Feldman v Feldman*, 204 AD2d 268 [2d Dept 1994]; *Goldberg v Goldberg*, 172 AD2d 316 [1st Dep't 1991]).

5. Miscellaneous Observations

a. Attorney fiduciaries

i. SCPA 2307-a requires that certain disclosures be made to testators before attorneys are nominated as fiduciaries under wills (*see* SCPA 2307-a). These disclosures concern the nomination of fiduciaries and the failure to make them requires that an attorney fiduciary's commissions be reduced by one-half (*see id.*). There is no analogous provision for attorneys who are appointed to act under *inter vivos* trusts.

1. In *Matter of Rothwell*, 189 Misc 2d 191, 196 (Sur Ct, Dutchess County 2001), the decedent's lifetime trust nominated the instrument's attorney-draftsperson to serve as successor trustee. The instrument further provided that "the successor trustee 'shall be entitled to be paid trustee's commissions as provided by law and in addition to reasonable attorney's fees." There was no evidence of any SCPA 2307-a-type disclosures. The Surrogate's Court directed a *Weinstock* hearing to determine whether the attorney-draftsperson unduly influenced the grantor to make the appointment. The Court also directed a *Putnam* hearing to determine whether the trust was a product of undue influence in light of the fact that the trust called for a $50,000 distribution to the attorney's wife.

Appendix

THE INCREDIBLE REVOCABLE LIVING TRUST

John J. Barnosky*

INTRODUCTION

The revocable living trust is an increasingly popular will substitute.[1] Like Totten trusts, joint accounts with right of survivorship and insurance policies, the revocable living trust is a mechanism for passing title to assets on death to the beneficiaries of a decedent without the formalities or difficulties of the probate system.[2] Such trusts are now touted by financial planners and the media as a panacea for obtaining estate tax savings and avoiding all the perceived ills of the probate system. As a result, in many states the revocable living trust has found its way to be the estate planning device of choice among the legal community and the general public.[3] In New York, the revocable living trust is valid "provided that the trustee has real, well-defined duties to perform, and the settlor has not retained exclusive control of the trust corpus."[4]

However, in these days of lawyer bashing, the probate system is often portrayed as a complicated and mysterious system with no other legitimate purpose except to line the pockets of lawyers. Norman Dacey, in his million-seller book "How to Avoid Probate"[5] states:

---

* John J. Barnosky is a senior partner at the law firm of Farrell, Fritz, Caemmerer. Cleary, Barnosky & Armentano, P.C. of Uniondale, New York. He is a former Chair of the Trusts and Estates Law Section of the New York State Bar Association and the Nassau County Bar Association. He is also a member of the Estates, Powers and Trusts Law Advisory Committee and is a frequent lecturer and writer on trust and estate topics.

1. *See* Rochelle A. Smith, *Why Limit a Good Thing? A Proposal to Apply the California Antilapse Statute to Revocable Living Trusts*, 43 HASTINGS L. J. 1391, 1394 (1992) ("Because the probate process can be expensive, expose private family matters to the public, take years to conclude, and cause families trauma and anxiety, more and more estate planners are counseling clients to avoid probate by using will substitutes instead of wills to distribute the bulk of their estates.").

2. *See* Robert L. Wolff, *Elder Law Planning Tools*, 65 N.Y.B.J. 12, 49 (1993). In addition to avoiding the need to probate an estate, living trusts provide privacy, while at the same time providing for the orderly disposition of the estate.

3. Robert A. Esperti & Renno L. Peterson, *Joint Trusts Are a Good Planning Tool for a Married Couple*, 20 EST. PLAN. 148, 149-50 (1993) [hereinafter Esperti & Peterson].

4. Howard Oken, *Is a Revocable Living Trust Valid As a Will Substitute?*, N.Y. L.J., July 20, 1993, at 1.

5. NORMAN F. DACEY, HOW TO AVOID PROBATE! (1983).

> The probate system, conceived generations ago as a device for protecting heirs, has now become their greatest enemy. Almost universally corrupt, it is essentially a form of private taxation levied by the legal profession upon the rest of the population. All across the land, both large and small estates are being plundered by lawyers specializing in 'probate practice.'[6]

As with most controversial issues in society, the zealots argue the extreme positions on either side, while the true answer lies in the middle. Neither the probate system, nor the living trust alternative, is all bad, nor all good.

This article explores the historical reasons for the popularity of such trusts in some jurisdictions, and the advantages and disadvantages of their use in New York State from both tax and non-tax points of view.

I. NATURE OF THE BEAST

A. Definition

While inter-vivos trusts can be either revocable or irrevocable, the term "living trust" has come to mean an inter-vivos trust over which the grantor expressly retains the power to revoke the trust and re-acquire its assets.[7] Generally, a power to revoke must be expressly retained in the trust indenture, and such an express provision is recognized in New York.[8] A reservation of the right or power to modify or alter the trust, or to substitute trust securities, may be so unrestricted in its wording as to be the equivalent of a power to revoke.[9] However, a provision permitting a partial invasion of principal, or a provision giving the trustee a discretionary power to invade so much of the principal as may be necessary for the settler's well being, is not the equivalent of a power of revocation.[10]

---

6. *Id.* at 15.

7. *See* Wolff, *supra* note 2, at 49 (stating that in a revocable living trust, the grantor reserves the power to revoke and amend the trust thereby allowing the trust property to be transferred back to the grantor).

8. This recognition has a well-established pedigree. *See, e.g.*, Van Cott v. Prentice, 104 N.Y. 45, 52, 10 N.E. 257, 260 (1887) (stating that such a provision is plainly an amplification of the idea involved in the power of revocation, in that the beneficiaries shall take what they receive as proceeding from the grantor subject to his right to revoke at any moment).

9. *See* Bankers Trust Co. v. Topping, 180 Misc. 596, 599, 41 N.Y.S.2d 736, 738 (1943) (holding that the broad language used in the original indenture reserving to the settlor the right to modify and alter is equivalent to the right to revoke).

10. *See* Matter of Heller, 10 Misc. 2d 363, 365, 115 N.Y.S.2d 343, 346 (1948) (stating that provisions permitting [illegible] invasion of the principal of a trust have [illegible]

Typically, the living trust is funded by the grantor during lifetime by the transfer to the trust of virtually all of his or her assets. Additionally, the grantor may also have non-probate assets, such as life insurance and employee benefits, payable to the trust. During the grantor's lifetime, the grantor utilizes as much of the income or principal as is needed by simply withdrawing money or assets from the trust. Upon the grantor's death, the trust generally will become irrevocable and be disposed of pursuant to the terms of the trust instrument.[11] In the case of married couples, the classic marital deduction/credit shelter trust methodology is often used.[12] The trust is, in effect, a contract which is self-executing, effective, and requires no blessing from the surrogate's court to allow its terms to be carried out upon the death of the grantor.[13]

B. Execution Requirements

A living trust need not be executed with the same degree of formality as a will.[14] New York Estates, Powers and Trusts Law (hereinafter "EPTL") section 3-2.1 describes the formalities necessary for the proper execution of a will, which includes the requirement that there be at least two attesting witnesses.[15] There are no such statutory requirements for the execution of a living trust. It is simply a contract that must be signed by the grantor and trustee. It need not be witnessed, notarized, or ac-

---

peatedly held not to be the equivalent of a right of revocation); McKnight v. Bank of New York and Trust Co., 254 N.Y. 417, 420, 173 N.E. 568, 569 (1930) (holding that although the trustees were given a certain amount of discretion in applying the principal to the settlor's needs, it did not amount to a reservation of a power of revocation).

11. *See* Joseph R. Pozzuolo & Audrey Mittleman, *Living Trusts May Provide Tax Benefits*, TAX'N FOR ACCT., May 1993, at 285 [hereinafter Pozzuolo & Mittleman].

12. *Id.* at 286-87 ("For a married couple, a revocable living trust can ensure that each spouse's unified credit shields a full $600,000 from estate tax. This is accomplished by providing that $600,000 will pass without qualifying for the marital deduction, usually to a trust with the surviving spouse as income beneficiary or outright to other heirs.").

13. *See* JESSE DUKEMINIER & JAMES E. KRIER, PROPERTY 656 n.3 (3rd ed. 1993).

14. *See* N.Y. EST. POWERS & TRUSTS LAW § 3-2.1 (McKinney 1981). Section 3-2.1 states the statutory provisions for formality of will execution.

15. N.Y. EST. POWERS & TRUSTS LAW § 3-2.1(C)(4) (McKinney 1981). Section 3-2.1(c)(4) states:

> There shall be at least two attesting witnesses, who shall, within one thirty day period, both attest the testator's signature, as affixed or acknowledged in their presence, and at the request of the testator, sign their names and affix their residence addresses at the end of the will. There shall be a rebuttable presumption that the thirty day requirement of the preceding sentence has been fulfilled. The failure of a witness to affix his address shall not affect the validity of the will.

Id.

knowledged. This high degree of informality may make a living trust less susceptible to objection for lack of proper execution. On the other hand, this same informality may make it subject to abuse. In any event, it is recommended that all such trusts be acknowledged, since only acknowledged trusts may serve as a receptacle for a pour-over from a will.[16] EPTL section 3-3.7 authorizes wills which pour-over to a living trust, but requires that the trust be executed in the same manner required by New York law for recording a deed.[17] Since virtually every estate plan involving the use of a living trust will also include a simple pourover will to pick up any assets which may not have been conveyed into the living trust,[18] care should be taken that living trusts are signed and acknowledged by the parties.

C. Challenge to a Living Trust

Article 14 of the Surrogate's Court Procedure Act (hereinafter "SCPA"), lays out, in great detail, the procedure for probate of a will and the filing of objections.[19] No such statutory scheme exists to pro-

16. *See* N.Y. EST. POWERS & TRUSTS LAW § 3-3.7(a) (McKinney 1981); *see also* SANFORD I. SCHLESINGER & BARBARA J. SCHEINER, *Planning for the Elderly or Incapacitated Client*, ALI-ABA COURSE OF STUDY: PLANNING FOR THE SENIOR CITIZEN, November 15-16, 1991, at 205 (stating that in New York the trust must be executed simultaneously with or before the will is executed, and as such, a will can "pour over" only to a trust under a pre-existing instrument).

17. N.Y. EST. POWERS & TRUSTS LAW § 3-3.7(a) (McKinney 1981). Section 3-3.7(a) states in relevant part:

> A testator may by will dispose of or appoint all or any part of his estate to a trustee of a trust . . . provided that such trust instrument is executed and acknowledged by the parties thereto in the manner required by the laws of this state for the recording of a conveyance of real property, prior to or contemporaneously with the execution of the will, and such trust instrument is identified in such will.

Id.; *see also* N.Y. REAL PROP. LAW §§ 291, 298 (McKinney 1989) (stating in relevant part: "A conveyance of real property . . . may be recorded in the office of the clerk of the county where such real property is situated, and such county clerk shall, upon the request of any party, on tender of the lawful fees therefor, record the same in his said office.").

18. *See* DENIS CLIFFORD, MAKE YOUR OWN LIVING TRUST 16/4 (1993) ("A pourover will takes all the property you haven't gotten around to transferring to your living trust and at your death, leaves it . . . to that trust.").

19. N.Y. SURR. CT. PROC. ACT §§ 1408, 1410 (McKinney 1967 and Supp. 1995). Section 1408 states:

> (1) Before admitting a will to probate the court must inquire particularly into all the facts and must be satisfied with the genuineness of the will and the validity of its execution. The court may, however, accept an affidavit of an attesting witness in the manner and under the circumstances prescribed in this article.

vide a road map for challenge to a living trust. However, as with any contract, a living trust may be set aside if the grantor was incompetent at the time of its creation, or if its execution was the product of undue influence or fraud.[20] In the contest of a will, a proceeding for probate must be commenced by the proponent of the will, with notice to those who would take in intestacy and those adversely affected by the instrument offered for probate.[21] No such notice exists in the living trust scenario

> (2) If it appears that the will was duly executed and that the testator at the time of executing it was in all respects competent to make a will and not under restraint it must be admitted to probate as a will valid to pass real and personal property, unless otherwise provided by the decree and the will and decree shall be recorded.

Id.

Section 1410 states:

> Any person whose interest in property or in the estate of the testator would be adversely affected by the admission of the will to probate may file objections to the probate of the will or any portion thereof. The objections must be filed on or before the return day of the process or on such subsequent day as directed by the court; provided however that if an examination of the attesting witnesses be requested pursuant to 1404, objections must be filed within 10 days after the return day of the process or within such other time as is fixed by stipulation of the parties or by the court.

Id.

20. *See* Pozzuolo & Mittleman, *Living Trusts May Provide Tax Benefits*, TAX'N FOR LAW., July 1993, at 48 (stating that if the grantor was subject to undue influence or lacked the requisite mental capacity when the trust was created, such conditions will invalidate the trust).

21. N.Y. SURR. CT. PROC. ACT § 1402 (McKinney 1967). Section 1402(1) states:

> A petition for the probate of a will may be presented by (a) any person designated in the will as legatee, devisee, fiduciary or guardian or by the guardian of an infant legatee or devisee or the committee of an incompetent legatee or devisee; (b) a creditor or any person interested; (c) any party to an action brought or about to be brought in which action the decedent, if living, would be a party; [and] (d) the Public Administrator or County Treasurer on order of the court, where a will has been filed in the court and proceedings for its probate have not been instituted or diligently prosecuted.

Id. See also N.Y. SURR. CT. PROC. ACT § 1411 (McKinney 1967). The statute states:

> Whenever objections are filed to the probate of a will, the proponent shall file a notice stating; (a) the name of the testator; (b) the name and address of the proponent, each person named or referred to in the will who has not appeared in the proceeding, and such other persons as directed by the court to be notified; (c) that the will has been offered for probate, that objections have been filed thereto, and that such objections will be heard on a date or at a term of court stated or as may thereafter be fixed by the court.

Id. Section 1411 continues by stating such notice shall be served on each of the persons therein named in the manner and within the time directed by the court, and that in the event the proponent shall fail to file such notice, the court may authorize any party to the proceeding to do so. *Id.*

and it will be up to the potential objectant to a living trust to fashion a pleading, either in supreme court or surrogate's court, which seeks to set aside the trust.[22] While the procedural road to such objections may be a bit murky, there is no question that there is a right to challenge a living trust judicially, and ultimately the persistent objectant will have his day in court.

What is the standard of proof necessary to set aside a living trust? Here there is a major difference between a living trust and a will. In probate, the proponent has the burden of proof on capacity and must, as part of his prima facie case, meet the burden of proving that the testator had the necessary capacity to execute a will.[23] This is often described in terms of knowing "the natural objects of his or her bounty" and the "nature and extent of his or her assets."[24] In the living trust situation, however, the burden is entirely on the objectant as to capacity.[25] Every person is presumed under the law to be competent,[26] and the proponent of the living trust may rely simply on its proper execution and acknowledgment.

Ostensibly, it would appear that it is more difficult to set aside a living trust than a will. As a practical matter, however, there may not be any substantial difference. In a will contest, the proponent easily meets his burden on capacity by the testimony of the attesting witnesses who opine that the will was properly executed and that the testator, in their opinion,

---

22. *See* Fredda L. Cohen & Karen J. Walsh, *Revocable Trusts and Wills Compared*, ALI-ABA COURSE OF STUDY: PLANNING FOR THE SENIOR CITIZEN, (Nov. 15, 1991) at 59 [hereinafter Cohen & Walsh] (stating that if the grantor has died, objections to a revocable trust must be commenced by the objectant in a special proceeding in either the surrogate's court or the supreme court).

23. *See* Matter of Kaplan, 50 A.D.2d 429, 387 N.Y.S.2d 105 (3rd Dep't 1976) (holding that the proponents must establish that the decedent possessed the required testamentary capacity to execute a valid will).

24. *See* Matter of Bush, 85 A.D.2d 887, 446 N.Y.S.2d 759 (4th Dep't 1981) (stating in order to determine whether a testator possessed testamentary capacity, the court looks to, among other things, whether the testator knew those who would be considered the natural objects of his bounty and whether the testator knew the nature and extent of the property that he was disposing); *see also* Matter of Estate of Scalone, 170 A.D.2d 507, 566 N.Y.S.2d 75 (2nd Dep't 1991); Matter of Estate of Fish, 134 A.D.2d 44, 522 N.Y.S.2d 970 (3rd Dep't 1987).

25. *See* Matter of Estate of Obermeier, 150 A.D.2d 863, 540 N.Y.S.2d 613 (3rd Dep't 1989) (stating that the burden of proving incompetence rests with the party asserting incapacity).

26. *Id.* at 864, 540 N.Y.S.2d at 613; *see also* Matter of Beneway, 272 A.D. 463, 71 N.Y.S.2d 361 (3rd Dep't 1947) (stating as a general rule a testator is presumed to be sane

had capacity to make a will.[27] The proponent then rests and the objectant must rebut the proponent's proof. Additionally, the degree of competency necessary to create a living trust may be slightly higher than the capacity necessary to execute a will.[28] This issue was addressed by Surrogate Lambert of New York County in *Matter of A.C.N.*[29] In that case, the court was dealing with a challenge to the creation of an inter-vivos charitable remainder unitrust.[30] The court cited the familiar axiom that the making of a will requires "less capacity than the execution of any other legal instrument," but found that a living trust does not have the same standard.[31] The court found that a living trust is a contract, thus, the standard of capacity for making a contract should be the governing principle.[32] Surrogate Lambert discussed contractual capacity at length, which is described as the ability of a contracted party to comprehend the nature of the transaction,[33] as well as the "impulse test," which deals with whether the contracting party is entering into the contract as the result of an irrational and uncontrolled reaction to some mental illness or defect.[34]

D. The Merger Doctrine

While many states specifically authorize, and give validity to, a revocable living trust in which the grantor is the sole trustee and beneficiary during his or her lifetime,[35] New York has no such statutory imprimatur, and a serious question exists as to the validity during the grantor's lifetime of such a trust. The doctrine of merger, which comes into play when the same person acts as trustee and sole beneficiary, causes an ex-

---

27. *See* N.Y. SURR. CT. PROC. ACT § 1404 (McKinney 1967).

28. *See generally In Re* Coddington's Will, 281 A.D. 143, 118 N.Y.S.2d 525 (3rd Dep't 1952), *aff'd*, 307 N.Y. 181 (1954) (stating less capacity is required to enable one to make a will than to make a contract); Matter of Will of Goldberg, 153 Misc. 2d 560, 582 N.Y.S.2d 617 (Surr. Ct. 1992) (stating less mental capacity is required to execute a will than any other legal instrument).

29. Matter of Estate of A.C.N., 133 Misc. 2d 1043, 509 N.Y.S.2d 966 (Surr. Ct. 1986).

30. *Id.*

31. *Id.* at 1047, 509 N.Y.S.2d at 969.

32. *Id.*

33. *Id.* at 1047, 509 N.Y.S.2d at 970; Ortelere v. Teachers Retirement Bd., 25 N.Y.2d 196, 250 N.E.2d 460 (1969).

34. Estate of A.C.N., 133 Misc. 2d at 1046, 509 N.Y.S.2d at 970 (stating the test for contractual incapacity includes those "whose contracts are merely uncontrolled reactions to their mental illness").

35. *See* Michael Patiky Miller, *Update on Whether to Consider Using a Funded Living Trust to Avoid Probate*, 16 EST. PLAN. 140, 141 (1989).

tinction of the trust during the time the dual positions exist.[36] The trust, after the current life, may, if it has a remainderman, spring up in a valid form when the trustee and beneficiary interest separate, but until then the current trustee/beneficiary would be said to have a legal life estate free of trust.[37]

This conversion of the trustee/beneficiary's interest in the transferred property from that of a trust beneficiary to "a legal estate in such property of the same quality and duration and subject to the same conditions as his beneficial interest," is mandated by section 7-1.1 of the EPTL.[38] While the use of the phrase "the same conditions" in the statute would seem to mean that the merger is of little moment, there are differences. For example, it has been held that the spendthrift provisions of EPTL section 7-1.5,[39] which apply to a trust, do not apply to a legal life estate. As such, the beneficiary of the legal life estate is able to sell, assign or encumber his or her life interest notwithstanding an expressed intent to the contrary in the governing instrument.[40] Additionally, if there is no real trust during the income trustee/beneficiary's lifetime, much of the law of trusts may not apply which is most likely contrary to the intent of the testator.[41]

The merger doctrine is easily avoided by appointing a co-trustee, or more simply, by adding additional beneficiaries.[42] Such a situation is

---

36. *See* In re Sackler, 145 Misc. 2d 950, 953, 548 N.Y.S.2d 866, 869 (Surr. Ct. 1986); Matter of Reed v. Browne, 295 N.Y. 184, 189, 66 N.E.2d 47, 49 (1946). *See also* AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS 60 (4th ed. 1990) ("Where the life beneficiary is originally named as sole trustee, or becomes sole trustee by survivorship or by appointment by the court, the New York courts have sometimes said that the intended trust does not arise or that the trust is extinguished.").

37. *See* Weeks v. Frankel, 197 N.Y. 304, 90 N.E. 969 (1910) (stating because trustee was entitled to sole possession as well as entire rents and profits, his interest became a legal estate). *See also* SCOTT, *supra* note 36, at 61.

38. N.Y. EST. POWERS & TRUSTS LAW § 7-1.1 (McKinney 1992). ("Every person who by virtue of any disposition is entitled to the actual possession of property and the receipt of income therefrom has a legal estate in such property of the same quality and duration and subject to the same conditions as his beneficial interest.").

39. N.Y. EST. POWERS & TRUSTS LAW § 7-1.5(a)(1) (McKinney 1982).

40. *See* In re Reed v. Browne, 295 N.Y. 184, 66 N.E.2d 47 (1946) (holding that sister was the owner of a legal, and thus assignable, life estate in the fund).

41. *See* In re Will of Seidman, 88 Misc. 2d 462, 470, 389 N.Y.S.2d 729, 736 (Surr. Ct. 1976) (stating that no testator intends for a trust to terminate due to operation of law).

42. *Id.* The court will simply make provisions for an additional trustee whether or not the will makes a provision relating to such. *Id.*; *see also* SCOTT, *supra* note 36, at 49 ("Where there are several trustees or several beneficiaries, the trust is valid even though

clearly demonstrated by a Nassau County case; *Matter of Sackler*.[43] In that case, Mr. Sackler created a trust, but retained, as trustee, the discretion to pay income or principal to himself, his wife or descendants.[44] This addition of current beneficiaries other than the named trustee prevents merger. While a careful draftsman may get around the merger doctrine, it still remains a trap for the unwary. More beneficial would be legislation which would bring us into conformity with the law in many other states by specifically authorizing a sole grantor to serve as trustee and current income beneficiary without invoking the doctrine of merger and elimination of the true trust relationship.

II. ADVANTAGES AND DISADVANTAGES OF THE REVOCABLE LIVING TRUST IN NEW YORK: NON-TAX CONSIDERATIONS

As this article will discuss further, there are many advantages to the use of a living trust as the principal dispositive mechanism upon death.[45] However, living trusts have not been as popular in New York as in other states. This is not, as Mr. Dacey would suggest, because lawyers are seeking to protect their turf,[46] but simply because the reasons for using the living trust are not as compelling in New York as in other states. New York has probate in solemn form, meaning that notice is given to all distributees upon the filing of a probate petition.[47] The distributees have a set time to file objections prior to probate,[48] and once a probate decree is signed, the executor never needs to return to court unless there

---

43. In re Sackler, 145 Misc. 2d 950, 548 N.Y.S.2d 866 (Surr. Ct. 1989).

44. *Id.*

45. *See* CLIFFORD, *supra* note 18, at 1/7. The advantages of setting up a revocable living trust include saving your family time and money by avoiding probate. *Id.*

46. *See* DACEY, *supra* note 5, at 33 (stating likely reasons for lack of support for living trusts is the attorney's desire for continuing handsome legal fees as a result of probate).

47. *See* N.Y. SURR. CT. PROC. ACT §1406 (McKinney 1967).

48. *See* N.Y. SURR. CT. PROC. ACT §1410 (McKinney 1967). Section 1410 states in relevant part:

> Objections must be filed on or before the return day of the process or on such subsequent day as directed by the court; provided however that if an examination of the attesting witnesses be requested pursuant to 1404, objections must be filed within 10 days after the return day of the process or within such other time as is fixed by stipulation of the parties or by the court.

Id.

is some controversy or requirement of a judicial accounting proceeding.[49] The estate administration process is unsupervised. Once appointed, the executor can make investment decisions, pay creditors, and make distributions without any court involvement.[50]

This is not true in the states which have adopted the Uniform Probate Code[51] and other states which have probate in common form. In those states, the will is admitted to probate on an administrative basis without prior notice.[52] After probate, notice is given to the heirs and they have a certain time within which to file objections.[53] In those states, because the decree is not final until after the statutory time period for filing objections has passed, the statutes require the court to take an active and supervisory role over the estate administration process. Consequently, court approval may be required each time the estate is required to sell assets, pay creditors or make a distribution.[54] Legal fees generated in a supervised probate state may, accordingly and justifiably, be more than in an unsupervised state.[55]

Additionally, in some states, attorneys' fees for handling an estate are set forth by statute and are a percentage of the estate.[56] In these states,

49. *See* N.Y. SURR. CT. PROC. ACT § 2216 (McKinney 1995); *see also* Estate of Hoffman, 98 Misc. 2d 732, 414 N.Y.S.2d 863 (Surr. Ct. 1979) (stating that during an accounting, the court may direct a conveyance, delivery, or assignment of property).

50. *See* N.Y. EST. POWERS & TRUSTS LAW § 11-1.1(b) (McKinney 1995).

51. *See* DACEY, *supra* note 5, at 24. The states adopting the Uniform Probate Code include: Alabama, Arizona, Colorado, Florida, Hawaii, Idaho, Minnesota, Montana, Nebraska, New Mexico, North Dakota, and Utah. *Id.*

52. *See* In re Eighmie's Will, 121 Misc. 750, 753, 201 N.Y.S. 876, 878 (Surr. Ct. 1923) (stating that a will subject to common form is admitted to probate without giving notice to interested parties).

53. *See, e.g.*, Robert A. Weems & Katherine L. Evans, *Mississippi Law of Intestate Succession, Wills, and Administration and the Proposed Mississippi Uniform Probate Code: A Comparative Analysis*, 62 MISS. L.J. 1, 43. Under Mississippi law, a probated will can be contested within two years. Under the Mississippi Uniform Probate Code, it may be contested within 12 months of probate or three years from the decedent's death. *Id.*

54. *See* N.Y. SURR. CT. PROC. ACT ART. 19 (McKinney 1995), for the New York procedures, which are not mandatory.

55. *See* DACEY, *supra* note 5, at 25. Under the Uniform Probate Code, the attorney has more responsibility, needs to be more creative, and therefore, deserves to be compensated accordingly. *Id.*

56. *See, e.g.*, Mary Sue Donohue, *Probate and Trust Law: 1993 Survey of Florida Law*, 18 NOVA L. REV. 355 (1993) (stating statute utilizes a percentage of the value of the estate with an hourly rate); *see also* Miller, *supra* note 35, at 142 (stating California and Hawaii determine fees based on a percentage of the gross value of the decedent's assets subject to administration), CAL. PROB. CODE § 10810 (Deering 1995) (providing

the revocable living trust has gained popularity as a mechanism to avoid supervised probate and statutory attorneys' fees. New York, however, does not have either supervised probate or statutory fees. In addition, the New York probate process, in the majority of the proceedings where there is no contest and where waivers of citation can be submitted by all distributees, is extremely fast, usually no more than 45 days and often as quick as two weeks.[57]

A. Avoidance of Cost of Probate

The savings allegedly attributable to "avoidance of probate" has been the principal focus of articles and seminars which enthusiastically promote the living trust system.[58] Certainly there is money to be saved, although perhaps not at the level advertised by the promoters. First, if probate is completely avoided, there is no filing fee in the surrogate's court.[59] The filing fee for an estate of $500,000 or more is $1,000.[60] Secondly, there can be a savings in fiduciary commissions, since presumably the grantor will charge no commissions during lifetime,[61] and upon death, trustees' commissions may be less than an executor's commission.[62] Assuming a three year administration, trustees' commissions on an estate of $1,000,000 would come to $20,700 versus one full executor's commission of $34,000. The savings in fiduciary commissions, however, may be academic since more often than not a family member is named fiduciary and that family member may well serve without

"the attorney for the personal representative shall receive compensation based on the value of the estate accounted for by the personal representative . . . .").

57. *See* DACEY, *supra* note 5, at 24.

58. *See* Michael J. Berger, *How Title to Assets is Held Can Determine Whether Probate is Avoided*, 18 EST. PLAN. 98, 100 (1991) ("Probably the best method to avoid the entanglements of probate is to use a revocable living trust."); *see also* Miller, *supra* note 35; DACEY, *supra* note 5 (stating American Bar Association agrees with the recommendation that one utilize the living trust for probate avoidance).

59. JAMES F. FARR & JACKSON W. WRIGHT, JR., AN ESTATE PLANNER'S HANDBOOK 77 (4th ed. 1979). Property held in the trust is not included in probate and thus, the expense of probate court is entirely avoided. *Id.*

60. N.Y. SURR. CT. PROC. ACT § 2402(8) (McKinney 1967); *see also* Howard E. Sayetta, *No Service Provided For High Filing Fee*, N.Y. L.J., Nov. 29, 1993, at 1; John J. Barnosky, *Objections to Electronic Recording*, N.Y. L.J., May 8, 1992, at 1 (stating that surrogate's court filing fees are the highest in the country).

61. *See* Peter A. Borrok, *The Benefits of Living Trusts: Just a Figment of Your Imagination?*, 20 WESTCHESTER B.J. 295 (1993). Quite often a settlor is trustee and the commission will be avoided during settlor's lifetime. *Id.*

62. *See* N.Y. SURR. CT. PROC. ACT §§ 2307-2309 (McKinney 1967).

commissions.[63] Also, the savings in the surrogate's court filing fee may also be unrealized, since it may be necessary to probate the pour-over will in order to pick up any assets not held by the living trust at the time of death.[64]

It is in the area of attorneys' fees that some larger savings are claimed. Certainly there is the possibility of some savings. If probate is avoided completely, the attorney need not prepare the customary probate papers.[65] Additionally, the transfer of assets to the beneficiaries is more readily accomplished by a trust since the fiduciary is already in place and the assets are already registered in the name of the fiduciary.[66] However, most of the legal aspects of the administration of an estate are still present.[67] Some studies have indicated that the total savings in attorneys' time through the use of a living trust, assuming probate is avoided completely, might be in the 10-20% range. This number can be substantial, but must be weighed against the initial additional cost of creating a living trust versus a will, and the inconvenience of living one's life with virtually all assets titled in the name of the living trust.

B. Avoidance of Delay

When the grantor of a living trust dies, there is no interruption in the continuation of the trust.[68] The trust simply continues and bills may be paid immediately, as well as distributions made to the surviving spouse

63. *See* Paul J. Steer, *Estate Planning to Benefit the Medium Sized Estate*, 18 EST. PLAN. 218, 220 (1991) (noting a spouse or other family member willing to serve as a fiduciary is often willing to waive the statutory fee).

64. *See* JEROME A. MANNING, ESTATE PLANNING: HOW TO PRESERVE YOUR ESTATE FOR YOUR LOVED ONES 237-39 (1993) [hereinafter MANNING, PRESERVE YOUR ESTATE].

65. JEROME A. MANNING, ESTATE PLANNING 632 (4th ed. 1991) [hereinafter MANNING, ESTATE PLANNING]. Costs can be reduced significantly by using a living trust. *Id.* The major portion of attorney's fees are charged when an estate is to be administered. *Id.*

66. *Id.* at 633. This is to be distinguished from a fiduciary under a will who can do nothing until the probate court places that person in office. *Id.* Although such a situation may only take a short period of time, it can still be hurtful. *Id.*

67. For example, filing of the federal estate tax return, post-mortem income tax planning, planning for disclaimers, valuation of assets, transfer of assets to the name of beneficiaries, preparation of an accounting and obtaining either judicial settlement or settlement of the fiduciary's account by receipt and release, and preparation of 1041 form.

68. *See* MANNING, ESTATE PLANNING 65, at 633 ("One important advantage of such a trust is that immediately upon death the trustee who is then serving can deal promptly with assets. including selling what is needed to raise cash or avoid possible losses . . ..").

or other beneficiaries.[69] This compares to a month or two delay in obtaining probate and collecting assets in the typical probate estate administration. This delay in availability of funds in the probate scenario, however, is very often avoided through the use of joint accounts, life insurance, prompt issuance of preliminary letters testamentary,[70] or full letters.[71]

C. Avoidance of Probate Costs in Special Situations

In the case of a decedent who dies leaving minor children or remote distributees, the revocable living trust can provide a significant advantage. Under the probate system, a guardian ad litem is appointed to represent the interest of minor distributees.[72] The fee of the guardian ad litem, although often modest, is chargeable against the estate.[73] More importantly, however, depending on the speed of the guardian ad litem in filing his or her report, the system can create an additional delay of a month or two.[74]

In the case of a decedent who has remote heirs whose whereabouts are not readily known or who simply does not know who his distributees are, a revocable living trust can be a godsend. Here, the entire cost of publication, the fee of a guardian ad litem and the delay involoved in

---

69. *Id.* at 675. The individual chosen by the grantor to manage the affairs of the grantor has the power of both management and investment authority which includes distributions based on provisions which were made for successors. *Id.*

70. *See* N.Y. SURR. CT. PROC. ACT § 1412 (McKinney 1967 and Supp. 1995).

71. *See* N.Y. SURR. CT. PROC. ACT § 1414 (McKinney 1967 and Supp. 1995).

72. *See* N.Y. SURR. CT. PROC. ACT §§ 402-403 (McKinney 1994). ("[A]n infant over the age of 14 years or his parent or guardian may petition the court on or before the return day of process for the appointment of a named attorney as his guardian ad litem."). *See also* Leona Beane, *The Role of the Guardian Ad Litem in Court Proceedings, Fiduciary Appointment How To's: Receivers, Guardians Ad Litem, Conservators*, March 31, 1992.

73. *See* Seidel v. Werner, 81 Misc. 2d 220, 367 N.Y.S.2d 694 (Sup. Ct. N.Y. 1975) (holding that it was proper to require the trustees to pay the necessary compensation for the guardian ad litem out of the share of the trust that was the subject of the litigation); Livingston v. Ward, 248 N.Y. 193 (1928) (holding that the Appellate Division had power to allow the guardians ad litem compensation for their services, payable by the adverse parties or out of the proceeds of the property which was the subject-matter of the action).

74. *See* Robin Herman, *Planning for the Elderly Client*, TAX MGMT. EST.. GIFTS & TR. J., September 1989, at 139 (stating that the drawbacks of appointing a guardian include the possibility of delay in the appointment of a fiduciary and court approval of proposed transactions, expense of legal fees and court fees, and record keeping burdens in accounting to the court).

tracking down the missing heirs and the due diligence attendant thereto, can be avoided completely.

D. Privacy

Another argument for a living trust is that under the probate system, anyone can review the records of the surrogate's court, and in some cases, know the estate tax return,[75] the assets of the decedent, identify the estate beneficiaries and the decedent's dispositive plan.[76] Accordingly, for the testator with an extreme concern about privacy, the living trust may provide an advantage.

E. Avoiding Guardianship During Lifetime

A growing number of senior citizens are putting their assets into a revocable living trust because they want to avoid having their assets put under control of a court appointed conservator or guardian should they become unable to manage their own affairs.[77] The guardianship proceeding is expensive, involving a guardian ad litem and bonding requirements of the fiduciary.[78] It is also time consuming, since frequent applications to the court are required for a sale of assets and other rather routine administrative tasks.[79] The placing of assets into a living trust can avoid these complications and expenses completely. A durable power of attorney might also suffice in most situations, but a well drawn trust does permit additional flexibility in terms of the powers of the fiduciary to make gifts and utilize other tax planning devices.[80]

---

75. *See* N.Y. RULES OF COURT § 207.20(c) (McKinney 1995).

76. *See* MANNING, ESTATE PLANNING, *supra* note 65.

77. *See generally* LAWRENCE A. FROLIK & ALLISON PATRUCCO BARNES, ELDERLAW 783 (1992) [hereinafter FROLIK & BARNES]. Guardianship is a device by which the judgment of a more capable person is substituted by the court for the judgment of an impaired individual. *Id.* This substitution clearly raises the issue as to what extent an individuals right to self-determination must be recognized. *Id.* at 783.

78. Priv. Ltr. Rul. 91-50-012 (Sept. 12, 1991).

79. *See* Herman, *supra* note 74.

80. *See* MANNING, ESTATE PLANNING, *supra* note 65, at 246 ("Among [the] powers you might want your agent to have is the authority to sign your tax return and deal with the I.R.S. Some people even give their agents the authority to make gifts from their

F. Avoidance of Ancillary Probate

If the decedent owns real property located in another state, the executor will normally have to bring ancillary proceedings in that state as well. This often involves retention of out-of-state counsel to bring ancillary probate proceedings in the foreign jurisdiction. The use of a living trust can avoid this procedure entirely, provided that the assets located in the foreign jurisdiction have been transferred into the living trust prior to the death of the grantor.[81] If a decedent owns real estate in a number of states outside of New York, the value of the living trust is even more beneficial.

Having explored the historical reasons for the popularity of the revocable living trust and the non-tax pros and cons, this article will now discuss the tax advantages and disadvantages of the use of such trusts and provide some helpful tips as to their drafting and administration. Both income and estate tax considerations must be considered prior to the establishment of a living trust. The nature of the assets and size of the estate, as well as the dispositive inclinations of the client, must also be addressed.

III. INCOME TAX CONSIDERATIONS

A. Grantor Trust

Under the Internal Revenue Code (hereinafter "IRC") section 676, the grantor of a revocable trust is treated as the owner of the trust for income tax purposes.[82] All items of trust income, deductions and credits attributable to the trust, are taken into account in computing the taxable income or credits of the grantor.[83] If the grantor is a trustee or co-trustee

81. Paul H. Waldman, *Estate Planning for the Terminally Ill Client,* TAX MGMT. EST., GIFTS & TR. J., July 11, 1991, at 144. The assets in a client's revocable trust are not subject to the probate process and, therefore, are not subject to ancillary probate for assets located in other jurisdictions. *Id.*

82. I.R.C. § 676 (West 1994). This section provides:

> The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to re-vest in the grantor title to such portion is exercisable by the grantor or a non-adverse party or both.

Id.

83. I.R.C. § 671 (West 1994). This section provides:

> Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in com-

of the trust, Treasury Regulation section 671-4(b) provides that no trust income tax returns need be filed.[84] The grantor will pick up such items on his personal income tax return as though no trust existed, and so, as a practical matter, the trust is invisible for income tax purposes.[85] If the grantor is not a trustee or co-trustee, then a separate fiduciary income return is required,[86] as well as a separate taxpayer identification number.[87] In such circumstances, simplified tax forms[88] are filed with the Internal Revenue Service and New York State.[89] These forms are filed for informational purposes only, and are filed simultaneously with the grantor's individual income tax return.[90] The revocable trust taxable year must be the same as the taxable year of the grantor, and the method of accounting must be the same.[91]

B. Holding Period of Property

Under IRC section 1223(11), any beneficiary who acquires property from a decedent, including property from a revocable trust, is deemed to have held such property for more than one year.[92] This may become important, especially if Congress passes legislation with respect to the tax on long-term capital gains and losses.

> puting the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual.

Id.

84. Treas. Reg. § 1.671-4(b) (1981).

85. Treas. Reg. § 1.671-4(b) (stating that all items of income, deduction, and credit from the trust should be reported on the individual's Form 1040 in accordance with its instructions).

86. *See* Howard M. Zaritsky, *An Estate Planner's Perspective of Recent Developments*, TAX MGMT. EST., GIFTS & TR. J., Jan. 1991, at 5. If the grantor is not a trustee or co-trustee, then the general rule is that items of income, deduction, and credit must be reported by the trustee on a separate statement attached to a 1041form. *Id.*

87. Page 8 of the Instructions for Form 1041, line C, provides that every estate or trust must have an employer identification number. This identification number must be different than the grantor's identification number.

88. Form 1041 and IT-205 (N.Y. Fiduciary Income Tax Form).

89. Treas. Reg. § 1.671-4(b)(3) (1981).

90. Treas. Reg. § 1.671-4(b)(3) (1981). If the grantor is not a trustee or co-trustee, then items of income, deduction, and credit are not reported by the trust on a separate fiduciary income tax return (Form 1041), but should be shown on a separate statement attached to that form. *Id.*

91. *See* Rev. Rul. 57-390, 1957-2 C.B. 326.

Any asset transferred to a revocable trust has a carry-over holding period from the grantor.[93] If the revocable trust becomes irrevocable, a new holding period begins.[94] Although the trust becomes irrevocable upon the death of the grantor,[95] many trusts also provide that they become irrevocable upon incapacity.[96] Since the trust changes from revocable to irrevocable, it also changes the holding period. Therefore, tax considerations should be taken into account.[97]

C. Sale of Principal Residence

Even though the grantor's principal residence is transferred into the revocable trust, the rules with respect to the roll-over provisions under IRC section 1034 still apply. Therefore, if the grantor purchases a new residence in excess of the sales price of the former residence, within the statutory time period of 24 months, the recognition of gain by the grantor may be deferred.[98]

It also appears that if the trust sells the grantor's principal residence and the grantor is over the age of 55, IRC section 121 may still be used to exclude from gross income $125,000 of the gain.[99]

---

93. I.R.C. § 1223(2) (1986). Section 1223(2) states, in pertinent part, "In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person..."

94. *See* Rev. Rul. 73-209, 1973-1 C.B. 614.

95. See FROLIK, *supra* note 77, at 1197.

96. *Id.*

97. *Id.*

98. I.R.C. § 1034(a) (1986). Pursuant to section 1034, if a taxpayer sells his principle residence, and within two years purchases a new principle residence, the gain from the sale shall be the sales price of the old residence (minus certain expenses for work performed on the old residence in order to assist in its sale) minus the purchase price of the new residence.

99. I.R.C. § 121 (West. 1994) states:

At the election of the taxpayer, gross income does not include gain from the sale or exchange of property, if -

(1) the taxpayer has attained the age of 55 before the date of such sale or exchange, and

(2) during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as his principal residence for periods aggregating 3 years or more.

Id.; *see also* Priv. Ltr. Rul. 80-07-050 (November 23, 1979).

IV. OTHER INCOME TAX CONSIDERATIONS

As a result of the grantor trust rules under IRC sections 671-677, lifetime income taxation of the income from the grantor's property is not affected by the transfer of that property into a revocable trust.[100] For example, the transfer of Series E, EE, H or HH bonds to a revocable trust will not be a transfer requiring the reporting of accrued interest.[101] Neither will a transfer of an installment obligation to the revocable trust be deemed a disposition that accelerates the reporting requirements of deferred gain under IRC section 453(e) and (f)(1).[102]

V. GIFT TAX CONSIDERATIONS

Upon transfer of assets by the grantor into a revocable trust, a gift is considered incomplete in every instance where the grantor has reserved the power to re-vest the beneficial title to the property in himself, or to the extent that a reserved power gives him the right to name the beneficiaries, or even to change the interests of the beneficiaries as between themselves.[103] However, significant problems arise if the trust provides that it becomes irrevocable upon the incapacity of the grantor.[104] While

100. *See* Borrok, *supra* note 61, at 295

101. I.R.C. § 454(a) (West Supp. 1994); *see also* Brenda J. Rediess-Hoosein, *Methods of Transferring Assets to Minors Affected by Recent Tax Changes*, 18 EST. PLAN 86, 89 (1991) (stating that shifting assets to a minor through Series EE savings bonds can defer taxable income until the bonds are redeemed and that the deferral period can be extended by converting bonds to Series HH bonds); *see also* C. Douglas Miller & R. Alan Rainey, *Dying With the "Living" (Or "Revocable") Trust and Federal Tax Consequences of Testamentary Dispositions Compared*, 37 VAND. L. REV. 811, 817 [hereinafter Miller & Rainey] (stating a grantor may transfer "E" or "H" bonds to a revocable trust without income tax consequences).

102. Mertens Law of Fed Income Tax § 15.76 (1993); *see* Frederick R. Keydel, *Use of Trusts in Estate Planning 1988*, PLI TAX LAW & EST. PLANNING COURSE HANDBOOK SERIES NO. 180; *see also* Miller & Rainey, *supra* note 102, at 817 (stating grantor may transfer installment obligations to a revocable trust without income tax consequences); *see also* Rev. Rul. 74-613, 1974-2 C.B. 153.

103. Treas. Reg. § 25.2511-2 (c) (1981) states:

> A gift is incomplete in every instance in which a donor reserves the power to re[-]vest the beneficial title to the property in himself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

Id.

104. Fifth Ave. Bank of New York v. United States, 41 F. Supp. 428, 432 (1941) (stating that the death of the grantor which ended the revocability of the trust and fixed

neither the creation of the revocable trust nor its revocation and return of the property to the grantor are deemed to be taxable gifts, in such a situation, there would be a completed gift upon the incompetency of the grantor.[105] IRC section 2702 provides for valuation rules in cases of transfers of an interest in trust.[106] Arguably, and most probably, any transfer in trust which becomes irrevocable and was established by the grantor, will fall within the purview of IRC section 2702.[107] This section provides that with respect to any transfer in trust for the benefit of a family member, the value of the retained interest held by the grantor will be valued at zero unless one of several exceptions apply.[108] Almost all existing revocable trusts with such provisions concerning incapacity are subject to this rule even if created before the effective date of the statute.[109]

For years, the IRS has issued private letter rulings stating that any distributions from a revocable trust made within three years of the decedent's death are included in the gross estate.[110] The IRS has been relying upon both the statute and case law.[111]

Once again, the IRS has recently reviewed this issue in a technical advisory memoranda, wherein the issue was whether transfers from the decedent's revocable trust were included in her gross estate under IRC sections 2035(a) and 2038.[112] During the three years prior to the decedent's death, the trustee acted upon the decedent's written instructions to

the basis for the valuation of the property also began the period of holding the trust within the meaning of section 117(a)).

105. Jeff Kohn, Jr., *Revocable Trusts - An Overview*, 49 ALA. L. REV. 332, 336 (1988) (stating that upon incapacity of grantor, a gift to the trust may be complete and gift tax consequences may be imposed).

106. I.R.C. § 2702 (1986).

107. *Id.*

108. I.R.C. § 2702(a)(2) and (a)(3) (1986). "The value of any retained interest which is not a qualified interest shall be treated as being zero." *Id.* However, the exceptions of section 2702(a)(3) provide that this rule will not apply to any transfer "(i) to the extent such transfer is an incomplete transfer, or (ii) if such transfer involves the transfer of an interest in trust all the property in which consists of a residence to be used as a personal residence by persons holding term interests in such trust." *Id.* at (a)(3).

109. Under section 11602(e)(1)(A) of the Revenue Reconciliation Act of 1990, section 2702 applies only to transfers made after October 8, 1990. Therefore, section 2702 will not apply to a trust created before October 8, 1990, but will only apply to transfers of property made after October 8, 1990.

110. *See* Borrok, *supra* note 61, at 295.

111. *See* Estate of Jalkut v. Commissioner of Internal Revenue, 96 T.C 675 (1991); *see also*, I.R.C. § 2702 (a)(2)(A) (West 1994) (stating "the value of any retained interest which is not qualified interest shall be treated as being zero.").

112. Tech. Adv. Mem. 92-26-007 (Feb. 28, 1992).

transfer shares of stock to various individuals. The trust assets were reported on the decedent's estate tax return. However, the gifts were not reported as includable in her gross estate for federal estate tax purposes. The IRS determined that transfers within three years of the date of death are includable in the gross estate under section 2038.

In Estate of *Jalkut v. Commissioner of Internal Revenue*, the decedent created a revocable trust during his lifetime.[113] The trust provided for payments of income and principal to the grantor as the grantor requested.[114] The grantor appointed himself as trustee.[115] If the grantor became unable to manage his affairs, the trustee was authorized to make payments to designated individuals, similar in nature to those the grantor had been accustomed to making.[116] During the three-year period prior to his death, the grantor became unable to manage his affairs, and a successor trustee was appointed.[117] Distributions were made to the grantor's family both before and after the appointment of a successor trustee.[118] The court held that the distributions made before the grantor became unfit to manage his affairs were properly characterized as withdrawals by the grantor,[119] followed by direct gifts from the grantor to the distributees,[120] because under the terms of the trust, the grantor was the only permissible distributee of the trust during this period.[121] However, the court concluded that direct transfers from the trust made after the decedent was declared unfit,[122] although specifically authorized by the trust instrument,[123] could not properly be recharacterized as withdrawals by the grantor from the trust.[124] Rather, the transfers were viewed as direct transfers from the trust to the beneficiaries.[125] Accordingly, those transfers were includable in the gross estate of the decedent.[126]

Subsequent to *Jalkut*, however, a bill was passed by Congress that amended IRC section 2035 to include in the decedent's gross estate, the

113. 96 T.C. at 675.
114. *Id.* at 676.
115. *Id.*
116. *Id.*
117. *Id.* at 677.
118. *Id.* at 676.
119. *Id.* at 685.
120. *Id.*
121. *Id.* at 684.
122. *Id.* at 685.
123. *Id.*
124. *Id.*
125. *Id.*

value of property transferred by the decedent during the three-year period ending on the date of the decedent's death.[127]

VI. ESTATE AND POST-DEATH TAX CONSIDERATIONS

A. Estate Tax Savings

There is a common misconception among some practitioners and most clients that the creation of a living trust will, in and of itself, save estate taxes. This is incorrect. Under IRC section 2038, the value of the gross estate includes the value of any and all revocable transfers.[128] IRC section 2038(a)(1) refers to this power to revoke as "by the decedent alone, or by the decedent in conjunction with any other person."[129] This also includes the power to alter, amend or terminate the trust.[130] Even if this power is relinquished three years prior to death, IRC section 2038, in conjunction with IRC section 2035,[131] will bring the entire trust balance into the estate.[132] Also, IRC section 2036 would bring the revocable trust back into the grantor's estate due to the retained right to the income of the trust.[133]

B. S-Corporation Stock

The transfer of S-corporation stock into a revocable trust may constitute poor planning. Although under IRC section 1361(c)(2), a revocable trust may qualify as a shareholder of an S-corporation,[134] the statute

127. H.R. Rep. No. 4210, 102nd Cong., 2nd Sess., 1382, 1441 (1992) (seeking to amend the Internal Revenue Code of 1986 to provide incentives for increased economic growth and to provide tax relief for families).

128. I.R.C. § 2038(a) (1986).

129. *Id.*

130. *Id.*

131. I.R.C. § 2035(a) (1986). (providing that the value of the decedent's gross estate includes the value of any property which the decedent transferred, by trust or otherwise, within three years before the decedent's death).

132. I.R.C. § 2038(a)(1) (1986). Pursuant to this section, transfers of property the decedent made after June 22, 1936 will be included in the gross estate, even where any power to alter, amend, revoke, or terminate the transfers had been relinquished during the three-year period before the decedent's death. *Id.*

133. I.R.C. § 2036(a) (1986). Section 2036(a) only applies if the decedent retains the right to "(1) the possession or enjoyment of, or the right to the income of, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." *Id.*

134. I.R.C. § 1361(c)(2) (1986).

provides that upon the death of the grantor, the trust may only continue for a period of two years without losing eligibility as an S-corporation shareholder.[135] Circumstances may arise such as a contest to the trust or a prolonged IRS audit, which might cause the S-corporation to remain in the revocable trust beyond the two-year period. However, in an estate, the rule is different. An estate may continue as a shareholder for the full reasonable period of estate administration, even beyond two years.[136] If the estate administration is unduly prolonged for an unreasonable length of time, however, it may lose its eligibility as an S-corporation shareholder.[137]

C. Passive Gains and Losses

As with S-corporation stock, assets which generate passive activity losses may be better retained in the grantor's individual name than transferred to a revocable trust prior to death.[138] Under IRC section 469(i), an individual who is active in the participation of rental real estate activities may be allowed to deduct-against other income losses from such activities up to $25,000.[139] After the individual's death, IRC section 469(i)(4) provides that the decedent's estate may take this loss for two years after the grantor's death.[140] However, this rule does not apply to a

135. I.R.C. § 1361(c)(2)(ii) (1986) (providing that a trust which was owned by an individual who is a citizen or resident of the United States, and if the entire corpus of the trust is includible in the gross estate of the owner, shall continue in existence after the death of the owner for a period of two years without losing eligibility as an S-corporation shareholder).

136. An estate may properly continue as a shareholder of an S-corporation. However, an estate may only be kept open during a period (up to 15 years) for extended payments of estate taxes under section 6166. *See* Rev. Rul. 76-23, 1976-1 C.B. 264.

137. See *Old Virginia Brick Co v. Commissioner of Internal Revenue*, 44 T.C. 724 (1965), *aff'd*, 367 F.2d 276 (4th Cir. 1966) (citing Treas. Reg. § 1.641(b)-3(a) (1986)) (holding if the estate administration is unduly prolonged, the estate is deemed terminated after the expiration of a reasonable period for the performance by the executor of all the duties of administration, thus, if the estate no longer exists, it cannot be an S-corporation shareholder).

138. I.R.C. § 469(a)(1) and (b) (1986) (stating a grantor may want the passive activity losses on his or her income tax return to net against activity income).

139. I.R.C. § 469(i) (1986).

140. I.R.C. § 469 (P) (4) (West Supp. 1994) stating:

In the case of taxable years of an estate ending less than 2 years after the date of the death of the decedent, this subsection shall apply to all rental real estate activities with respect to which such decedent actively participated before his death.

revocable trust.[141] Therefore, it may be advantageous to maintain all rental real estate property in the individual name of the decedent. In addition, there are other rules which appear to be available to an estate with respect to disposition of passive activity losses, which are clearly not available to a revocable trust after the death of the grantor.[142]

VII. OTHER TAX CONSEQUENCES

A. Taxable Year

Generally, an estate may pick and choose its own fiscal year.[143] For example, assume a decedent died on March 15, 1994, and a large source of income is received by the estate during June of that same year. A trust would be required, under IRC section 645(a), to adopt a calendar year.[144] Therefore, the beneficiaries may be required to recognize a large amount of income during 1994. However, an estate may elect a taxable year up until February 28, 1995. This will result in a deferral of income of one year.

B. Personal Exemption

An estate is allowed a personal exemption of $600 while the simple trust and complex trusts are only entitled to a $300 and $100 personal exemption, respectively.[145]

---

141. Lisa Brown Petkun & Deborah M. Lerner, *Income Taxation of Trusts and Estates Under TRA '86*, 66 J. TAXATION 38 (1987) [hereinafter Petkun & Lerner] (Rule 469 (i) (4) applies only to estates. Prohibiting trusts enacted so that individuals could not circumvent the ceiling by transferring rental real estate to trusts); *see also* Anne K. Hilker, *Post - Mortem Tax Planning*, 854 ALI - ABA COURSE OF STUDY: PLANNING FOR THE SENIOR CITIZEN, 1639 (1993) (stating I.R.C. 469 (i) does not currently run to trust).

142. ANDREW M. KATZENSTEIN, *Special Passive Loss Rules Applicable to Trusts, Estates, Create Planning Opportunities*, 15 EST. PLAN 106 (1988).

143. Lloyd Leva Plaine, *Post Mortem Tools for Income Tax Planning In Light of the TRA - 86*, 1 PROB. AND PROP. 56, 58 (1987); *See* David W. Reinecke, *Post - Mortem Tax and Estate Planning*, 9 T.M. COLLEY L. REV. 383, 395 (1992) (stating estates are permitted to elect a taxable year other than the calendar year).

144. I.R.C. § 645 (a) (West 1988) states, "The taxable year of any trust shall be the calendar year."

145. I.R.C. § 642 (b) (West Supp. 1994); *see also* Miller & Rainey, *supra* note 101, at 831 (stating personal exemptions for estate of $600 in computing taxable income. a deduction of $100 for a complex trust, and a $300 deduction for a simple trust).

C. Estimated Taxes

Under IRC section 6652, estates are not required to file quarterly estimated income taxes for the first two years following the decedent's death.[146] Revocable trusts are required to file quarterly estimates immediately upon the death of the grantor.[147]

D. Throwback Problems

Estates are not subject to the throwback rule on accumulated distributions, so income taxed to an estate will not thereafter have to be taxed at the beneficiaries' brackets.[148] However, after the decedent's death, a revocable trust is fully subject to the throwback rule.[149]

E. Charitable Set Aside Deduction

Under IRC section 5642(c), an estate receives an income tax deduction for amounts paid or permanently set aside for charities.[150] However, except for certain trusts created before October 9, 1969, a revocable trust will receive no deduction for amounts set aside for charitable purposes.[151] Therefore, if a qualified charitable organization is the residuary beneficiary of an estate, capital gains realized during the administration period can be deducted when set aside,[152] but a trust recognizing such gains cannot deduct them until they are actually paid out.[153]

---

146. I.R.C. § 6654 (L) (2) (West Supp. 1994): *See* Reinecke, *supra* note 143, at 395 ("estates are not required to make federal estimated tax payments in any taxable year ending within a 24-month period after the date of decedent's death").

147. Dic Dorney, *Changes in the Income Tax Treatment of Estates and Trusts*, 66 MICH. B.J. 620 (1987) (stating revocable trust is required in order to file declarations from the death of the estate owner); *see also* Keydel, *supra* note 102 (stating disadvantages of post death revocable trust include quarterly estimated tax payments).

148. I.R.C. § 643(a)(3) (1986).

149. Treas. Reg. § 1.665(a) - 0A(a)(1) (1972); *see* Miller & Rainey, *supra* note 101, at 835 (throwback rule not applicable to a simple trust); *see also* Caroline D. Strobel & Cheryl A. Hamilton, *Trapping Distributions From Estates to Trust Can Permanently Save Taxes or Defer Them*, 13 EST. PLAN 90 (1986) [hereinafter Strobel & Hamilton] (stating "complex trusts are subject to the throwback rules").

150. I.R.C. § 642(c) (1986). This deduction is in lieu of the deduction for charitable contributions and gifts under section 170(a) of the Internal Revenue Code.

151. I.R.C. § 642(c)(2) (1986).

152. Treas. Reg. § 1.643(a)-3 (1994). If a capital asset is required to be paid, credited, or distributed to a qualified organization under the terms of the trust document, gains from the sale or exchange of the capital assets are included in the computation of distributable net income. *Id.*

153. I.R.C. § 643(a)(3) (1986). Section § 643(a)(3) states:

F. Distributions Within 65 Days of Taxable Year

Under IRC section 663(b), trustees are afforded the ability to treat distributions made within the first 65 days of any taxable year of the trust to be considered paid or credited on the last day of the preceding taxable year.[154] This rule only applies to a complex trust.[155] The amount elected may not exceed the greater of the amount of the trust income or the amount of the trust's distributable net income less any amounts paid, credited or required to be distributed.[156] This irrevocable election is made on the appropriate line on Form 1041[157] and is effective only for the year of election.[158] This election allows the trustee to prevent a trust from accumulating income which would be subject to the throwback rule under IRC section 665.[159] The beneficiary must include the amount covered by the election in his income covered by the election.[160] This election is not available to an estate.[161]

VIII. JOINT TRUSTS

Some practitioners have created a joint revocable trust for the benefit of a husband and wife. If the combined assets of the husband and wife do not exceed the $600,000 federal exemption equivalent, this may be

> Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c).

Id.

154. I.R.C. § 663(b)(1) (1986).

155. Strobel & Hamilton, *supra* note 149, at 90 ("A simple trust is one which...is required to distribute its entire accounting income to designated beneficiaries in the current year . . . ." Therefore, a simple trust has no need for the election in section 663(b).).

156. I.R.C. § 662(a) (1986).

157. Douglas L. Siegler, *Relief May be Available for Missed Tax Elections*, 21 EST. PLAN 139, 145 (1994); *see also* Treas. Reg. § 1.663(b)-2(a)(1) (1994).

158. I.R.C. § 663(b)(2) (1986). Section 663(b) applies only to the taxable year in which the fiduciary elects the distribution treatment.

159. Pozzuolo & Mittleman, *supra* note 20, at 46 (stating section 663(b) allows the trustee to distribute income, thus avoiding the "accumulation" problem of the "throwback rule"); *see also* Strobel & Hamilton, *supra* note 1549, at 92. (stating "throwback rules" are designed to tax the beneficiary of a trust that accumulates, rather than distributes, all or part of its income currently).

160. Treas. Reg. § 1.663(b)-1(a)(2)(ii) (1994).

161. *See* Miller & Rainey, *supra* note 101, at 834. (stating election to treat distributions within the first sixty-five days of a taxable year as occurring during the preceding taxable year is available to revocable trusts not to estates). *Id.*

advantageous. However, in situations where the estate is greater than $600,000, problems arise.

In a joint trust situation, the ability to shelter the $600,000 exclusion becomes difficult. If upon contribution by a husband and wife of assets into a revocable trust, there is a commingling of those assets, it is difficult to determine with which assets to establish a credit shelter trust for the surviving spouse and the IRS may claim that there were insufficient separate assets of the first spouse to fully fund the credit shelter trust. Although use of such a joint trust is not recommended, if it is done, each contribution of property by a husband or wife should be separately maintained within the trust. However, the use of this type of trust is generally more complex during administration than separate trusts for the husband and wife. Keeping records of the separate shares can be difficult and time consuming. A possibility always arises as to commingling between the shares which may defeat the estate tax planning the couple originally intended.

Attorneys who have clients planning for Medicaid also may determine that a joint trust may not be advisable.

IX. UPCOMING LEGISLATION

Legislation drafted by the EPTL/SCPA Advisory Committee dealing with revocable trusts was introduced in the 1995 Session of the New York State Legislature.[162] The legislation dealt with large issues such as execution requirements, funding, and elimination of the Merger Doctrine. On the procedural side, the legislation provided for a clear roadmap on how to proceed in the case of challenges to the validity of a revocable trust as well as other proceedings. It is expected that the bill will be introduced in the next legislative session in 1996.

CONCLUSION

As advisors to their clients, attorneys must make a determination whether or not a revocable trust will meet their needs. In this article we have reviewed the pros and cons of the revocable trust from both a tax and non-tax perspective. These should be discussed with each client in detail. In many situations, the revocable trust may be the most appropriate estate planning tool.

---

162. The legislation did not pass primarily because of requests by the New York State Bar Association Trust & Estates Section for additional time to comment.

CPLR Article 77 and Trust Litigation in Supreme Court

By Frank T. Santoro

For good reasons, trusts and estates litigators gravitate towards the Surrogate's Court as the appropriate venue for litigated matters pertaining to the affairs of decedents and lifetime trusts. The Surrogate's Court, with its expansive jurisdiction, routinely presides over cases involving substantive matters of law concerning trusts and estates.[1] Moreover, the Surrogate's Court has a structure and staff specifically geared to handle such matters, and the necessary resources to handle issues that arise in the administration of decedent's estates.[2]

While the Supreme Court, as New York's court of general jurisdiction,[3] has the power to probate a will and issue letters testamentary and trusteeship, the Surrogate's Court is really the only appropriate venue for a probate proceeding. Similarly, accountings, discovery proceedings, and other miscellaneous proceedings pertaining to estates and testamentary trusts most often belong in the Surrogate's Court.

However, the Surrogate Court's jurisdiction should not necessarily eliminate consideration of Supreme Court as an appropriate venue for disputes pertaining to trusts. Civil Practice Law and Rules (CPLR) 7701, which introduces CPLR article 77, authorizes a special proceeding for the determination of matters relating to express trusts.[4] Article 77 is intended to provide an economical and relatively expeditious method for the adjudication of trustees' accountings and other trust matters in Supreme Court.[5] Article 77 is seldom discussed at length—for example, *Siegel's New York Practice*, an old friend to all civil litigators, mentions article 77 only once, stating "[a] special proceeding is also used in the Supreme Court to determine matters relating to a trust."[6] Given the goals underlying article 77, economy and swift adjudication of disputes pertaining to trusts, Supreme Court is a venue worth considering when bringing such a proceeding. A closer look at article 77 is thus in order—this article addresses only the basics.

> *"While the Supreme Court, as New York's court of general jurisdiction, has the power to probate a will and issue letters testamentary and trusteeship, the Surrogate's Court is really the only appropriate venue for a probate proceeding."*

The Statute and Cases Decided Thereunder

Article 77 has only a few sections and incorporates certain provisions of the Surrogate's Court Procedure Act (SCPA) by reference. CPLR article 4, governing procedure in all special proceedings, applies to special proceedings commenced pursuant to CPLR article 77.[7] As stated, CPLR 7701 introduces article 77, and is followed by five more sections that are specific to trusts.

- CPLR 7702 provides that a trustee seeking a judicial discharge on an accounting must file his accounting with an affidavit of accounting party in the manner prescribed by SCPA 2209.
- CPLR 7703 incorporates the SCPA's virtual representation provisions to article 77 proceedings.
- CPLR 7704 limits the court's power to appoint a referee in certain circumstances.
- CPLR 7705 and 7706 provides for the filing of an account settled informally and procuring an order thereon in a manner similar to SCPA 2202. CPLR article 4, governing all special proceedings applies in a special proceeding brought pursuant to article 77.

While article 77 contains only a few provisions, the Supreme Court has addressed a myriad of issues and disputes in article 77 proceedings. For example, the proper application of Estates Powers and Trust Law (EPTL) Section 7-1.9 was addressed in an article 77 proceeding in *Elser v. Meyer*.[8] In *Elser*, the Supreme Court held that a settlor of a lifetime trust could revoke a trust without the consent of the trustee notwithstanding language in the trust instrument which, in sum and substance, required the consent of the trustee to revoke the trust. The Appellate Division reversed, and remitted the matter to the Supreme Court to determine whether the trustee had unreasonably withheld his consent.[9]

In *Andrews v. Trustco Bank*,[10] the Supreme Court, *inter alia*, addressed objections to an accounting reviewing New York's former Principal and Income Act.[11] In *Addesso v. Addesso*,[12] the Supreme Court dismissed an article 77 proceeding to compel a trustee to account and compel a distribution where uncontroverted evidence before the court showed that there were no assets remaining in the trust account and the petitioner previously had been provided with an accounting.

In another article 77 proceeding where beneficiaries sought an accounting from a trustee, the court extended judicial approval of a sale of a parcel of real property.[13] Removal of a trustee on the grounds that the trustee has disregarded court orders and engaged in self-dealing has also been granted in an article 77 proceeding.[14]

Concurrent Jurisdiction and Removal to Surrogate's Court

Concurrent jurisdiction notwithstanding, the courts generally err on the side of transferring matters pertaining to trusts and estates to the Surrogate's Court. A petitioner seeking relief from the Supreme Court with respect to a trust may find himself mired in the delay and expense of motion practice, and may find himself ultimately awaiting the administrative transfer of his article 77 proceeding from Supreme Court to the Surrogate's Court following decision and order on a motion. Under N.Y. Const. art. VI, § 19(a) and CPLR 325, the Supreme Court may, and quite often does, transfer trusts and estates-related disputes to the Surrogate's Court.

Where there are existing proceedings pending pertaining to an estate or a trust in the Surrogate's Court, the Supreme Court will generally refrain from exercising its concurrent jurisdiction where all the relief requested may be obtained in the Surrogate's Court and where the Surrogate's Court has already acted.[15] Thus, by way of example, the Supreme Court is unlikely to exercise jurisdiction over a proceeding to remove a trustee where that trustee has petitioned the Surrogate's Court for judicial settlement of her account. However, the Supreme Court will retain jurisdiction over a dispute affecting a decedent's estate when it is the first court to assume jurisdiction over the matter, especially where no motion is made in Supreme Court asking it to exercise its discretion to transfer of the action to the Surrogate's Court.[16]

While the law favors the Surrogate's Court as a venue for adjudicating disputes pertaining to trusts, the cases cited above plainly show that the Supreme Court deals with trusts regularly. Moreover, the Supreme Court, and in particular the commercial division as it exists in some counties,[17] frequently addresses the kinds of issues that are featured prominently in trust litigation. For example, the administration and management of closely held businesses, solely owned or controlled by a trust, will often raise questions of self-dealing, prudence, and the proper exercise of fiduciary power. Issues surrounding corporate governance, complex taxation, business valuation, and real estate valuation are as commonly encountered in trust litigation as they are in business divorce litigation in the Supreme Court.

Under the right circumstances, the Supreme Court should be persuaded to decline to exercise its power to transfer an article 77 proceeding to the Surrogate's Court. It would seem, in a situation involving a lifetime trust over which the Surrogate's Court has never entertained jurisdiction for any purpose, that the Supreme Court should exercise and retain its jurisdiction to fulfill article 77's goals of expediency and economy in the adjudication of disputes pertaining to trusts. While the Supreme Court may not frequently delve into the minutiae of the Principal and Income Act[18] or explore the canons of trust construction, as New York's court of general jurisdiction, it is well-equipped to do so, and to administer justice in matters involving same.

Practical Issues May Arise

While it always falls upon the practitioner to ensure that jurisdiction is obtained over all necessary parties, and to ensure that all pleadings include the necessary information for the court to afford the relief requested by the petitioner, the Surrogate's Court is unique. The Supreme Court does not have an accounting clerk or a miscellaneous clerk who will evaluate accountings or pleadings and firmly inform the practitioner as to the minimum requirements that, in the clerk's view, must be met before process issues. While article 77 incorporates by reference the SCPA's provisions pertaining to virtual representation, and requires that an accounting and affidavit of accounting party be filed in a proceeding seeking judicial approval of accounting, it does not, for example, statutorily identify all of those parties entitled to notice in an accounting proceeding. Creditors, potential creditors, beneficiaries, legatees, devisees, co-trustees, successor trustees, court-appointed guardians, fiduciaries of deceased beneficiaries (or the beneficiaries or distributees of the deceased beneficiary where no fiduciary is appointed), and the New York State Attorney General[19] are all parties who may be interested in a trust accounting.[20] A binding decree in an accounting proceeding approving a trustee's accounting will only be binding on those who had notice and opportunity to be heard with respect to same, so it is critical that all interested parties be joined therein.[21] Moreover, the failure to join a necessary party, such as the New York State Attorney General where there is a charitable interest in the trust, can result in a motion to dismiss for failure to join an indispensable party, resulting in unnecessary delay and expense.[22]

Similarly, where the Surrogate's Court will almost always automatically appoint a guardian *ad litem* for an infant or a person under a legal disability to ensure that their interests are protected, the practitioner in an article 77 proceeding should highlight the necessity of a guardian *ad litem*, or move pursuant to CPLR 1202 to seek the appointment of a guardian *ad litem* where appropriate at the outset of the proceeding.

There are other practical considerations that must be considered before commencing an article 77 pro-

ceeding. For example, the service provisions of the SCPA are unique to the Surrogate's Court,[23] while the general service provisions of CPLR article 3 apply in a special proceeding under article 77.[24]

Conclusion

In sum, practitioners should not discount the Supreme Court as an appropriate venue for litigating disputes pertaining to trusts, especially with respect to lifetime trusts. Depending on the circumstances, deference to the Surrogate's Court's experience in matters pertaining to trusts and estates may yield to other considerations, and Supreme Court is a permissible and suitable venue for the adjudication of disputes pertaining to trusts.

Endnotes

1. *In re Piccione's Estate*, 57 N.Y.2d 278, 289, 456 N.Y.S.2d 669 (1982); *Wagenstein v. Shwarts*, 82 A.D.3d 628, 920 N.Y.S.2d 55 (1st Dep't 2011); SCPA 207; SCPA 209(6).
2. *Cipo v. Van Blerkom*, 28 A.D.3d 602, 813 N.Y.S.2d 532 (2d Dep't 2006); *Zamora v. State of New York*, 132 Misc. 2d 119, 503 N.Y.S.2d 262 (NY Ct. Cl. 1986).
3. N.Y. Const. Art. VI, § 7(a).
4. *Chiantella v. Vishnick*, 84 A.D.3d 797, 922 N.Y.S.2d 525 (2d Dep't 2011).
5. *See* Alexander, Practice Commentaries, McKinney's Cons. Laws of N.Y., Book 7B, CPLR 7701.
6. Siegel, N.Y. Prac. § 547 (5th ed.).
7. Id. §§ 550-556.
8. 29 A.D.3d 580, 814 N.Y.S.2d 684 (2d Dep't 2006).
9. *Id.*
10. 289 A.D.2d 910, 735 N.Y.S.2d 640 (3d Dep't 2001).
11. *See* EPTL 11-2.1.
12. 131 A.D.3d 1052, 16 N.Y.S.3d 472 (2d Dep't 2015).
13. *In re Jensen*, 107 A.D.3d 1222, 967 N.Y.S.2d 495 (3d Dep't 2013).
14. *Gouiran v. Gouiran*, 263 A.D.2d 393, 693 N.Y.S.2d 127 (1st Dep't 1999).
15. *In re Tabler's Will*, 55 A.D.2d 207, 389 N.Y.S.2d 899 (3d Dep't 1976).
16. *Gaentner v. Benkovich*, 18 A.D.3d 424, 795 N.Y.S.2d 246 (2d Dep't 2005).
17. N.Y. Comp. Codes R. & Regs. tit. 22, § 202.70.
18. EPTL art. 11-A.
19. EPTL 8-1.4
20. *See* SCPA 2210.
21. *See In re Hunter*, 4 N.Y.3d 260, 794 N.Y.S.2d 286 (2005); *Estate of Monroe*, N.Y.L.J., June 20, 2001, p. 1, col. 5 (Sur. Ct., N.Y. Co.).
22. *See* CPLR 3211 (a)(10); CPLR 1001.
23. *See* SCPA 307.
24. *See* CPLR 403(c).

Frank T. Santoro is counsel with the trusts and estates litigation group at Farrell Fritz, P.C. in Uniondale.

SOUTH DAKOTA TRUST COMPANY LLC

Serving Families in Perpetuity:

- ✓ **Trust accounts** representing more than **$30 billion** in assets under administration
- ✓ **No products** of any kind – purely **trust administration services**
- ✓ Work with all **outside investment managers and custodians** of the **clients' choice** globally
- ✓ Work with most types of **non-financial assets** (both onshore and offshore)
- ✓ **Excellent**, timely and inexpensive **reformation/modification** and **decanting statutes and processes**
- ✓ Currently work with over **80 billionaire** and **200 centa-millionaire** clients
- ✓ **Private Family Trust Company relationships** worth in excess of **$80 billion** (www.privatefamilytrustcompany.com)
- ✓ **250** combined **years of experience**
- ✓ **15%** of clients are **international families**
- ✓ **Highest ranked trust jurisdiction** in the United States: #1 in all categories by *Trusts & Estates* magazine (January 2016)

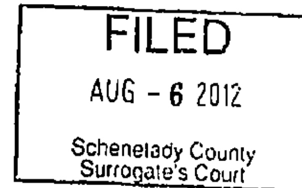
Pierce McDowell
(605) 338-9170
piercemcdowell@sdtrustco.com

Al King
(212) 642-8377
alking@sdplanco.com

James Paladino
(212) 642-8377
jpaladino@sdplanco.com

www.sdtrustco.com ***www.directedtrust.com*** ***www.privatefamilytrustcompany.com***

(paid advertisement)



STATE OF NEW YORK
SURROGATE'S COURT COUNTY OF SCHENECTADY

PROBATE PROCEEDING,

WILL OF ARMOND X. MASTROIANNI
a/k/a ARMOND MASTROIANNI,

ARMOND X. MASTROIANNI,

Deceased.

DECISION/ORDER

File No. 2008-90

APPEARANCES:

Attorneys for Petitioner, Nathaniel H. Daffner, Trustee:
Christopher Massaroni, Esq.
McNamee, Lochner, Titus & Williams, P.C.
677 Broadway
Albany, New York 12207-2503

Attorneys for Respondents Mary V. Mastroianni, Mary Drescher, Josepha Abba, Anthony Mastroianni, Pasquale Mastroianni, and Laura Salvatore:
Kenneth J. Bobrycki, Esq.
Melvin & Melvin, PLLC
217 South Salina Street
Seventh Floor
Syracuse, New York 13202-1390

Attorneys for Respondent Tracy Mastroianni:
Margaret J. Gillis, Esq.
Whiteman, Osterman & Hanna, LLP
One Commerce Plaza
Albany, New York 12260

Attorneys for Respondents Howard Maximilian Miller, Aurelia Mensh, Esq. and Josepha Miller:
Aurelia Mensh, Esq.
Roemer Wallens Gold & Mineaux LLP
13 Columbia Circle
Albany, New York 12203

VINCENT W. VERSACI, S.

By Order to Show Cause dated April 18, 2012, the Petitioner, Nathaniel H. Daffner, the Trustee of two (2) separate trusts created by the Decedent's Last Will and Testament (collectively referred to herein as the "Trusts"), brought this proceeding pursuant to SCPA §2107 seeking the advice and direction of the Court concerning the ownership of the

shares of stock of Mastroianni Bros., Inc., a New York corporation previously owned by the Decedent as sole shareholder. Specifically, the Petitioner requests an Order confirming (1) that the Trusts collectively are the holders of 100% of the shares of stock of Mastroianni Bros., Inc., and (2) that Nathaniel H. Daffner, as the Trustee of the Trusts, is solely authorized to manage the day-to-day operations of the business and to make any and all decisions that owners of shares of stock of a corporation are authorized to make. In the Petition and the other papers filed in support of the Order to Show Cause, the Petitioner states that this proceeding has been made necessary by the recent claims of the Decedent's mother, Mary V. Mastroianni, who proposes that she owns some of the shares of the stock. The Petitioner disputes this alleged claim, and essentially seeks a declaratory judgment silencing any claim she may have due to its staleness and/or untimeliness.

In opposition to the Petition, Respondent Mary V. Mastroianni along with the other individuals represented by Attorney Bobrycki solely argue that this SCPA §2107 proceeding must be dismissed because this statute does not govern disputes over title to property and therefore it is not a proper proceeding within which a determination can be made as to the ownership of the corporate stock. They contend that since this is not the proper proceeding to determine title to property, Mary Mastroianni is therefore not obligated to assert her ownership claim in this proceeding, which claim would be more appropriately addressed in a plenary action brought in Supreme Court under the provisions of the Business Corporation Law or the Civil Practice Law and Rules.

In addition to opposing the Petition, Respondent Mary Drescher, who is one of the remaindermen of the Trusts, filed a Cross-Petition to Compel an Intermediate Accounting from the Trustee. In her Cross-Petition, Ms. Drescher raises certain questions concerning the operation and management of the corporation and the financial activity that has occurred under the control of the Trustee. Her questions were formed after a preliminary forensic review was conducted by John Dubiel, CPA/CFF, CFE, CVA, an expert retained

by the remaindermen of the Trusts to review the financial statements and books of the corporation.

The Court has considered all of the papers that have been submitted, as well as the oral argument of counsel presented on May 23, 2012. While the Court had reserved decision pending settlement discussions on a global level, it has recently become apparent through various correspondences from counsel that the parties are at an impasse in trying to achieve a global settlement, thus rendering a decision on these proceedings necessary.

FACTS

Prior to his death on January 18, 2008, the Decedent was the sole shareholder of Mastroianni Bros., Inc. (hereinafter referred to as the "Bakery"). The Decedent executed his Last Will and Testament on April 20, 2006, providing that all of his right, title and interest in the Bakery is to be conveyed to Mr. Daffner as the Trustee named therein, to be held in trust and to pay the income to the Decedent's wife, Tracy Mastroianni, during her life. Upon her death, the Trustee is to pay the remaining principal of the trust to the Decedent's siblings or their issue, per stirpes. The Decedent's Will was admitted for probate without objection on February 22, 2008. Simultaneous therewith, Mr. Daffner was appointed as the Executor and as the Trustee of the testamentary trust. Thereafter, in October, 2008, the Trustee elected to divide the trust into two separate trusts pursuant to EPTL §7-1.13 and IRC §2056(b)(7), thereby creating the Armond X. Mastroianni Credit Shelter Trust which holds 63% of the shares of stock of the Bakery, and the Armond X. Mastroianni QTIP Testamentary Trust which holds 37% of the shares of stock of the Bakery. The Trusts hold no assets other than the stock in the Bakery.

According to the Stockholder's Transfer Ledger for the Bakery, annexed to the Petition as Exhibit "H", a total of 114 shares of stock were originally issued to the Decedent's father, Pasquale Mastroianni back in 1996. From 1996 to 2002, the Decedent's father periodically transferred some of his shares of stock to the Decedent, in

increments of 4 shares at a time, totaling 28 shares. Then on August 7, 2002, the remaining 86 shares held by the Decedent's father were conveyed to the Decedent, making the Decedent the sole shareholder of all 114 shares of stock. These shares were transferred to the Decedent's Estate after the Petitioner was appointed Executor and Trustee, and then subsequently reissued to the Trusts. All 114 shares of stock that were originally issued remain outstanding, and are now owned by the Trusts in proportion to the percentages mentioned above. (See Exhibit "H").

The Petitioner represents that based on his personal involvement with the Bakery as its accountant and consultant prior to the Decedent's death, and then as Trustee since the Decedent's death, he has personal knowledge that the Decedent acted with full authority as the sole shareholder of the Bakery and that to his knowledge, the Decedent's mother never challenged his authority until August of 2009 when she retained counsel and asserted a claim to ownership of some of the shares of stock in the Bakery. Despite her retention of counsel, the Decedent's mother to date has not commenced an action to adjudicate her purported claim or otherwise filed a formal claim to establish her ownership of shares of stock in the Bakery.

LEGAL ANALYSIS

The Court will first address the Respondents' single argument in opposition to the Petition that this SCPA §2107 proceeding is not the proper proceeding for determination of the validity of title to property. In suggesting that the appropriate course of action would be to commence a plenary action in Supreme Court to resolve this title dispute, the Respondents are essentially arguing that this Court lacks the jurisdiction and power to adjudicate the issue of the ownership of the stock which is the sole asset of the Trusts.

The subject matter jurisdiction of the Surrogate's Court is derived from the New York State Constitution, Article VI, §12, which by an amendment effective September 1, 1962, expanded the historically limited jurisdiction of the Court and conferred jurisdiction "over

all actions and proceedings relating to the affairs of decedents, probate of wills, administration of estates and actions and proceedings arising thereunder or pertaining thereto, guardianship of the property of minors, and such other actions and proceedings, not within the exclusive jurisdiction of the supreme court, as may be provided by law." NY Const. Art. VI, §12(d). This broad jurisdiction has also been codified by statute. SCPA §201 delineates the general jurisdiction of the Surrogate's Court and specifically provides as follows:

> 3. The court shall continue to exercise full and complete general jurisdiction in law and in equity to administer justice in all matters relating to estates and the affairs of decedents, and upon the return of any process to try and determine all questions, legal or equitable, arising between any or all of the parties to any action or proceeding, or between any party and any other person having any claim or interest therein, over whom jurisdiction has been obtained as to any and all matters necessary to be determined in order to make a full, equitable and complete disposition of the matter by such order or decree as justice requires.

SCPA §201(3). In addition, the Surrogate's Court has extensive powers incidental to its jurisdiction, including but not limited to the power to "determine a decedent's interest in any property claimed to constitute a part of his gross estate subject to estate tax, or to be property available for distribution under his will or in intestacy or for payment of claims, **and to determine the rights of any persons claiming an interest therein, as against the decedent, or as between themselves**, and to construe any instruments made by him affecting such property." SCPA §209(4). [Emphasis added]. See also, SCPA §202, entitled "Enumerated proceedings not exclusive."

In construing the foregoing provisions of law, our State's Judiciary has consistently recognized the broad jurisdiction and powers of the Surrogate's Court to hear and decide all matters pertaining to a decedent's estate and all claims affecting the affairs of a decedent. The Court of Appeals in Matter of Piccione, 57 N.Y.2d 278, clearly defined the breadth of the Surrogate's Court jurisdiction over all matters that relate, even if only

peripherally, to a decedent's estate, and held that "[a]bsent the need for specific statutory authorization for a particular proceeding, the emphasis now shifted so that, 'for the Surrogate's Court to decline jurisdiction, it should be abundantly clear that the matter in controversy in no way affects the affairs of a decedent or the administration of his estate.'" Id. at 288. The Court in that case found that the eviction proceeding brought by the executors in order to wind up the administration of the estate and sell the real property held by the estate was cognizable in the Surrogate's Court. Id. at 290. See also, Matter of Stern, 91 N.Y.2d 591, 598 ("the subject matter jurisdiction of New York's Surrogate's Courts is necessarily more embracive when it is the predominant tribunal for administering and preserving estate rights and assets").

Other courts have similarly ratified the expansive subject matter jurisdiction of the Surrogate's Court. See, Maki v. Estate of Ziehm, 55 A.D.2d 454 (Surrogate exercised jurisdiction over a stockholders' derivative action); Wagenstein v. Shwarts, 82 A.D.3d 628 (Surrogate had jurisdiction over a partition action); Goodwin v. Rice, 79 A.D.3d 699 (transfer to the Surrogate's Court of a breach of contract action was warranted); Cipo v. Van Blerkom, 28 A.D.3d 602 ("The Supreme Court and the Surrogate's Court have concurrent jurisdiction over the administration of a decedent's estate . . . However, '[w]herever possible, all litigation involving the property and funds of a decedent's estate should be disposed of in the Surrogate's Court'").

Applying these well settled principles to the case at bar, there can be no doubt that this Court has jurisdiction over the controversy concerning the ownership of the stock of the Bakery, the only asset of the Decedent's testamentary trust. Whether the Trusts own all of the stock of the Bakery or only some of the stock is clearly a matter that affects the administration of this estate. In other words, it certainly cannot be said that this controversy in no way affects the Decedent's estate when a resolution of this controversy will directly affect the extent of the assets for which the Trustee must eventually account

to the Trust beneficiaries.

Moreover, Mary Mastroianni's purported claim to part ownership of the Bakery stock apparently stems from the Decedent's father, Pasquale's, transfer of stock to the Decedent in 2002. Any challenge to the validity of that stock transfer, and the extent of the Decedent's ownership of the stock at the time of his death, clearly relates to the affairs of the Decedent and is therefore cognizable in this Court pursuant to the vast legal authority and precedents cited above.

Turning now to the issue of whether an SCPA §2107 proceeding for advice and direction is a proper proceeding within which to hear and decide the dispute over the ownership of the corporate stock, the Court begins with a recitation of the broad language contained in SCPA §2107(2), which provides that the "court may entertain applications by a fiduciary to advise and direct in other extraordinary circumstances such as . . . where there is conflict among interested parties". Clearly, the purported claim of the Decedent's mother to part ownership of the stock of the Bakery is in conflict with the Trustee whose position is and has always been that all of the stock was owned by the Decedent prior to and at the time of his death and is now owned solely by the Trusts.

To the extent that the Respondents argue that Mary Mastroianni is not an "interested party" in this proceeding because she is not a distributee of the Decedent nor a beneficiary of the Estate or Trusts, this fact is of no consequence. As quoted above, SCPA §209(4) gives this Court the authority "to determine the rights of **any** persons claiming an interest" in any property constituting part of the gross estate. SCPA §201(3) also grants this Court jurisdiction to "determine all questions . . . arising between . . . any party **and any other person** having any claim or interest therein" (emphasis added). In furtherance of this command, the Surrogate is not only permitted to but is required to join necessary parties "who might be inequitably affected by a judgment" so that "complete relief can be accorded between the parties". See, CPLR §1001(a) and SCPA §102

(provisions of the CPLR are applicable in *Surrogate's Courts* unless SCPA provides otherwise).

Mary Mastroianni, who is purportedly claiming an interest in property belonging to a testamentary trust, is clearly an interested party in this proceeding. Her rights, if any, to part ownership of the Bakery stock "might be inequitably affected" by the Court's decision in this proceeding. Complete relief could not be accorded unless Mary Mastroianni was made a party to this proceeding. Thus, despite the fact that she was not an interested party in the probate proceeding, nor would she have standing in a trust accounting proceeding, Mary Mastroianni was properly named as a party respondent in this proceeding to determine whether she has a viable claim to any part of the trust assets.

Nor does the Court find any merit to the argument that the Court should not entertain this proceeding because to do so would be merely to substitute the Court's judgment for that of the fiduciary. The Trustee is not asking this Court to exercise its business judgment over the administration of the Trusts. Rather, the Trustee needs the Court to give its advice and direction by resolving the legal dispute over the ownership of the Bakery stock so that the Trustee can effectively manage the business and pursue a sale of the business while having clear title to all of the stock. These extraordinary circumstances clearly bring this matter well within the broad scope of a SCPA §2107 proceeding. See, Matter of Morse, 150 Misc.2d 415, where the Surrogate entertained a SCPA §2107 proceeding to resolve an ownership dispute over a testamentary asset; Matter of DeChiaro, 35 Misc.2d 485, where a SCPA §2107 proceeding was used to resolve a family dispute regarding the ownership of corporate stock.

The Respondents' reliance on Matter of Gerold, NYLJ at 29 (Queens County Surrogate's Court Oct. 29, 1999), in light of the overwhelming statutory and common law authority to the contrary, carries no weight with this Court. The decision in that case offered no reasoning for the denial of the SCPA §2107 petition, and in any event, it is not

binding on this Court which has the discretion to entertain applications "in order to make a full, equitable and complete disposition of the matter as justice requires." SCPA §201(3).

Having found that this Court has jurisdiction over the stock ownership dispute and that a proceeding brought under SCPA §2107 is a proper proceeding for adjudication of this dispute, the Court can now turn to the merits of the dispute. Although the Respondents did amend their Answer to the Petition to deny the allegations that the Decedent was the sole shareholder of the Bakery at the time of his death, they have not in any of their papers before the Court addressed the merits of Mary Mastroianni's purported claim to part ownership of the stock. As stated earlier, the sole argument the Respondents made in opposition to the Petition was a procedural one, that this SCPA §2107 proceeding is not a proper proceeding within which to determine the validity of title to property. Not only did they not address the merits of any claim, they did not even describe to the Court the nature of the claim Mary Mastroianni would ultimately pursue.

Having failed to come forward with any proof in admissible form in support of a claim, or even present an argument as to the merits of a claim, the Respondents have failed to raise an issue of fact sufficient to warrant a hearing in this matter. The bare denial contained in the Respondents' Amended Answer that the Trusts solely own all of the Bakery stock, without more, is simply insufficient as a matter of law to raise a triable issue of fact or preclude a judgment being awarded summarily to the Petitioner.

Alternatively, even if the Respondents had raised a triable issue of fact preventing the Court from summarily granting the Petition, the Court agrees with the Petitioner that any claim Mary Mastroianni might have to some of the shares of stock is now barred by the applicable statute of limitations and the doctrine of laches. Based on the correspondences between counsel that are annexed to Attorney Massaroni's Affidavit in support of the Petition, it appears that Mary Mastroianni purports to challenge the validity of the August, 2002 stock transfer from the Decedent's father to the Decedent on the basis of fraud.

CPLR §213(8) governs the statute of limitations for actions based upon fraud which "must be commenced within six years from the date the cause of action accrued or two years from the time the claimant discovered the fraud, or could with reasonable diligence have discovered it, whichever is greater." Any cause of action based on fraud would have accrued on August 7, 2002, the date of the last transfer of stock to the Decedent, and therefore would have to have been commenced by August 7, 2008. Or, assuming that Mary Mastroianni did not discover the alleged fraud until August 18, 2009 at the very latest, which is the date of correspondence from counsel retained by Mary Mastroianni questioning the Decedent's sole ownership of the stock, her action would have to have been commenced at the very latest within two years of that date, or by August 18, 2011. No such action for fraud was filed before the expiration of the statute of limitations, nor has any such action or formal claim been filed to date.

Any claim Mary Mastroianni may have to set aside the August, 2002 stock transfer is also barred by the equitable doctrine of laches. See, Bryer v. Bank of New York, 72 A.D.3d 532, wherein the petitioner was found guilty of gross laches absent a valid excuse for the 12-year delay in seeking to vacate a probate decree; White v. Priester, 78 A.D.3d 1169, wherein the plaintiff's deliberate inaction in formally pursuing an ownership claim to real property, together with the prejudice caused by the 6-year delay, warranted application of the doctrine of laches; Dedeo v. Petra Inv. Corp., 296 A.D.2d 737, wherein the defense of laches operated as a bar to recovery when the neglect in promptly asserting a claim for relief caused prejudice to one's adversary.

Mary Mastroianni is clearly guilty of laches based on her lengthy delay and neglect in prosecuting her purported claim, resulting in prejudice to the Petitioner who has had to live with the threat of this potential claim for several years and certainly would be at a disadvantage if forced to defend against this claim years after the subject transaction since both parties to the transaction are now deceased. Mary Mastroianni's failure to formally

pursue an ownership claim to the Bakery stock is inexcusable and warrants application of the doctrine of laches.[1]

Simply put, any ownership claim that Mary Mastroianni may now try to pursue squarely falls under the Black's Law Dictionary definition of a "stale claim", which is one that "has long remained unasserted, or is first asserted after an unexplained delay, rendering it difficult for the Court to ascertain the truth of the matters in controversy and do justice between the parties." Where the delay is so long, it "creates a presumption against the existence or validity of the claim, or a presumption that the claim has been abandoned or satisfied. The doctrine is purely an equitable one, and arises only when, from the lapse of time and laches of the claimant, it would be inequitable to allow a party to enforce his or her legal rights at this time." Black's Law Dictionary, 5th ed.

Accordingly, for all of the foregoing reasons, the Court finds that Mary Mastroianni has no viable claim to ownership of any of the shares of stock of the Bakery. The Petition is hereby granted to the extent that the Court declares that the Trusts collectively are the holders of 100% of the shares of stock of Mastroianni Bros., Inc., and that Nathaniel H. Daffner, as the Trustee of the Trusts, is solely authorized to manage the day-to-day operations of the business and to make any and all decisions that owners of shares of stock of a corporation are authorized to make.

Lastly, with respect to the Cross-Petition to Compel an Intermediate Accounting of the Trusts, the Court finds that the Cross-Petitioner has not demonstrated a need for a formal accounting at this time given the extensive, informal financial disclosure that has been voluntarily produced to the Respondents by the Trustee in response to their questions and demands. In addition to a formal accounting being unnecessary, it would not be in the best interests of the estate to require the Trustee to devote resources to the

[1] Notably, nowhere in their opposition papers did the Respondents respond to or in any way address either the statute of limitations or the laches defense raised by the Petitioner.

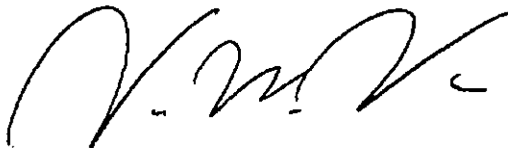
preparation of an accounting at this time. See, SCPA §2205(1).

It is also premature to order a formal accounting of the Trusts at this time. No sale of the Bakery has yet occurred or is even on the horizon. As suggested by the Petitioner and the Respondent Tracy Mastroianni, the Court will revisit this issue towards the latter part of this year, and will entertain a renewal of this request at such time. The Cross-Petition is therefore denied, without prejudice to refiling it at a later date.

The parties' remaining arguments, to the extent not specifically addressed herein, have been considered and found to be unavailing. All other requests for relief that have not heretofore been granted herein, including any request by the Petitioner for an order confirming that he is authorized to sell the Bakery, are hereby denied.

The foregoing shall constitute the Decision and Order of this Court.

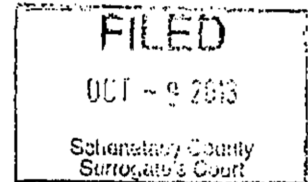
Signed at Schenectady, New York, this 6th day of August, 2012.



HON. VINCENT W. VERSACI
Surrogate

ENTER: August 6, 2012

12



State of New York
Supreme Court, Appellate Division
Third Judicial Department

Decided and Entered: April 4, 2013 515506

In the Matter of the Estate of
ARMOND X. MASTROIANNI,
Deceased.

NATHANIEL H. DAFFNER, as
Trustee of Certain Trusts
Made by the Will of
ARMOND X. MASTROIANNI,
Deceased,
Respondent;

MARY V. MASTROIANNI et al.,
Appellants,
et al.,
Respondents.

(Proceeding No. 1.)

MEMORANDUM AND ORDER

In the Matter of the Estate of
ARMOND X. MASTROIANNI,
Deceased.

MARY DRESCHER,
Appellant;

NATHANIEL H. DAFFNER, as
Trustee of Certain Trusts
Made by the Will of
ARMOND X. MASTROIANNI,
Deceased,
Respondent,
et al.,
Respondents.

(Proceeding No. 2.)

Calendar Date: February 13, 2013

Before: Mercure, J.P., Rose, McCarthy and Garry, JJ.

Melvin & Melvin, PLLC, Syracuse (Elizabeth A. Genung of counsel), for appellants.

McNamee, Lochner, Titus & Williams, PC, Albany (Christopher Massaroni of counsel), for Nathaniel H. Daffner, respondent.

McCarthy, J.

Appeal from an order of the Surrogate's Court of Schenectady County (Versaci, S.), entered August 6, 2012, which, among other things, dismissed Mary Drescher's application to compel an intermediate accounting of certain trusts.

Nathaniel H. Daffner is the trustee of two testamentary trusts of decedent's estate. The sole assets of the trusts are shares of Mastroianni Brothers, Inc., a corporation that operates a bakery. In 2009, respondent Mary V. Mastroianni, decedent's mother, contacted Daffner and informally asserted a potential claim to some of the corporation's shares. Daffner subsequently commenced proceeding No. 1 seeking advice and direction from Surrogate's Court (see SCPA 2107), specifically determinations on the ownership of the shares and Daffner's authority to control the affairs of the corporation. Several of the trusts' remaindermen opposed the petition, and Mary Drescher cross-petitioned seeking an intermediate accounting. Surrogate's Court granted Daffner's petition, holding that the trusts own 100% of the corporation's shares and Daffner, as trustee, had the right to control the corporation's affairs. The court dismissed the cross petition. Mary Mastroianni and remaindermen Anthony Mastroianni, Pasquale Mastroianni, Josepha Abba, Laura Salvatore and Mary Drescher (hereinafter collectively referred to as

respondents) now appeal.[1]

Surrogate's Court properly entertained Daffner's petition. Preliminarily, respondents do not attack the court's substantive determination on this issue, nor did they address the substance in their response to the original petition. Instead, they only argue that the court erred in entertaining Daffner's petition because SCPA 2107 is allegedly inapplicable in these circumstances. That statute provides that "[t]he court may entertain applications by a fiduciary to advise and direct in . . . extraordinary circumstances such as . . . where there is conflict among interested parties" (SCPA 2107 [2]). The court may entertain such applications in its sole discretion (see SCPA 2107 [2]). Respondents acknowledge that the court had jurisdiction over this proceeding (see SCPA 205; see also SCPA 201 [3]). Indeed, Surrogate's Court has jurisdiction over all matters that affect the affairs of a decedent or the administration of an estate, even without "specific statutory authorization for a particular proceeding" (Matter of Piccione, 57 NY2d 278, 288 [1982]; see SCPA 202; Matter of Lupoli, 275 AD2d 44, 51-52 [2000], lv dismissed 97 NY2d 649 [2001], lv denied 99 NY2d 503 [2002]).

Daffner's application specifically requested relief in the form of an order confirming that the trusts own 100% of the corporate shares and that he had the authority to act on behalf of the corporation. The application included the facts applicable to the requested relief and notice was given to the proper individuals (see SCPA 2101 [1] [c]; [3]). Even if the application was more in the nature of a request for a declaratory judgment (see CPLR 3001) than for advice and direction (see SCPA 2107 [2]), Surrogate's Court could ignore the improper form of the application and treat the matter as if it had been commenced in the proper form (see CPLR 103 [c]; SPCA 102; Matter of Van Patten, 190 AD2d 322, 326 [1993]; see also SCPA 2101 [1], [4]). Respondents did not address the substance of Daffner's

---

[1] The trusts' other remaindermen take no position on appeal. The lifetime beneficiary supports Daffner's position on appeal.

application, instead raising only procedural arguments. Thus, Surrogate's Court properly entertained the application and did not abuse its discretion in determining the proper ownership of the corporate shares (see Matter of Van Patten, 190 AD2d at 326; cf. H & G Operating Corp. v Linden, 151 AD2d 898, 901 [1989]; Matter of Garofalo, 141 AD2d 899, 900-901 [1988]).

Surrogate's Court did not err in denying Drescher's cross petition seeking an intermediate accounting. Where a trust holds a controlling share of stock in a corporation, the trustee can be compelled to "disclose the details of the corporate activities" (Matter of Sylvester, 5 AD2d 970, 970 [1958]; accord Matter of Brandt, 81 AD2d 268, 276 [1981]). "Although the SCPA does not require a fiduciary to give periodic or intermediate accountings, where trusts are managed over a lengthy period trustees often account periodically" (Matter of Hunter, 4 NY3d 260, 267 [2005] [footnote omitted]). As for the timing of such accountings, certain persons may seek to compel an intermediate or final accounting, which the court may order a fiduciary to complete if such an accounting appears to be in the best interests of the trust or estate (see SCPA 2205; Tydings v Greenfield, Stein & Senior, LLP, 11 NY3d 195, 202 [2008]). A court's determination in this regard will not be disturbed absent an abuse of discretion (see Matter of Sangiamo, 116 AD2d 654, 654 [1986]; Matter of Taber, 96 AD2d 890, 890 [1983]).

Here, Daffner had provided respondents with financial information related to the trusts and corporation, including an informal interim accounting, financial statements for five years, tax returns for three years, and a confidential analysis and report prepared by a business consultant. Daffner also provided answers to 31 questions posed by respondents regarding the corporation's operations and finances, and offered to answer any further questions that arose. Surrogate's Court favorably considered the extensive voluntary financial disclosures provided by Daffner. Although respondents deemed the information and answers insufficient, the court did not abuse its discretion in finding that a formal accounting was not currently in the best interests of the trusts and denying the request for an intermediate accounting at that time.

Mercure, J.P., Rose and Garry, JJ., concur.

ORDERED that the order is affirmed, with costs.

ENTER:

Robert D. Mayberger
Clerk of the Court

2018 NY Slip Op 51732(U)

In the Matter of the Kosmo Family Trust, dated July 18, 1994. LAURA E. KNIPE WIELAND, Petitioner,
v.
DONNA SAVINO, Respondent.

2018-235

New York Surrogate's Court, Albany County

Decided on December 3, 2018

Richard D. Cirincione, Esq., Attorney for Petitioner, McNamee Lochner, PC, 677 Broadway, Albany, New York 12207

William F. Ryan, Jr., Esq., Attorney for Respondent, Tabner, Ryan & Keniry, LLP, 18 Corporate Woods Blvd., Ste. 8, Albany, New York 12211

Stacy L. Pettit, S.

Pending before this Court is respondent Donna Savino's motion for summary judgment to dismiss the petition brought by petitioner, Laura E. Knipe Wieland, which seeks an order determining that the first, second and third amendments to the Kosmo Family Trust are void due to the lack of capacity of Janet D. Kosmo (hereinafter decedent) or the exercise of undue influence upon her by respondent. Respondent argues that petitioner lacks the authority to challenge the trust amendments. Petitioner opposes the motion, and the matter is submitted for decision.

Decedent died in December 2017, a resident of Orange County, California. She was survived by two of her three children, petitioner and Richard X. Knipe. Her third child, Claudia

Page 2

Knipe, was diagnosed with Down's Syndrome and resided in a group home where respondent worked as a health care worker, until her death in 2006. Decedent was also survived by two adult grandsons, Brent Knipe and Steven X. Knipe. In 1994, decedent and her spouse, Joseph Kosmo, created the Kosmo Family Trust, naming themselves as the trustees of the trust upon its creation. Kosmo died a resident of California in January 2013, predeceasing decedent. Under the 1994 trust, after the death of Kosmo and decedent, petitioner was to receive the residue of decedent's half of the trust, after some general gifts to other family members.

In 2008, decedent and Kosmo executed the Amendment and Restatement of the Kosmo Family Trust dated August 25, 2008. Pursuant to the terms of the 2008 trust, after the death of Kosmo and decedent, the remaining trust assets would be divided in half, and decedent's half would be distributed 90% to Richard X. Knipe and 10% to Charles Wendel. Thereafter, decedent executed three amendments to the trust, in 2013, 2015 and 2016. Pursuant to the 2013 amendment, the residue of decedent's share was left in equal shares to Steven Knipe and Brent Knipe, after a $25,000 gift to respondent and to decedent's friends. The 2015 amendment kept the cash gift to decedent's friends and left the remainder to respondent. Finally, the 2016 amendment left decedent's entire share to respondent. The trusts contain a choice of law provision, which provides that California law shall apply to the validity of the trust and the construction of its beneficial provisions, regardless of any change in the residence of the trustee.

Petitioner alleges that respondent exercised undue influence over decedent which resulted in decedent executing the amendments to the 2008 trust, ultimately removing her friends and family as beneficiaries and leaving the entirety of the trust assets to respondent. In March 2018, petitioner commenced this proceeding to

Reprinted with permission.

invalidate the 2013, 2015 and 2016 amendments to the 2008 trust. Thereafter, jurisdiction was obtained over all interested parties. Respondent answered the petition, raising several affirmative defenses including inconvenient forum, and contemporaneously moved to dismiss the petition pursuant to CPLR 327. By decision and order of this Court dated May 29, 2018, respondent's motion to dismiss for inconvenient forum was denied.

Respondent then brought this motion for summary judgment under CPLR 3212 to dismiss the petition. Respondent asserts that petitioner did not have the legal authority to challenge the amendments to the 2008 amended and restated trust because petitioner was not a beneficiary of the trust under Cal Prob Code § 17200 and she did not have an interest in the 2008 trust at the commencement of the proceeding in March 2018. In July 2018, after this motion was made, petitioner's brother, Richard X. Knipe, assigned 50% of his interest in the 2008 trust to petitioner pursuant to Cal Civ Code § 699. In response to the filing of the assignment, respondent argues that standing must be established at the outset of the proceedings and cannot be established retroactively through a later assignment of interest. Respondent further argues that the proceeding is time barred because the assignment of interest took place after the statute of limitations to challenge the trust amendments expired pursuant to Cal Prob Code § 16061.8. In opposition, petitioner argues that the assignment of her brother's interest in the trust gave her standing to contest the amendments to the 2008 trust. Petitioner also asserts that respondent is precluded from raising a defense that the proceeding was barred by the statute of limitations because it was not raised in her answer or pre-answer motion as required by CPLR 3211 (e). Finally, petitioner argues that New York's six-year statute of limitations should apply under

conflicts of law rules.

DISCUSSION

To determine whether petitioner has the legal authority to challenge the amendments to the 2008 amended and restated trust, it must be found by the Court that petitioner has both the legal capacity and standing to bring this proceeding. Capacity and standing are related, but distinguishable, legal concepts. Capacity is a threshold matter that seeks to determine whether "the legislature invested [petitioner] with authority to seek relief in court," whereas standing relates to "whether a party has suffered an injury in fact conferring a concrete interest in prosecuting the action" (Matter of World Trade Ctr. Lower Manhattan Disaster Site Litig., 30 NY3d 377, 384 [2017] [internal quotation marks omitted]; see also Community Bd. 7 of Borough of Manhattan v Schaffer, 84 NY2d 148, 155 [1994]; Socy. of Plastics Indus. v County of Suffolk, 77 NY2d 761, 772-773 [1991]).

The Court must first consider whether California or New York law applies to the capacity and standing issues raised in respondent's motion to dismiss. Article VIII (E) and (F) of the Declaration of Trust dated July 18, 1994, along with all of the amended and restated trusts, contain a choice of law provision which states that "[t]he validity of this trust and the construction of its beneficial provisions shall be covered by the laws of the State of California in force on the date of execution of this instrument." A choice of law provision such as this one operates to apply California law to substantive issues, however, procedural matters are left to the forum state (see Tanges v Heidelberg N. Am., Inc., 93 NY2d 48, 54 [1999]; Kilberg v Northeast Airlines Inc., 9 NY2d 34, 41 [1961]). In determining whether an issue is substantive or procedural, the law of the forum applies (see Tanges v Heidelberg N. Am., Inc., 93 NY2d at 54; see also Nestor v Putney Twombly Hall & Hirson, LLP, 153 AD3d 840,

Reprinted with permission.

842 [2d Dept 2017], lv denied, 30 NY3d 907 [2017]).

Under New York law, capacity is a substantive issue to be determined by California law (see Matter of World Trade Ctr. Lower Manhattan Disaster Site Litig., 30 NY3d at 384). Respondent argues that petitioner lacks capacity to bring this proceeding, citing Cal Prob Code § 17200. This section provides that "a trustee or beneficiary of a trust may petition the court . . . concerning the internal affairs of the trust or to determine the existence of the trust" (Cal Prob Code § 17200 [a]). As explained by the court in Barefoot v Jennings, (27 Cal App 5th 1, 237 Cal Rptr 3d 750, 753 [2018], review filed [Oct. 19, 2018]), "[t]he plain language of section 17200 makes clear that only a beneficiary or trustee of a trust can file a petition under [this section]." However, this section is intended to allow beneficiaries and trustees operating under a trust agreement to resolve their disputes, and is not dispositive in the dispute before this Court because "[s]eparate proceedings against [a] trustee in his or her official or personal capacities are already available to resolve disputes regarding the validity of proffered trust agreements and are not foreclosed by the existence of section 17200" (Barefoot v Jennings, 27 Cal App 5th 1, 237 Cal Rptr 3d at 753-754; see Lintz v Lintz, 222 Cal App 4th 1346, 167 Cal Rptr 3d 50, 59-60 [2014]). Trust contests under California law on the basis of incapacity, undue influence and fraud may be brought by an "interested person" as defined in Cal Prob Code § 48, including "[a]n heir, devisee, child, spouse, creditor, beneficiary, and any other person having a property right in or claim against a trust estate or the estate of a decedent" (Cal Prob Code § 48; see Lintz

Page 4

v Lintz, 222 Cal. App 4th 1346, 167 Cal Rptr 3d at 59-60).[1] Petitioner, as decedent's intestate heir, has capacity to bring this proceeding under the applicable law of California.

Whether petitioner has the legal authority to bring this proceeding also requires a determination that petitioner has standing. Under conflicts of law principles, standing "goes to the jurisdiction of the court" and is a procedural matter to be determined by New York law (*see Matter of World Trade Ctr. Lower Manhattan Disaster Site Litig*., 30 NY3d at 384, *quoting City of New York*, 86 NY2d 286, 292 [1995]). To establish standing, New York courts require that a "litigant have something truly at stake in a genuine controversy" (*Saratoga County Chamber of Commerce, Inc. v Pataki*, 100 NY2d 801, 812 [2003]; *see also Socy. of Plastics Indus. v County of Suffolk*, 77 NY2d at 772). Under New York's Surrogate's Court Procedure Act, a "person interested" includes "[a]ny person entitled or allegedly entitled to share as a beneficiary in the estate" (SCPA 103 [39]). The definition of "estate" under SCPA 103 (19) includes the property of a trust (*see Matter of Stephen Dehimer Irrevocable Trust*, 52 Misc 3d 1203[A] [Sur Ct, Oneida County 2016], *affd* 155 AD3d 1600 [4th Dept 2017]). The beneficiaries of a trust are defined as "the persons or classes of persons, or the successors in interest of persons . . . upon whom the settlor manifested an intention to confer beneficial interests (vested or contingent) under the trust, . . . [including] persons who have succeeded to interests of beneficiaries by assignment, inheritance or otherwise" (*Matter of Wells Fargo Bank*, 2018 NY Slip Op 31883[U] [Sup Ct, NY County 2018], *citing* Restatement [Third] of Trusts § 48, Comment a]). Although petitioner is the assignee of a beneficial interest under the 2008 trust, the assignment did not occur until four months after the commencement of this proceeding. While interests in trusts may be assigned under California law (*see* Cal Civ Code §§ 699; 1458), petitioner did not have an interest in the 2008 trust in March 2018 when this proceeding was commenced and therefore

Reprinted with Permission.

lacked standing to bring this proceeding (*see Matter of Brown*, 144 AD3d 587, 587 [1st Dept 2016]). Post-filing events do not cure standing defects that exist at the time a proceeding is filed (*see Shareholder Representative Servs. LLC v Sandoz Inc*, 46 Misc 3d 1228[A], 2015 NY Slip Op 50326[U] [Sup Ct, NY County 2015]). Accordingly, respondent's motion to dismiss is granted, without prejudice, given petitioner's lack of standing at the outset of this proceeding. It is noted that petitioner now has standing to commence a proceeding on the facts of this case, given the assignment of an interest in the trust. The dismissal of this proceeding is not on the merits.

Although unnecessary to the determination of this motion, the Court will address respondent's argument that, by the time petitioner had a pecuniary interest in the trust, the statute of limitations to challenge the trust amendments had expired under Cal Prob Code § 16061.8 because the 120-day time period to challenge the trust had expired. Under conflicts of law principles, statutes of limitations are procedural matters to be determined by the law of the forum because they are considered "as pertaining to the remedy rather than the right" (*Portfolio Recovery Assoc., LLC v King*, 14 NY3d 410, 416 [2010], *quoting Tanges v Heidelberg N. Am.*, 93 NY2d at 54-55). In New York, the statute of limitations to set aside a revocable trust on the basis of undue influence and fraud is six years from the settlor's death (*see Tilimbo v Posimato*,

Page 5

20 Misc 3d 1116 [A], 2008 NY Slip Op 51366[U] [Sur Ct, Bronx County 2008]; CPLR 213). Respondent argues that even if the statute of limitations were to be determined under New York law, the Court must apply the shorter of the two time-periods pursuant to CPLR 202 because the cause of action accrued in California. This rule, which states that the shorter of the time limits should be applied except "where the cause of action accrued in favor of a resident of [New York]," is designed to prevent forum shopping by a *non-resident* and is inapplicable in this case (*see* CPLR 202). Petitioner is a resident of New York, and CPLR 202 requires the application of the New York statute of limitations in that case.[2] Finally, even if California law did apply, respondent waived the statute of limitations defense by failing to raise it in her answer or in a motion to dismiss pursuant to CPLR 3211 (e). Because this proceeding has not been dismissed on the merits and the Court has determined that the statute of limitations has not expired, petitioner may re-file this proceeding. Any remaining contentions, to the extent not specifically addressed, have been considered and found to be lacking in merit.

Accordingly, it is

ORDERED that respondent's motion to dismiss for lack of standing is granted, without prejudice.

This constitutes the Decision and Order of the Court.

Dated and Entered: December 3, 2018

Hon. Stacy L. Pettit, Surrogate

Papers Considered:

1) Respondent's Notice of Motion, Memorandum of Law and Affirmation of William F. Ryan, Esq. in Support of Respondent's Motion for Summary Judgment, with exhibits, dated June 29, 2018;

2) Assignment of Interest in Trust dated July 16, 2018;

3) Affirmation of Richard D. Cirincione, Esq., with exhibits, in Opposition to Respondent's Motion for Summary Judgment, dated July 25, 2018;

Reprinted with permission.

4) Reply Affirmation of William F. Ryan, Jr., Esq., with exhibits, and Memorandum of Law in Support of Respondent's Motion, dated August 1, 2018;

5) Petitioner's Sur-reply in Opposition to Respondent's Motion for Summary Judgment, dated August 8, 2018;

6) Respondent's Memorandum of Law in Further Support of Summary Judgment, dated October 17, 2018;

7) Supplemental Affirmation of Richard D. Cirincione, Esq., with exhibits, and Supplemental Memorandum of Law in Opposition to Respondent's Motion, dated October 17, 2018.

Footnotes:

[1.] Under New York law, petitioner would also have capacity to challenge the amendments to the 2008 trust (*see Matter of Davidson*, 177 Misc 2d 928, 930 [Sur Ct, NY County 1998]).

[2.] It is noted that Respondent is also a resident of New York.

Reprinted with permission.

43 Misc.3d 1214(A)
Unreported Disposition
(The decision is referenced in
the New York Supplement.)
Surrogate's Court, Nassau County, New York.

In the Matter of the Proceeding to
Invalidate the Alleged Amendments to the
Living Trust of **John LEDDY**, dated
February 25, 2013 and March 15, 2013.

No. 2013–374927/A.
|
Feb. 28, 2014.

Attorneys and Law Firms

Nelson A. Vinokur, Esq., Long Beach, for Respondent.

Robert M. Harper, Farrell Fritz P.C., Uniondale, for Petitioners.

Opinion

EDWARD W. McCARTY III, J.

***1** In this proceeding to determine the validity of an amendment to an inter vivos trust, petitioners move for an order compelling disclosure.

Decedent died on March 18, 2013 survived by five children four of whom are the petitioners in this proceeding. A purported will of the decedent dated February 25, 2013 bequeaths the residue of the estate to an inter vivos trust. The instrument is on file with the court but has not been offered for probate. An inter vivos trust, dated April 12, 2011, designates the decedent/grantor as the income beneficiary and provides for the division of the remainder into equal shares for his children. A purported amendment to the trust directs the payment of the entire remainder to one child, Richard **Leddy**, respondent in this proceeding. Petitioners commenced this proceeding to determine the validity of the amendment.

At issue on this motion is the disclosure of communications between the decedent and the attorney-draftsman of the amendment. The attorney represents the respondent in this proceeding. At a deposition, the attorney refused to testify regarding communications with the decedent on the grounds of attorney-client privilege.

Barbara Ruff, one of the petitioners on this proceeding, is the nominated executor of the instrument dated February 15, 2013. However, she lacks standing to waive the privilege, in the capacity of executor (*Maryorga v. Tate,* 302 A.D.2d 11 [2d Dept 2002]) as the instrument has not been admitted to probate. She cannot receive preliminary letters testamentary as the instrument has not been offered for probate. Petitioners seek the issuance of temporary letters of administration for the purpose of exercising control of the privilege.

CPLR 4503 pertains to a proceeding concerning the validity, probate and construction of a will. Petitioners make a persuasive argument that the trust is the "functional equivalent of a will," based upon the pour over provision in the February 15, 2013 instrument. The court need not determine whether this meets the statutory requirement.

It is generally recognized that, in addition to the statutory exception, the privilege does not apply in a dispute between parties as to an interest in property which they claim through the same decedent (Restatement [Third] of the Law Governing Lawyers § 81 [2000]; *see also Matter of Levinsky,* 23 A.D.2d 25 [2d Dept 1965; appeal denied 16 N.Y.2d 484 [1965]; 1 McCormick on Evid. § 94 [7th ed.]).

It is therefore concluded, consistent with this court's decision in *Matter of Bronner* (7 Misc.3d 1023[A] [Sur Ct, Nassau County 2005]) that petitioners can examine the attorney as to communications with the decedent concerning the drafting of the amendment in question.

Settle order.

All Citations

43 Misc.3d 1214(A), 988 N.Y.S.2d 523 (Table), 2014 WL 1508829, 2014 N.Y. Slip Op. 50643(U)

End of Document © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Reprinted with permission.

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

New York County Surrogate's Court
Date: October 4, 2018

--x

In the Matter of a Proceeding for Various Types of Relief in Relation to a Trust Created by

LUCILLE B. WILLIAMS,

as Grantor,

under Agreement dated October 2, 2007.

File No. 2012-2554/A/B

--x

ANDERSON, S.:

Presently before the court is a motion for summary determination (CPLR 3212) in a contested proceeding involving a revocable trust (the "Trust") established by Lucille B. Williams (the "Grantor") on October 2, 2007, and restated by her on November 7, 2008, and on March 20, 2009.[1] The proceeding was commenced by Grantor's five stepchildren, who seek various types of relief in relation to the Trust. Movant, Grantor's daughter, asks the court to dismiss her step-siblings' petition.

Factual Background

To the extent that the facts are undisputed, they are as follows. Grantor died on October 9, 2011, aged 83, survived by movant as her sole distributee. On the date of Grantor's death, her probate estate had a value of approximately $200,000 and the Trust remainder had a value of more than $10 million. Grantor's second husband, Bob, to whom she was married for about 30 years, had died some 15 years earlier. The couple had each brought children to the marriage -- his four sons and a daughter and her son and daughter (in combination, "the seven children").

---

[1]Movant purports to make this motion in the probate proceeding that is currently pending in Grantor's estate, as well as in the present proceeding. However, the probate proceeding is uncontested, and a motion for summary determination therein would be anomalous (*see* CPLR 3212[a]). Accordingly, the court must limit its analysis of the motion to the issues raised in the present proceeding.

With Bob's three older children already living independently, the household established by Grantor and Bob consisted of his two younger children and both of hers. Whether the blended-family arrangement generally fared as badly as movant alleges or as well as objectants would have it is a sharply disputed question. For present purposes it is enough to identify the points upon which the parties agree in such connection.

For one, from the start of their marriage Grantor and Bob in various respects took pains to be even-handed toward the seven children. For another, when Bob died, on December 27, 1995, he left his estate outright to Grantor, but only after directing (in a pre-residuary bequest) that $600,000 be divided among the seven children equally. Notably, the bulk of the assets that Bob left to Grantor consisted of securities held in a brokerage account then valued at approximately $10 million (the "Brokerage Account").

Another point of agreement among the parties is that Grantor and Bob had at some point established a practice of regular, joint, and equal giving to the seven children (and, from time to time, to the couple's grandchildren) in the form of semi-annual cash gifts celebrating the end-of-year holidays and the date of their marriage. It is undisputed that after Bob's death Grantor continued the tradition for years, but discontinued it in 2009, which was in several respects a pivotal year for her. That year was the first following the death of her son (movant's brother) as a result of a motorcycle accident on September 7, 2008, that had left him hospitalized as a paraplegic to the date of his death (December 20, 2008). Although the son's relationship with his step-siblings through the years is among the matters presently in dispute, all parties agree that the son's death was a deeply tragic loss for Grantor, who as she aged had come to rely increasingly on his companionship and assistance as to her household and other personal needs,

including the hiring of round-the-clock aides to help her cope with her various physical ailments. It is also undisputed that movant, who lived with her husband and children in Pennsylvania and whose contact with Grantor over the decades was mainly by telephone, came to occupy a considerably more important practical role in Grantor's life – with, as movant puts it, a relationship that was "stronger"after the son was hospitalized and then after he died. Although the frequency of the step-children's own in-person visits with Grantor over the years is itself a point of some disagreement, it is undisputed that only two of them lived in the New York area, but it is also undisputed that they remained in contact with Grantor by phone and in writing both before and after the son's death.

The record establishes that Grantor executed two testamentary instruments prior to the one now propounded as her will. The first, executed in 1984, left her tangibles and any real estate interests to Bob if he survived her and bequeathed her residuary estate to the seven children in equal shares. The second, executed in 2001, left the investment assets in the Brokerage Account – representing the bulk of her estate -- to the seven children, again in equal shares, with the residuary passing to her son and daughter.

The third testamentary instrument, now propounded as Grantor's will, was executed on November 7, 2008, on which date Grantor also executed a power of attorney and health care proxy naming her daughter as her agent (replacing Grantor's son as her agent under instruments executed at the time the Trust was created) . The third testamentary instrument left Grantor's tangibles to her daughter and her residuary to the Trust created about a year earlier. The original Trust agreement between Grantor and her son, the latter as her co-trustee, provided that at Grantor's death the investment assets in or traceable to the Brokerage Account were to be

divided equally among the seven children, with the balance of the Trust's assets (including her Manhattan apartment) to be divided between her son and daughter. An amendment of that instrument, executed concurrently with the propounded will, was prompted by the son's changed circumstances in the wake of his accident: it provided that his share of the remainder was to be held in further trust, and it replaced the son with the daughter as co-trustee. By contrast, a second instrument to amend the Trust (the "Trust Restatement"), executed some four months later and now at the center of the parties' dispute, substantially altered decedent's dispositive provisions for the remainder: under it, the entire trust remainder was left to Grantor's daughter, with a provision explaining that the absence of any gift to the step-children was not for want of love and affection for them but because, as the provision put it, they had been "adequately" provided for from other sources.

In their petition for relief concerning the Trust, the step-children seek to set aside the Trust Restatement on the grounds that Grantor lacked capacity to execute it and that it was the product of movant's fraud and undue influence. The step-children's other stated "grounds" for invalidating the Trust Restatement (lack of due execution, duress, "overreaching") are in essence mere variations of lack of capacity and undue influence.

Standards Applicable to Summary Determinations

Although on summary judgment motions the phrases "burden of proof" and "preponderance of the evidence" are occasionally invoked by the courts or, as in this case, repeatedly by the parties, the phrases are misplaced in such a context. Where a factual dispute is raised in an action or proceeding, at trial one of the parties will necessarily have a heavier burden than the other to prove or disprove the fact. However, the very premise of a motion for summary

judgment is that the material facts are not open questions and that the issues therefore can be determined as a matter of law, *i.e.*, without the need for trial. Thus, although a movant for summary judgment has an evidentiary burden, for purposes of the motion he does not have a "burden of proof" within the standard meaning of that phrase. Instead, the movant must submit evidence making a prima facie case for his position on the law, "tendering sufficient evidence to demonstrate the absence of any material issues of fact" (*Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986]).

In considering whether the movant has made a prima facie case, a court must be mindful that she cannot do so through evidence that is hearsay as to her (*see Zuckerman v City of New York*, 49 NY2d 557, 562). Nor may she do so through evidence that would violate section 4519 of the CPLR, the so-called "Dead Man's Statute" (*see Phillips v Kantor & Co.*, 31 NY2d 307).

Where the movant has succeeded in making a prima facie case of entitlement to a favorable ruling as a matter of law, the adversary must then demonstrate that a material issue of fact nonetheless is in genuine dispute ([*id.*]) and that a trial is therefore necessary (*see Zuckerman v City of New York*, *id.*). If the adversary fails to do so, the motion must be granted.

Since a summary ruling against a party on the merits deprives that party of the opportunity to have a trial, such relief should be considered with caution (*F. Garofalo Elec. C. v NY Univ.*, 300 AD2d 186, 188 [1st Dept 2002]. On the other hand, "timidity in exercising the power [to rule summarily] in favor of a legitimate claim and against an unmerited one ... contributes to calendar congestion which, in turn, denies to other suitors their rights to prompt determination of their litigation" (*Di Sabato v Soffes*, 9 AD2d 297, 299 [1st Dept 1959]).

On a motion for summary determination, the opposing party must be allowed the benefit

of any reasonable inference in that party's favor. Moreover, a credibility issue clearly points to the need for trial (*Dauman Displays v Masturzo*, *supra*, at 205). Finally, allegations by the party opposing the motion must be "substantiated by evidence in the record; mere conclusory assertions will not suffice" (*Matter of O'Hara*, 85 AD2d 669, 671 (2d Dept 1981), and mere speculation cannot serve as a substitute for proof (*see, e.g., Shaw v Time-Life Records*, 38 NY2d 201 [1975]; *Matter of Eastman*, 63 AD3d 728, 740 [2d Dept 2009]; *Matter of Hatzistefanou*, 77 Misc 2d 594 [Sur Ct, NY County 1974]).

Motion for Summary Determination as to Capacity

On the capacity issue, the parties disagree as to the standard of capacity that applies where the instrument in question involves a revocable trust. According to movant, the standard is fixed by the character of the Trust as a testamentary substitute, revocable as it was during Grantor's lifetime. Thus, movant contends that, to have executed the Trust Restatement effectively, Grantor needed no more than testamentary capacity – the least demanding condition of mind required of an individual executing a legal instrument (*see Matter of Coddington*, 281 AD 143 [3rd Dept 1952]). Under that standard, a testator must understand the nature and extent of his property and, at least on an elementary level, the function and content of the will disposing of that property, as well as that certain persons would ordinarily be the natural objects of his bounty (*Matter of Kumstar*, 66 NY2d 691 [1985]).

According to the stepchildren, by contrast, the standard of capacity applicable to the Trust Restatement, as a bilaterally executed instrument amending an "agreement," is the more demanding standard applied to contracts (*see Ortelere v Teachers' Retirement Bd.*, 25 NY2d 196, 202-203 [1969])(under traditional contract standard of capacity, party to employment-severance

contract must have ability to understand nature and consequences of transaction and to make a rational judgment concerning it);[2] *Blatt v Manhattan Med. Group, P.C.*, 131 AD2d 48 [party to contract had capacity where his mental faculties were sharp enough to allow him to understand nature of the give-and-take between himself and other party and to assess agreement's affect on his personal interests]; *see Matter of Goldberg*, 153 Misc 2d 560 [Sur Ct, NY County 1992] [same as to antenuptial agreement]).

As it happens, the capacity issue is a somewhat awkward one for each side. The problem for the step-children is implicit in their attempt to invalidate the Trust Restatement on the ground that Grantor was without capacity when it was executed, since they thereby risk raising a question as to her capacity to have created the Trust less than 18 months earlier. The problem for movant, on the other hand, is that the court in *Matter of ACN* (133 Misc 2d 1043 [Sur Ct, NY County 1986]) – the decision she claims as support for validating the Trust Restatement by applying the lower standard of testamentary capacity – did the exact opposite when it invalidated the trust involved in that case. The problem for both parties is that there is no square precedent to guide us on the capacity issue arising with respect to this revocable trust.

In the end, however, the very differences between this case and *ACN* point to the appropriate standard for determining capacity here. It was clearly pivotal to the *ACN* ruling that the charitable-remainder unitrust there at issue amounted to an irrevocable surrender of its grantor's full ownership of the entrusted property during his lifetime. Such a transaction was

[2]Although the enactment of Article 81 of the Mental Hygiene Law, in 1992, to some extent altered the effect of the *Ortelere* standard, it did not do so to the extent relevant to the issues here.

appropriately put to a more stringent test for validity than should be applied to the revocable gift in this case, which, viewed from the time the Trust Restatement was executed, would take effect (if ever) only upon the owner's death (*id.*, at 1046-1047).

The mere the fact that the Trust Restatement had two signatories did not per se make the instrument the product of a negotiated transaction warranting the more rigorous test for capacity that is appropriate to a negotiated contract. Rather, as another court has noted, the fact of two signatures on a trust "agreement" may be "largely a matter of form" (*Matter of Goldberg*, 153 Misc 2d 560, 565 [Sur Ct, NY County 1992]). In any event, the instrument creating the trust in this case was by its express terms amendable by Grantor unilaterally, and the dispositive change effected by the Trust Restatement therefore had not required any signature other than Grantor's and thus cannot be said to have entailed a negotiation requiring the degree of mental acuity on Grantor's part as would be demanded of a contract.

For the foregoing reasons, the court concludes that the gauge of capacity to be applied here is the less demanding, testamentary standard.

The question as to whether movant has made a prima facie case for capacity need not detain us long. As a threshold matter she is aided by the law's presumption of capacity (*see, e.g., Matter of Betz*, 63 AD2d 769 [3d Dept 1978]; *Matter of Smith*, 180 AD 669 [2d Dept 1917]; *Jones v Jones*, 17 NYS 905, 908 [1st Dept 1892]["the legal presumption is that every man is compos mentis"]). In addition, movant has submitted the affidavit and deposition testimony of two lawyers, partners in the same firm, with whom Grantor consulted in relation to their preparation and her execution of the Trust Restatement, as well as the lawyers' written

memorializations of their discussions with Grantor concerning the Trust Restatement. The lawyers' separate accounts as to Grantor's responses and questions during their discussions near or at the time the Trust Restatement was executed describe a client who understood the nature of the legal steps that she was taking and of the property that would pass pursuant to those steps; who was aware of the identity of the natural objects of her bounty and of the provisions that she had made for them in the past; and who was mentally flexible enough to evaluate her estate-planning alternatives. Additional submissions by movant, including the affidavit and deposition testimony of, among others, one of the stepchildren and a home care aide who had worked for Grantor for some ten years (both before and after the Trust Restatement was executed), are consistent with the proposition that Grantor had not declined so far mentally that she would have been unable to execute a valid will or will substitute. In short, movant has made a prima facie case that Grantor had capacity for purposes of executing the Trust Restatement.

The stepchildren can successfully resist summary dismissal of their capacity objection only if their evidence puts movant's prima facie case for such dismissal into genuine question. To that end, they have submitted their own sworn statements and deposition testimony; the affidavit and deposition testimony of the home care aide; the deposition testimony of several of the medical doctors who treated Grantor within the last few years of her life; and the medical records of Grantor's several visits to hospitals in the years immediately preceding her death. The foregoing indicates that, by the time Grantor executed the Trust Restatement, she had suffered noticeable memory loss and instances of confusion. She had also experienced apparent delusions or hallucinations (repeatedly complaining of skin problems purportedly caused by lice or ticks, pests that were, however, undetectable to her medical providers, and repeatedly reporting to

police that she was being contacted by UFOs and terrorists).

But such proof of mental decline does not establish lack of capacity for purposes of probate. As precedents establish, even a diagnosis of Alzheimer's Disease or senile dementia would not per se disprove testamentary capacity if execution occurred during a lucid interval (*Gala v Magarinos*, 245 AD2d 336 [2d Dept 1997]; *Matter of Morris*, 208 AD2d 733 [2d Dept 1994]; *Matter of Hedges*, 100 AD2d 586 [2d Dept 1984]; *Matter of Villani*, 28 AD2d 76 [1st Dept 1967]; *Matter of O'Donnell*, NYLJ, Oct. 28, 2008, at 35, col 2 [Sur Ct, NY County]). Indeed, among objectants' own proofs are medical records, compiled near or after the Trust Restatement was executed, reporting that Grantor appeared to be "oriented" as to time, place, and person." Nor is incapacity proved by evidence that decedent entertained a delusional belief or experienced hallucinations unless – as does not appear to be the case here – a delusion or hallucination caused or altered the dispositive provisions of the propounded will (*see, e.g.*, *Matter of Honigman*, 8 NY2d 244 [1960] [remand to jury to determine whether delusion as to wife's infidelity was the basis for reduction of her inheritance]; *American Seamen's Friend Soc. v Hopper*, 33 NY 619, 625 [1865] [will invalidated by delusion if testamentary dispositions "were or might have been caused or affected by ... delusion"]; *Matter of Etoll*, 30 AD2d 224, 228 [3d Dept 1968] ["lack of capacity evidenced by abiding, insane delusion directed at the person who would normally be the principal or only object of testatrix'[s] concern and bounty"]).

In the absence of evidence that would create a genuine question as to capacity, the motion to dismiss the objection as to lack of capacity is granted.

Motion for Summary Determination as to Undue Influence

The premise of an objection alleging undue influence is that the legal instrument at issue expresses the wishes of someone other than the instrument's purported creator. This is not to say that influence per se is necessarily "undue." But where an instrument is proved to be the product of "a moral coercion, ... restraining independent action and destroy[ing] free agency, ... which, by importunity[,] ... constrained [the purported creator to execute the instrument] ... against [her] free will and desire," it must be invalidated (*Children's Aid Society v Loveridge*, 70 NY 387, 394 [1877]).

As is often noted, undue influence can seldom be demonstrated by direct proof, since such an influence rarely occurs in plain view (*Rollwagen v Rollwagen*, 63 NY 504, 519 [1876]), instead taking the form of a "subtle but pervasive" (*Matter of Neary*, 44 AD3d 949, 951 [2d Dept 2007]) manipulation of another that is aimed at displacing the other's volition with one's own. Proof of undue influence must establish more than a motive to achieve such effect on another and an opportunity to do so: it must establish also that such effect was actually achieved (*Matter of Fiumara,* 47 NY2d 845 [1979]).

It is movant's task on this motion to lay bare her proof that the Trust Restatement was a natural expression of Grantor's knowing and free wishes. To that end, movant is aided by the fact that she was by that point Grantor's only living child (and, indeed, her only close blood relative), a relationship that on the face of it could make her an unsuspicious choice as Grantor's sole beneficiary. Moreover, although movant's own affidavit largely consists of evidence that cannot be considered in support of summary judgment, movant is aided by the sworn testimony

of others, including the affidavit and deposition testimony of the two lawyers who prepared the Trust Restatement after discussions with Grantor and the deposition testimony of the financial adviser with whom Grantor consulted for many years, until her death.

The lawyers attest that Grantor, some eight years earlier, had independently chosen their firm to draft the 2001 will for her, and then eventually to draft the Trust and various other legal instruments. According to the lawyers, the change effected by the Trust Restatement was prompted by Grantor's fear that the stock market might continue the very sharp declines it had experienced in 2008 and the first quarter of 2009 and that movant would not be adequately provided for as a result. The testimony of the financial advisor (who, two days before the Trust Restatement was executed, participated in a meeting with Grantor, movant, and the lawyers) agrees with the lawyers' testimony on this point. According to one of the lawyers, Grantor had volunteered the observation that Bob's outright bequest to her of the Brokerage Account reflected his intention to leave her free to dispose of it at her death as she wished. Moreover, according to the financial adviser, decedent had expressly commented that the stepchildren were otherwise provided for by inheritance from their mother, who had died some ten years earlier. The lawyers further testify that Grantor had specifically considered, and expressly rejected, their suggestion that she leave relatively modest bequests to each of them, coupled with an in terrorem clause, in order to discourage them from challenging the Trust Restatement. The lawyers and financial adviser are agreed that decedent had demonstrated a strength of will in other respects as well, such as her insistence on making certain investments frowned upon by the adviser.

The foregoing evidence is sufficient to make a prima facie case for dismissal of the objection as to undue influence. It remains to be considered, therefore, whether the

stepchildren's proofs create a genuine question as to that case.

Those proofs include, inter alia, the affidavits of two of the stepchildren as well as of the former spouse of one of them and the companion of another; the deposition testimony of all five of the stepchildren (which, as opposition to a summary ruling, can be considered); movant's own deposition testimony; the affidavit and deposition testimony of Grantor's long-time home aide; the deposition testimony of several doctors with whom decedent consulted during the time period proximate to her execution of the Trust Restatement; and the various testamentary and trust instruments executed by Grantor, as well as Bob's probated will. The stepchildren's testimony describes various ways in which Grantor and their father took pains to blend their respective offspring as naturally as possible and to avoid even the appearance of favoritism. The stepchildren's testimony, corroborated by that of the home aide, also describes a continuing and amiable relationship between Grantor and the stepchildren after Bob's death. Although all but two of the stepchildren lived outside New York during the last decades of decedent's life, their evidence shows that they and Grantor, by occasional in-person visits, but largely by mail and phone, retained some closeness until her death.

Even viewed in light of the stepchildren's evidence of a long-time affinity and affection between them and Grantor, the absence of a beneficial provision for the stepchildren could not by itself create a genuine question as to undue influence. Nor could such question be raised solely by the fact that, by the time Grantor executed the Trust Restatement, circumstances had made her more dependent upon her daughter than ever before (*cf. Children's Aid Soc. v Loveridge*, 70 NY 387, 394-395) ("attachment arising from consanguinity, or the memory of kind acts and friendly offices ... cannot be regarded as illegitimate or as furnishing cause for legal condemnation").

However, such a question arises when the daughter's positioning vis-a-vis the mother is viewed in combination with other aspects of Grantor's situation at the time she executed the Trust Restatement.

Thus, there is the evidence that, by March 2009, Grantor's physical and mental frailty had been aggravated by Grantor's then-recent loss of the son who had been her daily mainstay; that some degree of Grantor's dependency upon the son had transmuted into some degree of dependency upon movant (as witness the power of attorney and health care proxy that Grantor gave movant when the son was no longer available to act under the same type of agency instruments that she had previously given him). There is the additional evidence that Grantor and Bob had for decades treated their children and stepchildren equally in relation to their worldly goods; that, until the Trust Restatement, Grantor's estate plan had continued the pattern of equal treatment as to the major property at her disposal – the Brokerage Account that the stepchildren's father had established, nurtured, and then bequeathed to her; that 18 months earlier, when the daughter was slated to receive only half of Grantor's assets outside the Brokerage Account, Grantor had seen fit to give her only one-seventh of the Account.

Also to be considered is the stepchildren's evidence that Grantor would not have had cause for the concern that movant attributes to her, *i.e.*, that movant had become less well-heeled financially as a result of her divorce and was thus in need of the entire Brokerage Account in addition to all of Grantor's net estate; and there is the fact that, until March 2009, the stepchildren's inheritance from their mother years earlier (such as it was) had not prompted Grantor to deny them the stakes in the Brokerage Account that she had given them under her prior estate plans. Added to that is the evidence that, in early 2009, Grantor had initially turned

to the lawyers to prepare an instrument amending the Trust that would have simply deleted the provisions for her now-deceased son, leaving the Trust on the same dispositive course as she had set for it a few years earlier. To be considered also is evidence that movant was a participant in the discussion with the lawyers, only a few days before execution of the Trust Restatement, during which Grantor first expressed an intent to depart from that course.

Furthermore, all of the foregoing is informed by two major elements in the record. The first, on the one hand, is the absence of evidence that Grantor's sentiments toward the stepchildren had critically changed by the time she executed the Trust Restatement. The second, on the other hand, is the presence in the record of movant's decades-long, almost palpable, animus toward her step-sister and stepbrothers. These two elements add to the genuineness of the question as to whether the Trust Restatement's elimination of benefits for the stepchildren, to movant's gain, was an expression of Grantor's wishes or her daughter's.[3]

As the First Department observed many years ago, "A change of intent from a formal instrument, with a carefully thought-out plan of distribution, to a subsequent plan which benefits a person charged with undue influence is always an important element for consideration in a contest" (*Matter of Brush*, 1 AD2d 625, 629 [1st Dept 1956], *quoting Matter of Lachat*, 184 Misc 492, 497 [NY County, 1944]). This of course is not to say that a major departure from the immediately preceding estate plan alone could support invalidation of the challenged instrument.

---

[3]. In light of the foregoing, there is no present need to determine whether, as objectants contend, there was a confidential relationship between movant and Grantor that would significantly strengthen objectants' position as to undue influence (*see Matter of Satterlee*, 281 AD 251 [1st Dept 1953]).

Nor is it to say that a court may properly regard an instrument with suspicion solely on the basis that the change was in favor of an adult child who had sway over her parent. But there are several additional factors here to prompt concern as to the validity of the trust instrument in question: that the parent's mental and physical condition had by then been seriously compromised by advanced age and further buffeted by a traumatic event proximate in time to the challenged instrument; that the dispositive plan from which the challenged instrument departs was long-held; that the adult child participated in the process by which the past dispositive plan was radically altered in that child's favor, to the loss of beneficiaries for whom there is no evidence (outside of the challenged instrument itself) of change in the parent's heart. In such a case, the party claiming undue influence should be allowed to put the facts underlying that claim to the test of trial.

For the above reasons, the motion for summary dismissal of the petition on the ground of undue influence is denied.

This decision constitutes the order of the court.

Dated: October 4, 2018

SURROGATE

FILED
SURROGATE'S COURT
SUFFOLK COUNTY

DEC 19 2014

MICHAEL CIPOLLINO
CHIEF CLERK

SURROGATE'S COURT : SUFFOLK COUNTY

In the Matter of the Petition of Michelle Engstrom as a beneficiary of the

LEONARD B. HARMON 2003 TRUST,

Created pursuant to instrument, dated April 25, 2003, as restated by instrument dated January 27, 2010, for a decree determining and declaring invalid the instrument purporting to be a restatement of the LEONARD B. HARMON 2003 TRUST, dated January 27, 2012.

DECISION

By: HON. JOHN M. CZYGIER, JR.,

Surrogate

Dated: 12/19/14

File #: 2013-918

Before the court are a motion and cross-motion for summary judgment in the captioned proceeding. For the reasons set forth herein, respondent's motion is granted, in part, and denied, in part; petitioner's cross-motion is denied.

Background and Arguments

Leonard B. Harmon ("Harmon") died testate on November 27, 2012. His last will and testament, dated April 5, 2003, and a codicil, dated December 23, 2003, were admitted to probate by this court on November 22, 2013, whereupon letters testamentary issued to Richard Pinner and Harris Polanksy. The residuary estate, pursuant to the terms of said will, poured over into captioned trust. According to the probate petition, Harmon was survived by only one distributee, a paternal first cousin, who has no beneficial interest in his estate.

Petitioner describes herself as a close family friend, upon whom Harmon came to depend. According to petitioner, respondent Richard Pinner ("Pinner") is an attorney, who was Harmon's godson. It is alleged that Pinner was Harmon's attorney-in-fact, who orchestrated a change in Harmon's dispositive (trust) provisions in order to benefit himself and his sister.

As restated by the instrument dated January 27, 2010, Harmon made $100,000 bequests to petitioner, Maxine Pinner, Elizabeth Pinner, Richard Pinner and the Unitarian Universalist Congregation of the South Fork in Water Mill, New York. The balance of the trust was to be divided among Elizabeth Pinner Glezerman (3 shares), Richard Pinner (3 shares) and petitioner (2 shares). The instrument named Harmon, Pinner and Harry Polansky (an accountant

and friend) as trustees. According to the January 27, 2012 restatement at issue herein, Pinner was named sole trustee; $100,000 was bequeathed to petitioner, Maxine Pinner, Elizabeth Pinner Glezerman and Pinner; $25,000 was bequeathed to the Unitarian Universalist Congregation of the South Fork; and the residue was to be split between Pinner and his sister (Elizabeth). The instrument was executed ten (10) days after Harmon suffered a stroke and was residing in a nursing home. Petitioner alleges that Harmon was significantly impaired, at that time.

Respondent Pinner, in his responsive pleading, refers to petitioner as a housekeeper hired by Harmon's late wife who stayed on after her death; and that this proceeding is merely an expression of her disappointment in the gift left to her by the latest version of the trust, which was amended no fewer than six times in nine years. Pinner denies all allegations of undue influence and fraud; and registers a counterclaim against petitioner for funds allegedly owing the trust in an uncertain amount (less than $2,000).

In her reply to the counterclaim, petitioner avers that the counterclaim fails to state a cause of action and is barred by the doctrine of laches, unclean hands, waiver and estoppel.

It is noted that the Office of the Attorney General has also filed a responsive pleading in this matter, asking the court to determine the allegations made in the petition.

Respondent Pinner has moved for summary judgment, supported by numerous exhibits obtained during the course of discovery, claiming that Harmon communicated all changes embodied in his most recent restatement of trust to his personal attorney (Attorney Hager) in private conversations more than a month before the stroke he sustained on January 17, 2012. Pinner alleges that he did not contribute to the most recent restatement, which was, he maintains, not a significant deviation from prior iterations of the trust. It is also Pinner's argument that Harmon's care givers and medical providers all assessed his mental status just before execution of the 2012 instrument and found him to be competent.

Pinner and his sister Elizabeth were Harmon's godchildren, the children of a very close friend of Harmon's who is deceased. They are named in each of the versions of the trust executed after Harmon's wife died in 2003.

Leonard B. Harmon 2003 Trust

Medical records obtained from Stony Brook University Hospital for the period following Harmon's transfer from Southampton Hospital (January 17, 2012 - January 20, 2012) where he was initially hospitalized after a stroke affected his speech, repeatedly refer to Harmon as alert, oriented and able to communicate and make his needs known. Such descriptions continued upon his admission to Smithtown Center for Rehabilitation and Nursing Care on January 20, 2012 and continued through the morning of January 27, 2012. Indeed, Pinner notes that Harmon's examining physician opined that he had full mental capacity and his social worker concluded that he could participate in medical decisions.

Respondent Pinner argues that the record reflects that Harmon's attorney (Hager) delivered the drafted version of the 2012 restatement to Pinner so that he could obtain Harmon's execution of same. When questioned during his deposition in this matter, Hager testified that Pinner was unaware of the dispositive provisions in the latest restatement, and that he (Hager) was unaware of any cognitive impairment affecting Harmon's ability to sign the papers, which had been discussed and drafted before Harmon's stroke. Harmon himself told the staff at Smithtown Center that someone would be bringing him documents to sign and that he would require a notary. The social worker noted in her progress notes that Harmon had a clear understanding of what he was signing. The notary confirmed that her signature on the document reflected that she was satisfied that Smithtown Center's policy had been followed concerning Harmon's understanding with respect to the instrument he was signing.

Pinner also refers to the testimony of a private duty nurse (Baan), who saw Harmon at Smithtown Center and attested to his recognizing her and watching the game show Jeopardy on television and answering correctly, as supporting his allegations of Harmon's cognitive awareness.

It is Pinner's argument that, not only is there no evidence of undue influence, but the trust agreement, although amended six times, consistently left the majority of assets to Pinner and his sister Elizabeth. According to Pinner, petitioner is the one who explained why Harmon reduced the bequest to the Unitarian Universalist Congregation of the South Fork in the 2012 restatement. In fact, Pinner stresses that Harmon was handling his own finances up until the time he suffered the stroke in January 2012, and that it was petitioner who sent Pinner the checkbook so that Harmon's bills could be paid. Pinner notes that Harmon's

financial advisor discussed investments with Harmon up until August, 2012; and, while acknowledging that his physical health was in decline, his mind was still sharp.

Based on the foregoing view of the facts at his disposal, Pinner maintains that petitioner, who Pinner argues has the burden of proof on issues of undue influence and Harmon's mental acuity, cannot offer more than speculative and conclusory allegations concerning these issues. It is Pinner's argument that petitioner must overcome a presumption of competency; and that the mere fact that Harmon had a stroke does not, in and of itself, establish the contrary. Harmon was not isolated and, apparently, had access to various care givers, as well as acquaintances. Further, Pinner claims that he took no action either under the power of attorney or as co-trustee. It is also claimed that the court should counterbalance the power of attorney with Pinner and Harmon's "close, family-like relationship" (Memorandum of Law in Support Pinner's Motion for Summary Judgement, p.38).

In addition, Pinner argues that there is no evidence of fraud. No statement appears to be forthcoming that would allow for the conclusion that Pinner exercised fraud in order to obtain the latest restatement of trust. Nor is there any evidence supporting an allegation of duress.

Finally, Pinner contends that the 2012 restatement was executed in accordance with the requisites of EPTL 7-1.17(a).

In opposition to the motion and in support of her cross-motion for summary judgment, petitioner essentially claims that Pinner is cherry-picking the evidence obtained during discovery. Pinner stood in a confidential relationship with the decedent when the 2012 restatement was executed and that it was not properly acknowledged, making it void *ab initio*. Further, she claims that Harmon's capacity is a question of fact, which should be submitted to the trier of fact. It is noted that petitioner filed a jury demand on May 1, 2013.

Petitioner maintains that, after the death of Harmon's wife in 2003, she (petitioner) became "most precious" (Affirmation in Opposition..., p.2, ¶4) to Harmon whose health steadily waned in the years since his wife's death. By 2011, there are indications that Harmon was suffering from memory loss, noted by Pinner in an email at the end of 2011. Petitioner argues that Harmon was a different man after the stroke in January, 2012.

Leonard B. Harmon 2003 Trust

It is petitioner's claim that the execution presided over by Pinner was botched and that the notary admitted during depositions that no acknowledgment took place, as required by EPTL 7-1.17.

An email exchange between Pinner and Harmon's attorney Hager reflects an advance discussion concerning the changes to the 2012 restatement, including questions concerning Harris Polansky's continuing as co-trustee.

Petitioner maintains that, as Pinner was in a confidential relationship with Harmon, the burden of proving that the 2012 restatement was procured without undue influence is Pinner's burden.

It is petitioner's contention that she began working as a housekeeper for Harmon in the 1980's, but eventually after his wife passed, they became the "closest of friends" (Affirmation in Opposition..., p.7, ¶23).

Petitioner refers to medical records obtained from Harmon's primary care physician (Dr. Dempsey) indicating that Harmon was being treated for depression and memory loss as early as 2009, and was referred to a neurologist in 2011 for memory loss.

Petitioner produces emails generated by Pinner in 2011 indicating that he felt Harmon's cognition was waning, and contacting Harmon's legal advisors to curtail transactions undertaken by Harmon without his (Pinner's) approval. This allegedly became more compelling after Harmon's stroke in January, 2012. Petitioner produces medical records from Stony Brook University Hospital, indicating that an occupational therapist noted Harmon's impaired orientation and limited cognition. Petitioner, as Harmon's health care agent, signed the papers after Harmon's stroke for his medical treatment. Upon Harmon's transfer to the Smithtown Center, petitioner points to a short term care plan produced as an exhibit that indicates Harmon was confused and was alert and oriented only as to person (not place). Cognitive decline was noted in his occupational therapy progress reports subsequent to the date of the January, 2012 trust restatement.

Petitioner maintains that respondent Pinner acted as Harmon's attorney-in-fact, and often attorney-at-law, after the stroke. Attorney Hager's deposition testimony supports the contention that Hager came to the conclusion that Harmon suffered a small stroke and had capacity to execute the trust restatement.

On his sole visit to the Smithtown Center, Pinner brought the trust restatement, documents concerning Harmon's social security and military pension, and a deed to effectuate the transfer of Harmon's home into the trust.

Petitioner points out inconsistencies in the Smithtown Center's social worker's deposition, argues that the notary did not verify Harmon's identity and could not establish that an acknowledgment took place.

Petitioner supports her arguments with affidavits from a licensed practical nurse who tended Harmon from 2010 to 2012 (Baan); Harmon's accountant, long time friend and co-trustee (Polansky); a personal friend (Greenberger); Harmon's minister (Cornish); an aide who provided care to Harmon from 2007 until his death (Lowig); and petitioner's spouse (Engstrom). All of these individuals attest to petitioner and Harmon's devotion to each other and the change in his condition after the stroke he suffered in January, 2012.

In response to the foregoing, respondent Pinner produces an affidavit from Attorney Hager, who emphasizes his private discussions with Harmon concerning the changes Harmon himself wanted to make to the trust on three separate occasions before Harmon had his stroke. Hager insists that he did not take direction from Pinner concerning the trust restatement, but merely answered Pinner's questions concerning administration of the trust. Hager states that it was his suggestion that Pinner take the draft to Harmon for execution, when he learned that Harmon would not have received the draft(s) sent to Harmon's home while he was either in the hospital or the nursing home. Hager further insists that Pinner knew nothing about the dispositive provisions of the restatement before he was asked to bring them to Harmon for execution.

Also in reply to petitioner's papers, respondent Pinner reiterates his position that petitioner is merely disappointed with the specific bequest Harmon left her in the 2012 trust restatement, and that petitioner has failed to demonstrate fraud or duress, or establish that Pinner wielded power over Harmon. Pinner emphasizes the notes of medical personnel minutes before the trust execution to show that Harmon was alert and oriented, with the requisite understanding, ***at that time*** (emphasis added), dismissing his sister Elizabeth's testimony that Harmon had experienced a cognitive decline as the result of a comparison of Harmon to his younger self

and not the more objective measurement employed by Harmon's care givers and medical providers.

With respect to the acknowledgment, the notary had no independent recollection of the event, but Pinner notes that she testified that her usual practice and the facility's policy required that she determine whether Harmon understood what he was signing.

Pinner argues that all indications from Harmon's medical records and providers' notes reflect that he had capacity at the time the restatement was executed. He further states that petitioner was named as a residuary beneficiary on only one iteration of the trust (the 2010 restatement), the residuary bequests to Pinner and his sister Elizabeth appear in each iteration.

In short, Pinner argues that all indications are that Harmon had capacity at the time the 2012 restatement was executed, petitioner has failed to satisfy the requisites of her undue influence claim and has not demonstrated the presence of a disparate power of Pinner over Harmon sufficient to establish that a confidential relationship should shift the burden of proof to respondent Pinner, has provided no admissible evidence of fraud or duress, and has failed to provide evidence that the restatement was not properly acknowledged, pursuant to EPTL 7-1.17(a).

Discussion and Analysis

Summary judgment is designed to eliminate from the trial calendar litigation that can be resolved as a matter of law (see *Andre v. Pomeroy*, 35 NY2d 361). The court's burden is not to resolve issues of fact, but merely to determine if such issues. exist (see *Dyckman v. Barrett*, 187 AD 2d 533). It is a drastic remedy that will only be awarded where there is no triable issue of fact (see *Barclay v. Denckla*, 182 AD2d 658). The court, therefore, must construe the facts in a light most favorable to the nonmoving party so as not to deprive that person of her day in court (see*Russell v. A. Barton Hepburn Hospital*, 154 AD2d 796).

The party moving for summary judgment must make a *prima facie* showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact (see *Zarr v. Riccio*, 180 AD2d 734). Failure to make out a *prima facie* case requires a denial of the motion regardless

of the sufficiency of opposing papers (see *Winegrad v. New York University Medical Center*, 64 NY2d 851). If, however, this burden is satisfied, the burden of going forward shifts to the opposing party to establish the existence of material issues of fact requiring a trial (see *Romano v. St. Vincent's Medical Center*, 8 AD2d 467), by the tender of evidentiary proof in admissible form (see *Friends of Animals, Inc. v. Associated Fur Manufactures Inc.*, 46 NY2d 1065).

EPTL 7-1.17(a) requires that:

> Every lifetime trust shall be in writing and shall be executed and acknowledged by the person establishing such trust and, unless such person is the sole trustee, by at least one trustee thereof, in the manner required by the laws of this state for the recording of a conveyance of real property or, in lieu thereof, executed in the presence of two witnesses who shall affix their signatures to the trust instrument.

A copy of the 2012 trust restatement reflects the signatures of Harmon, as grantor and trustee, and Pinner, as trustee. Both signatures are notarized; Pinner's on January 30, 2012, and Harmon's on January 27, 2012 by Donna M. Paliugli, stating that Harmon "...personally known to me or proved to me on the basis of satisfactory evidence to be the individual whose name is subscribed to the within instrument and acknowledged to me that he executed the same in his capacity, and that by his signature on the instrument, the individual...executed the instrument as grantor and trustee."

In the notary's deposition testimony (Cross-Motion Exhibit KK), she testified that she does not notarize a Smithtown Center resident's documents unless a social worker advises her that the resident understands what he/she is signing (Paliugli Deposition Transcript, pp. 18-19). She had no independent recollection of notarizing Harmon's signature (Paliugli Deposition Transcript, p. 22, 1.4), but then testified to her usual procedure when asked to notarize a resident's signature. This procedure includes being present when a social worker, who the deponent later indicated asks all the questions during the process, identifies the resident (Paliugli Deposition Transcript, p. 25, 11.13-15).

This process was also the subject of social worker Duffy-Phillip's deposition, who testified that while assessing a resident's ability to make a decision, she does not take into account the complexity of the specific document being signed (Duffy-Phillip Deposition Transcript, p.34, ll.16-21, Cross-Movant Exhibit LL). The social worker also indicated that her notes reflected that Harmon verbalized to her his understanding of what it was he was signing (Duffy-Phillip Deposition Transcript, p.56, ll.15-25).

It is petitioner's argument that, in the absence of an oral declaration by Harmon and the notary's verification of Harmon's identity, the certificate of acknowledgment attached in accordance with RPL §306 is meaningless (Petitioner's Memorandum of Law in Support of Cross-Motion, p.17). Petitioner cites *Galetta v. Galetta*, 21 NY3d 186 for this proposition. In response to this argument, Pinner notes that petitioner has the burden of proving that the document was not properly executed, citing language from *Galetta, supra*, to argue that all the relevant statutes require is that the notary knew the signer or obtained satisfactory evidence of the signer's identity (RPL §303), its primary purpose being to prove the identity of the signer.

The court finds that the statutory requisites of EPTL 7-1.17(a) concerning acknowledgments has been satisfied by the statement that the notary received proof "...on the basis of satisfactory evidence..." that Harmon was the individual whose name was subscribed on the 2012 trust restatement, and upon the notary's testimony concerning the process she followed when asked to notarize an instrument for a resident.

Before addressing the claims of undue influence, fraud and duress, the court must address the allegations concerning whether respondent Pinner stood in a confidential relationship with Harmon.

The burden of establishing the existence of a confidential relationship rests with the party asserting it. A confidential relationship may be inferred if one party has disparate power over the other such as the power of an attorney, an attorney-in-fact, guardian, clergymen, doctor or nursing home director *(Matter of Zirinsky*, 10 Misc3d 1052(A)*8, *aff'd.* 43 AD3d 946, *lv den.* 9 NY3d 815; see also *Matter of Hoerter*, 15 Misc3d 1101(A)*9; citing *Ten Eyck v. Whitbeck*, 156 NY 341, 353), where a confidential relationship is said to exist as a matter of law. The law recognizes, however, that a close family relationship

"counterbalances any contrary legal presumption" and it has been said that an "explanation by the [agent] is not required" (*Matter of Hoerter*, supra; citing N.Y. PJI 7:56; other citations omitted).

The relationship between an attorney-in-fact and the grantor of that power of attorney is one which can rise to the level of a confidential relationship when the relationship is one of disparate power (see *Estate of Lee*, 11/23/2009 NYLJ p.41, (col.5); citing *In re Petix*, 15 Misc3d 1140(A)). As indicated, despite the existence of a power of attorney and any presumptions that may arise through this relationship, a close family relationship can "counterbalance any contrary legal presumption" (*In re Walther's Will*, 6 NY2d 49; *In re Moskowitz' Will*, 279 AD 660, *aff'd*, 303 NY 992; *In re Camac*, 300 AD2d 11). The essence of the confidential relationship is the disparate power of one party over another (*In re Zirinsky*, 43 AD3d 946; *Ten Eyck v. Whitbeck*, 156 NY 341) where one party is in a position of weakness, dependence or trust (*Gordon v. Bialystoker Center and Bikur Cholim, Inc.*, 45 NY2d 692, 699; *In re Mazak*, 288 AD2d 682). When one acts as attorney-in-fact for another, he is considered the agent of the principal and from such agency necessarily flows a relationship of trust and confidence that the agent will act with the utmost good faith and loyalty toward the principal (*In re Estate of DeBelardino*, 77 Misc2d 253). Once a confidential/fiduciary relationship is found to exist between the parties, transactions between them must be scrutinized with extreme vigilance and there must be a clear showing of integrity and fairness (*Matter of Gordon v. Bialystoker Ctr. & Bikur Cholim, supra*). Thus, under certain circumstances, such transactions are presumed void (*Cowee v. Cornell*, 75 NY 91). In the absence of such proof, the transaction must be set aside.

In the case before the court, Pinner maintains that he merely used the power of attorney to pay Harmon's bills after he became ill. While petitioner alleges that Pinner also drafted the deed, effectuating the funding of Harmon's home into the trust, which was executed when the 2012 restatement was executed, Pinner argues that every allegation petitioner makes concerning his alleged use of the power of attorney took place after the restatement was executed.

The court does not accept Pinner's contention that there was a close "family-like" relationship negating any possible finding of a confidential relationship as the only relationship enunciated here was one of a "god child" of Harmon, and, as such, is too far removed to be considered a "close family relationship" (*Matter of Hirschorn*, 11/5/2008, NYLJ p.36, (col.3)). The court, however,

cannot conclude that petitioner has established as a matter of law that the relationship between Pinner and Harmon was confidential. Pinner resided and worked in New York City and was rarely a presence on Harmon's property. All indications from the evidence before the court is that he was unaware of the 2012 restatement dispositions until shortly before its execution. The use of the power of attorney was only demonstrated after the fact of the restatement's execution, and there is no evidence that Pinner exercised any authority as co-trustee of the trust up until that time.

While Harmon may have been in decline prior to his stroke, there is no demonstrated dependency on Pinner for his daily care. Reliance on someone in order to pay bills does not rise to the level of disparate power necessary to allow for the conclusion that this was a confidential relationship (*Estate of Stanton*, 12/5/2014, NYLJ p. 22, (col.6); citations omitted).

Assuming that petitioner has laid bare her proof, she has failed to establish that Pinner had a confidential relationship with Harmon allowing for the burden of proof to shift on the issues of fraud, duress and undue influence (see *Weber v. Burman*, 22 Misc3d 1104(A)*6; citing *Matter of Connelly*, 193 AD2d 602, *lv den.* 82 NY2d 656; *Sepulveda v. Aviles*, 308 AD2d 1, 7; *Matter of Gordon v. Bialystoker Center & Bikur Cholim, Inc.*, 45 NY2d 692, 699; other citations omitted; *In re Mazak*, 288 AD2d 682).

The elements of fraud include a knowing misrepresentation of a material fact, deception, and resultant injury (see *Matter of Zirinsky*, 43 AD3d 946; *Matter of Spangenberg*, 248 AD2d 543; *Matter of Walther*, 6 NY2d 49). An instrument may be set aside for fraud where the signer knew the contents of the instrument he executed, but was induced to execute it by the fraudulent representations of the grantee under such instrument or of someone in privity with the grantee (see *Matter of Coniglio*, 242 AD2d 901). There is absolutely no proof in the record before the court that Harmon was induced to sign the 2012 restatement by any fraudulent misrepresentations made by Pinner.

Nor is there any proof that Harmon was under duress or being threatened in any way (see *In re Estate of Rosasco*, 31 Misc3d 1214(A)).

Petitioner also has the burden of proving that the trust amendment was the product of undue influence. The influence

exerted must amount to a moral coercion which restrained Harmon's independent action and destroyed his free agency, or which constrained him to do something against his wishes (*Matter of Walther, supra*; see also *Matter of Fiumara's Estate*, 47 NY2d 845; *Matter of Efros*, 19 Misc3d 1113(A)).

To establish the undue influence claim, petitioner must show (1) the existence and exercise of undue influence; (2) the effective operation of undue influence as to subvert the mind of the grantor at the time of the execution of the testamentary instrument; and (3) the execution of a testamentary instrument that, but for undue influence, would not have occurred. Thus, the three elements are motive, opportunity and the actual exercise of the influence (*Matter of Walther, supra; Matter of Foranoce*, NYLJ, 8/7/2000, 25 (col. 6); citing, *Matter of Fiumara, supra; Matter of Holly*, 16 AD2d 611, *aff'd*, 13 NY2d 746). Among the factors to be considered when the court is asked to make a determination concerning a claim of undue influence are: (1) the testator's or principal's physical and mental condition; (2) whether the attorney who drafted the will (or instrument at issue) was the testator's/grantor's attorney; (3) whether the testamentary instrument at issue deviates from the testator's/grantor's prior testamentary pattern; (4) whether the person who allegedly wielded undue influence was in a position of trust; and, whether the testator/grantor was isolated from the natural objects of his affection (*Weber v. Burman*, 22 Misc3d 1104(A)*7; citations omitted).

As indicated above, there is no indication that Pinner influenced Harmon to make the 2012 changes to the trust. All indications, including the testimony of his personal attorney (Hager) are that the changes sought were drafted prior to Harmon's stroke and Pinner's increased participation in Harmon's affairs.

Petitioner has raised a triable issue of fact concerning whether Harmon had the requisite capacity at the time the 2012 restatement was executed. A person is, of course, presumed competent and it is up to the person challenging that competence to establish incapacity at the time the action, execution of the contested document(s), took place (*Matter of Obermeier*, 150 AD2d 863). On this record, it is unclear whether Harmon fully understood the terms of the trust at the time of its execution (see *Estate of Roth*, 9/15/2006, NYLJ, p. 33, (col.1); *Matter of Prevratil*, 121 AD3d 137). Even Pinner's papers admit that there were good days and bad days (Respondent's Memorandum of Law in

Further Support, p. 22). The court agrees that the moment of execution is the time at which Harmon's capacity must be measured. Indeed, Pinner almost appears to be arguing that, having directed his attorney to make the disputed changes in the trust agreement, Harmon's execution of same may be treated as a ministerial act.

While Pinner characterizes the testimony and assessment of the social worker and the medical records as "overwhelming" compared to Baan's testimony concerning Harmon's condition on the day in question and other medical records indicating an aging man in decline for at least a few years, this issue should be left to the trier of fact.

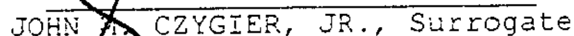
Accordingly, for the reasons set forth herein, it is

ORDERED that respondent Pinner's motion for summary judgment is granted solely to the extent of dismissing petitioner's claims sounding in fraud, duress, undue influence and improper execution; and it is further

ORDERED that the motion is denied with respect to petitioner's claims that Harmon lacked capacity on the day the 2012 restatement was executed, petitioner having raised triable issues of fact with respect thereto; and it is further

ORDERED that petitioner's cross-motion for summary judgment or partial summary judgment is denied.

Counsel for the parties shall appear in the Suffolk County Surrogate's Court on January 22, 2015 at 9:30am for further proceedings consistent herewith.



JOHN M. CZYGIER, JR., Surrogate

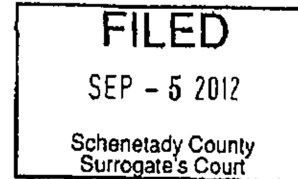
Farrell Fritz, P.C.
By: Frank T. Santoro, Esq.
Attorneys for Petitioner
1320 RXR Plaza
Uniondale, New York 11556

Leonard B. Harmon 2003 Trust

Greenfield Stein & Senior, LLP
By: Elana L. Danzer, Esq.
Attorneys for Respondent
600 Third Avenue
New York, New York 10016

Shlom & Littman, Esqs.
Attorneys for Unitarian Universalist
Congregation of the South Fprk
370 Lexington Avenue, Suite 202
New York, New York 10017

Office of the Attorney General
Of the State of New York
By: Robert R. Molic, Esq.
Assistant Attorney General
Charities Bureau
120 Broadway
New York, New York 10271



STATE OF NEW YORK
SURROGATE'S COURT   COUNTY OF SCHENECTADY

In the Matter of the Application of
DEBRA LECHLEITNER
As Limited Administrator of the

DECISION/ORDER

Estate of HARRY L. GRAEVE,

File No. 2010-126/B

Deceased,

To Discover Property Withheld.

APPEARANCES:

Attorneys for Petitioner Debra Lechleitner
Parisi, Coan & Saccocio, PLLC
Gerard F. Parisi, Esq., of counsel
376 Broadway, 2nd Floor
Schenectady, New York 12305

Attorneys for Respondents Harry S. Graeve and Karen Szubinski
Michael L. Breen, Esq.
P.O. Box 982
109-1 Railroad Avenue
Middleburgh, New York 12122

VINCENT W. VERSACI, S.

The Petitioner, Debra Lechleitner, who is the Decedent's daughter and the Limited Administrator of this Estate, commenced this discovery proceeding pursuant to SCPA §2103 against the Respondents, Harry S. Graeve, the Decedent's son, and Karen Szubinski, the Decedent's daughter-in-law, seeking the delivery or turnover of certain property belonging to the Decedent that is now in the possession or control of the Respondents. Specifically, the Petitioner alleges that two days before the Decedent's death, the property which served as the Decedent's residence located at 4

Lorelei Lane, Glenville, New York, was transferred to the Respondent, Harry S. Graeve, without consideration while the Decedent was in the hospital and on his deathbed. Petitioner seeks the return of this property to the Estate,[1] along with cash in excess of $200,000 and a 2008 Chevrolet pickup truck that were allegedly taken by the Respondent, Harry S. Graeve, just prior to or subsequent to the Decedent's death without proper authorization.

After issue was joined by the filing of a Verified Answer, the parties engaged in paper discovery and conducted depositions. Based on the testimony elicited at the depositions and other evidence, the Petitioner filed the instant Motion seeking an Order declaring that a confidential or fiduciary relationship existed between the Decedent and the Respondents. The Petitioner seeks this relief because if a confidential relationship is found to have existed, the burden of proof at trial will shift from the Petitioner to the Respondents to show by clear and convincing evidence that the transactions at issue were free from any undue influence exerted by them against the Decedent. See, Matter of Gordon v. Bialystoker Ctr. & Bikur Cholim, 45 N.Y.2d 692; Matter of Mazak, 288 A.D.2d 682.

In essence, the Petitioner's Motion is one for partial summary judgment, which asks this Court to find, as a matter of law, that there are no material facts in dispute as to the existence of a confidential relationship between the Decedent and the Respondents. The proponent of a summary judgment motion, herein the Petitioner,

---

[1] Since the property was subsequently sold by the Respondent, the Petitioner is actually requesting that the net proceeds from the sale be turned over to the Estate. The proceeds are being held in escrow pending the outcome of this proceeding.

must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence in admissible form to demonstrate the absence of any genuine material issues of fact. See, Alvarez v. Prospect Hosp., 68 N.Y.2d 320; Winegrad v. New York Univ. Med. Center, 64 N.Y.2d 851, 853. If the proponent makes such a prima facie showing, the burden shifts to the party opposing the motion to come forward and lay bare his evidentiary proof in admissible form sufficient to establish the existence of genuine material issues of fact which require a trial. See, Alvarez v. Prospect Hosp., supra, at 324; Zuckerman v. City of New York, 49 N.Y.2d 557, 562. On a motion for summary judgment, the facts must be viewed in the light most favorable to the non-moving party. Fundamental Portfolio Advisors, Inc. v. Tocqueville Asset Mgt., LP, 7 N.Y.3d 96, 105; Martin v. Briggs, 235 A.D.2d 192; McArdle v. M & M Farms, 90 A.D.2d 538. However, mere conclusions, unsubstantiated allegations, or expressions of hope are insufficient to defeat a summary judgment motion. Zuckerman v. City of New York, supra.

The deposition testimony reveals that the Decedent indeed had a close relationship with his son and daughter-in-law. They lived in close proximity to one another for more than a decade prior to the Decedent's death in 2009. Even when the Respondents moved, the Decedent would also move and reside within minutes of the Respondents, allowing for regular visits between them on a weekly basis. In 2005 or 2006, the Decedent moved to 4 Lorelei Lane in Glenville, the property in question, which was just down the road from the Respondents who lived at 20 Lorelei Lane. From this time forward, the Respondents would visit the Decedent daily, checking on him to make sure he had what he needed or wanted. The Petitioner claims that these

undisputed facts show the Decedent's reliance and dependence upon the Respondents.

The deposition testimony also revealed that sometime prior to his death, the Decedent added his son to his bank accounts, his safe deposit box in which the Decedent allegedly kept a large sum of cash, and also added his son on the title to his truck. The Petitioner claims that these actions demonstrate the Decedent's trust and confidence in his son to handle his affairs when the Decedent could no longer do so.

In the Fall of 2009, the Decedent was diagnosed with esophageal cancer. During his illness, the Decedent was cared for by the Respondents due to his physically weakened state. They would take him to doctor's appointments, clean his house, do his laundry and basically just keep him company. When the pain of the cancer became severe, the Decedent's son would administer morphine to him.

Upon becoming hospitalized a few weeks prior to his death, the Decedent executed a Health Care Proxy naming his son as his agent and his daughter-in-law as the alternate agent. Both of the Respondents were actively involved with the medical decisions related to the Decedent's care, including his admission to Baptist Health Nursing and Rehabilitation Center one (1) week prior to his death. The Respondents were at the nursing home every day, and arranged for the Decedent to speak to his daughter, the Petitioner, on the phone. The Petitioner also visited the Decedent about four (4) days prior to his death. The Petitioner described the Decedent as being "incoherent" during this visit.

There is no dispute that after the Decedent went into the nursing home, his son initially contacted Attorney Michael West regarding the contemplated transfer of the

Decedent's home to his son. Attorney West testified that the Decedent's son acted as a go-between for the Decedent and Attorney West. The Decedent's son advised Attorney West that his father had requested that he prepare a deed transferring his home to his son. Attorney West did so, and went to the nursing home where the Decedent signed the deed three (3) days before he died. Attorney West testified at his deposition that when the Decedent signed the deed, "there was really no question in my mind that he [the Decedent] knew what he was doing, . . . he knew what he wanted."

Despite the above events, it is undisputed that there is no evidence that the Decedent ever executed a Power of Attorney naming either of the Respondents as his attorney-in-fact. Nor is there any evidence that either of the Respondents ever wrote or signed any checks for the Decedent, conducted any banking transactions for him or handled any financial affairs for him other than the initial phone call made to Attorney West by the Decedent's son.

It is well settled that a confidential relationship exists between two parties when their relations are of a nature that they deal on an unequal footing, with one party having superior knowledge of the matter at hand and the other dealing from a position of "weakness, dependence, or trust justifiably reposed" upon the dominant party. Matter of Gordon v. Bialystoker Ctr. & Bikur Cholim, supra, at 699. See also, Oakes v. Muka, 69 A.D.3d 1139, 1140; Mazza v. Fleet Bank, 16 A.D.3d 761, 762. An indication that the parties are in fact dealing on unequal terms is the weaker party's "established lack of interest in, or ability to manage, [his] own finances, and concomitant dependence upon others to do so". Matter of Antoinette, 238 A.D.2d 762, 764.

Where a confidential relationship is found to have existed, "unfair advantage" in

a transaction between the parties "is rendered probable, the transaction is presumed void, and the burden shifts to the stronger party to show affirmatively that no deception was practiced, no undue influence was used, and that all was fair, open, voluntary and well understood." Matter of Gordon v. Bialystoker Ctr. & Bikur Cholim, supra, at 699; Oakes v. Muka, supra, at 1140; Mazza v. Fleet Bank, supra, at 762; Matter of Mazak, supra, at 684; Matter of Bumbaca, 182 A.D.2d 756, 757. However, "close family ties may negate the presumption of undue influence that would otherwise arise from a confidential or fiduciary relationship". Matter of Antoinette, supra, at 764, citing, Matter of Swain, 125 A.D.2d 574, 575. See also, Matter of Walther, 6 N.Y.2d 49, 56, wherein the Court of Appeals ruled that "[t]he sense of family duty is inexplicably intertwined in [a confidential] relationship which, under the circumstances, counterbalances any contrary legal presumption". This is not to say that a confidential relationship can never exist if the parties have a familial relationship. It simply means that all of the evidence must be carefully considered before deciding whether the accused party "acted not out of family duty, but rather cupidity." Matter of Antoinette, supra, at 764.

The underlying facts of this case as recited above clearly show that a very close, familial relationship existed between the Respondents and the Decedent for a long period of time prior to the Decedent's death. The transactions at issue occurred during the time when the Decedent was physically ill and the Respondents were actively involved with the Decedent's care on a daily basis. However, these facts do not support a finding, as a matter of law, that in addition to his physically weakened state, the Decedent in fact dealt with the Respondents from a mentally weakened and inferior position. Rather, the deposition testimony of Attorney West supports a contrary finding.

Specifically, Attorney West's testimony that the Decedent himself requested, albeit through his son, to have the deed prepared, that the Decedent understood and was fully aware of the nature of the transaction and expressed his independent desire to execute the deed in question, all suggests that the Decedent was not dealing from a position of weakness but was fully competent and exhibited an interest in and the ability to manage his own financial affairs right up to his death.

Nor do the Decedent's medical records submitted with the moving papers support a finding, as a matter of law, that the Decedent was in a mentally weakened state or was not competent to make decisions at the time of the transactions at issue. In fact, progress notes written three (3) days before the Decedent died, being at or around the same time that the Decedent executed the deed, indicate that the Decedent was "alert and able to make all needs known". In addition, as mentioned above, there is no evidence in the record presently before the Court that the Decedent ever executed a Power of Attorney, was ever unable to manage his own finances, or that the Respondents ever handled or took over any of the Decedent's financial affairs.

These facts render this case distinguishable from the cases relied upon by the Petitioner in which, after a trial, a confidential relationship was found to have existed. See, e.g., Matter of Gordon v. Bialystoker Ctr. & Bikur Cholim, supra (non-familial relationship, and evidence at trial established that the decedent was not coherent, was confused and was not capable of understanding); Matter of Mazak, supra (non-familial relationship, and the trial testimony revealed that the decedent was dependent on the respondent for all the essentials of daily living, including the payment of the decedent's bills); Oakes v. Muka, supra (the trial proof indicated that the decedent was suffering

from Alzheimer's disease, was consistently confused, delusional, and was having hallucinations); Matter of Antoinette, supra (jury verdict was not against the weight of the trial evidence which revealed the decedent's lack of involvement in and lack of understanding of the transactions at issue). Thus, not only were these cases decided after a full examination of all the credible evidence presented at a plenary trial, whereas the instant proceeding is only at the summary judgment stage, the facts of these cases are altogether different from the facts outlined herein.

Based on the above, the Court finds that at this summary judgment stage of these proceedings, an issue of fact exists as to whether the Decedent and the Respondents dealt on an unequal footing, precluding a finding as a matter of law that a confidential relationship existed between them. Since the Petitioner has failed to make a prima facie showing of entitlement to judgment as a matter of law, the Motion must be denied, and the issue of whether a confidential or fiduciary relationship existed between the Decedent and the Respondents is one that will be decided at trial.

Accordingly, based on all of the foregoing, the Petitioner's Motion is hereby denied. The Court hereby schedules a conference, for the purpose of scheduling a trial date in this matter, to be held on **Tuesday, October 2, 2012, at 10:30 a.m.**

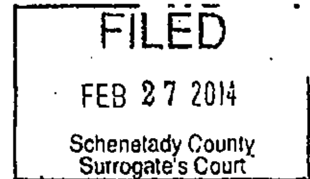
The parties' remaining arguments, to the extent not specifically addressed herein, have been considered and found to be unavailing.

The foregoing shall constitute the Decision and Order of this Court.

Signed at Schenectady, New York, this 5th day of September, 2012.

HON. VINCENT W. VERSACI
Surrogate

ENTER:



State of New York
Supreme Court, Appellate Division
Third Judicial Department

Decided and Entered: January 23, 2014 516748

In the Matter of the Estate of
HARRY L. GRAEVE, Deceased.

DEBRA LECHLEITNER, as
Limited Administrator of the
Estate of HARRY L. GRAEVE,
Deceased,
Appellant;

MEMORANDUM AND ORDER

HARRY S. GRAEVE et al.,
Respondents.

Calendar Date: November 14, 2013

Before: Rose, J.P., Lahtinen, McCarthy and Garry, JJ.

Parisi, Coan & Saccocio, PLLC, Schenectady (Gerald F. Parisi of counsel), for appellant.

Michael L. Breen, Middleburgh, for respondents.

Lahtinen, J.

Appeal from an order of the Surrogate's Court of Schenectady County (Versaci, S.), entered September 5, 2012, which denied petitioner's motion for partial summary judgment declaring that a confidential relationship existed between respondents and decedent.

Harry L. Graeve (hereinafter decedent) died in November 2009 and petitioner, his daughter, was granted limited letters in March 2011 to pursue a discovery proceeding pursuant to SCPA 2103. She sought information regarding: decedent's transfer

shortly before his death of his home (valued at about $180,000) to his son, respondent Harry S. Graeve (hereinafter respondent); the location of $200,000 in cash that was allegedly missing;[1] and the transfer of decedent's 2008 truck to respondent. Respondent Karen Szubinski, respondent's spouse, was added as a respondent and, following disclosure, petitioner moved for summary judgment declaring that a confidential relationship existed between respondents and decedent. Surrogate's Court denied petitioner's motion and petitioner now appeals.

We affirm. The existence of a confidential relationship shifts the burden to the stronger party in such a relationship to prove by clear and convincing evidence that a transaction from which he or she benefitted was not occasioned by undue influence (see Matter of Nealon, 104 AD3d 1088, 1089 [2013], affd ___ NY3d ___, 2014 NY Slip Op 00139 [2014]; Oakes v Muka, 69 AD3d 1139, 1140-1141 [2010], appeal dismissed 15 NY3d 867 [2010]). "In determining whether a confidential relationship exists, 'the existence of a family relationship does not, per se, create a presumption of undue influence; there must be evidence of other facts and circumstances showing inequality or controlling influence'" (Matter of Nealon, 104 AD3d at 1089, quoting Feiden v Feiden, 151 AD2d 889, 891 [1989]).

The proof was inadequate to establish a confidential relationship as a matter of law. Decedent died at age 84, a short time after being diagnosed with cancer. About two weeks before his death, he was admitted to a hospital and then was transferred to a nursing home. Prior to such time, he lived basically in an independent fashion. Respondents resided on the same street and, thus, visited more frequently than petitioner, who lived further away. Respondents assisted decedent with some chores and household matters, but he certainly was not completely dependent on respondents nor was there proof that his mental condition had deteriorated. Although respondent was listed on decedent's bank account and safe deposit box, there is no evidence that he accessed the accounts or funds prior to

---

[1] Respondent asserted that decedent gave the cash to petitioner, but she denied receiving the money.

decedent's passing or successfully exerted any pressure on decedent regarding his finances. Decedent's attorney testified at a deposition that, when respondent was not present in the room, he met with decedent at the nursing home and decedent ably discussed his estate and executed the transfer of real property. The attorney observed that, even at that time within days of his death, decedent was "bold in his voice" and "knew what he wanted." This record does not reflect the type of inequality and controlling influence such that, as a matter of law, respondents were exerting a confidential relationship (as that term is used in the context of a proceeding of this nature) rather than simply acting out of familial affection or duty.

Rose, J.P., McCarthy and Garry, JJ., concur.

ORDERED that the order is affirmed, with costs.

ENTER:

Robert D. Mayberger
Clerk of the Court

STATE OF NEW YORK
SUPREME COURT COUNTY OF SCHENECTADY

EMBAREK MESBAHI,

Plaintiff,

DECISION/ORDER

- against -

Index No. 2017-0953
RJI 46-1-2017-0677

PETER E. BLOOD,

Defendant.

APPEARANCES:

Attorney for the Plaintiff:
John T. Casey, Jr., Esq.
47 Second Street
Troy, New York 12180

Attorney for the Defendant:
Frederick W. Killeen, Esq.
The Killeen Building
179 ½ Jay Street
Schenectady, New York 12305

VINCENT W. VERSACI, A.S.C.J.

The Plaintiff, Embarek Mesbahi, commenced this declaratory judgment action against the Defendant, Peter E. Blood, on May 12, 2017, after a dispute arose between the parties regarding an Art Sales Agreement that the Plaintiff had entered into with Robert Blood, the father of the Defendant, on February 23, 2012. Robert Blood was a local sculptor who died testate on December 1, 2016. Pursuant to the terms of the Art Sales Agreement (hereinafter referred to as the "Agreement"), the Plaintiff, referred to in the Agreement as "Agent", had the right to sell the art work of Robert Blood, referred to in the Agreement as "Artist", "at prices agreed upon between Artist and Agent". The Agreement provided that the Plaintiff (hereinafter referred to interchangeably as the "Agent"), shall receive 40% of the sales price of the art work that he sells on behalf of Robert Blood (hereinafter referred to interchangeably as the "Artist" or the "Decedent"). The Agreement further provided that "[t]he art work shall remain the property of Artist at all times until such time it is transferred to buyer", and "[t]hat either party may terminate this Agreement upon notice to the other party". The Agreement also provided that it "shall continue after the

death of Artist", at which time the Agent "shall continue to sell the art work in [his] possession and shall be entitled to take possession of all artist's work located at artist's residence", and that "upon the sale of the art work in agents possession, the agent shall retain 60% of the proceeds of the sale and 40% of the proceeds of the sale shall become the property of Artist's son Peter E. Blood, his heirs and assigns." Lastly, the Agreement provided that "[t]he agent shall also have the authority to donate certain number of artist's pieces to a museum."

After the death of the Decedent, the Defendant was duly appointed as the Executor of the Decedent's Estate by the Schenectady County Surrogate's Court. The Defendant, in his capacity as the Executor of the Decedent's Estate, elected to cancel, rescind, and terminate the Agreement pursuant to and in accordance with the termination clause contained in the Agreement. A Notice of Termination was signed by the Defendant as the Executor of the Decedent's Estate, which also demanded the immediate return of any and all of the Decedent's art work in the Plaintiff's possession, and an accounting of all art work sold or transferred by the Plaintiff before or after the Decedent's death. The Notice of Termination was sent to the Plaintiff and his counsel on or about May 1, 2017, prompting the filing of this lawsuit.

Immediately following the joinder of issue, the Plaintiff filed a motion for summary judgment seeking a declaration that the Agreement is valid and remains in full force and effect, and that he has the sole and exclusive right to take possession of all of the Decedent's art work and to sell or donate the art work as he chooses in accordance with the explicit terms of the Agreement. In response thereto, the Defendant opposed the Plaintiff's motion and filed a cross-motion for summary judgment seeking a dismissal of the Complaint. The grounds upon which the Defendant's cross-motion is based are that the Plaintiff failed to sue the proper party and failed to pursue his claims in the proper court, rendering this action jurisdictionally defective. Specifically, the Defendant contends that

since the Agreement explicitly stated that the art work shall remain the property of the Artist until transferred to a buyer, all of the art work that remained unsold at the time of the Decedent's death became an asset of the Decedent's Estate immediately upon his death by operation of law, to be distributed by the Defendant in his capacity as Executor pursuant to the terms of the Decedent's Last Will and Testament. Thus, the Defendant argues that the proper party to name as the defendant in this lawsuit is not the Defendant in his individual capacity, but the Defendant as the Executor of the Decedent's Estate. In other words, the Defendant maintains that the Plaintiff's claims regarding the art work should have been brought in the Surrogate's Court where the Decedent's Will was probated and his Estate is being administered, not in the Supreme Court. Additionally, the Defendant argues that the Complaint should be dismissed on the merits based on the fact that the Defendant, in his capacity as the Executor of the Decedent's Estate, rightfully terminated the Agreement pursuant to the termination clause contained therein, thus triggering the Plaintiff's obligation under the explicit terms of the Agreement to return all of the Decedent's art work in the Plaintiff's possession to the Decedent's Estate.

Nevertheless, the Court must first determine whether this case has been properly filed in this Court and whether the Defendant individually, is the proper party to be sued herein. In order to determine these threshold jurisdictional questions raised by the Defendant, the Court must necessarily begin its analysis with a close reading of the Agreement itself within the framework of the basic principles and fundamental tenets of contract law.

There is no dispute between the parties as to the existence of the writing entitled "Art Sales Agreement", and that it was drafted by or with the assistance of the Artist's attorney, Dean Riggi, Esq. There is no dispute as to the authenticity of the signatures of the Artist and the Agent appearing at the foot of the Agreement, and that the Agreement was signed and properly sworn to before a Notary Public. Where the parties' positions

diverge is in their interpretation of the nature of the Agreement, what was intended by the Artist in entering into this Agreement and the use of certain language contained therein, and the legal and binding effect of the Agreement or lack thereof at the present time.

It is well settled that a contract, or written agreement, should be construed in accordance with the intent of the parties, and the best evidence of the parties' intent is what they express in their written agreement. If the terms of the written agreement are clear, unambiguous and unequivocal, the Court need only look between the four corners of the agreement to determine the rights and obligations of the parties to the agreement. A determination of whether or not an agreement is clear and unambiguous is a question of law to be decided by the Court, and only after an analysis of the four corners of the instrument. See, Kass v. Kass, 91 N.Y.2d 554, 566; Todd v. Grandoe Corp., 302 A.D.2d 789, 790. An agreement is unambiguous if "the language it uses has a definite precise meaning, unattended by danger of misconception . . . and concerning which there is no reasonable basis for a difference of opinion". Greenfield v. Philes Records, 98 N.Y.2d 562, 569, quoting, Vreed v. Ins. Co. of North America, 46 N.Y.2d 352, 355. See also, Williams v. Village of Endicott, 91 A.D.3d 1160, 1162. However, "if any ambiguity exists in the instrument, then the courts will look to extrinsic evidence and may consider such facts in its analysis of the terms contained therein". See, F & K Supply v. Willowbrook Dev. Co., 288 A.D.2d 713, 714; Ruthman, Mercadante & Hadjis v. Nardiello, 260 A.D.2d 904, 906. See also, Goldman v. White Plains Center for Nursing Care, LLC, 11 N.Y.3d 173, 176; MHR Capital Partners L.P. v. Presstek, 12 N.Y.3d 640.

Examining the language of the Agreement reveals that there are ten (10) enumerated paragraphs, each containing a separate operative provision of the Agreement. Each individual paragraph is clearly written, and when read in isolation from the other paragraphs, appears to have a definite, unambiguous meaning. However, when all of the paragraphs are read together and the Agreement is reviewed as a whole, the intent of the

parties regarding the nature of the Agreement, the manner in which it is to be executed, and its legal effect under the present circumstances is anything but clear and unambiguous and leaves many unanswered questions.

For instance, it is unclear whether the Artist gave the Agent the ***exclusive*** right to sell and the ***sole*** authority to donate ***all*** of the Artist's art work both before and after his death as advocated by the Plaintiff, despite the fact that the words "sole" and "exclusive" do not appear anywhere in the Agreement and the last paragraph refers to a "certain number" of artist's pieces, not all, that can be donated to a museum. It is unclear what, if any, prices at which to sell the art work were agreed upon between the Artist and the Agent as required in paragraph "1" of the Agreement, and how the Artist could possibly agree to any prices after his death despite the provision contained in paragraph "8" that the Agreement shall continue after the Artist's death. There is nothing contained in the Agreement that specifies the length of time the Plaintiff has, after the Artist's death, to either sell the art work or decide to donate the art work. It is also unclear who shall pay for the cost of delivery since the provision contained in paragraph "3" merely states that the Agent shall be responsible to "arrange" the cost of the delivery.

Turning to the heart of the present controversy, it is unclear from simply examining the contents of the Agreement whether it is in the nature of a trust as argued by the Plaintiff, or whether it could be construed as a consignment contract as argued by the Defendant. Furthermore, it is difficult to determine whether the Artist's right to terminate the Agreement as contained in paragraph "4" is personal to him and evaporates upon his death, as argued by the Plaintiff, or whether such right survives his death and vests in his Executor who now stands in the shoes of the Artist, as argued by the Defendant. Given all of these ambiguities which could lead reasonable minds to have different interpretations of the Agreement, the Court is compelled to consider the extrinsic evidence offered by both parties on these motions pursuant to the parol evidence rule. See, Matter of Friedman, 64

A.D.2d 70, 81-82.

First, the Defendant offers the Affidavit of Dean Riggi, Esq., who attests that he represented the Decedent in connection with a variety of legal matters over the years, including the preparation and execution of his Last Will and Testament dated March 17, 2004. He also provided assistance at the Decedent's request in connection with reviewing and drafting the Agreement at issue herein. Attorney Riggi states that the Decedent decided not to follow his recommendation to include certain terms and conditions in the Agreement because the Decedent wanted to keep the Agreement "short and simple".

Attorney Riggi represents that based upon his extensive discussions and communications with the Decedent, the Decedent's purpose, intent, and understanding of the Agreement was that the control and ownership of his art work would not be transferred to or vested in the Plaintiff, but rather that his art work would remain his property at all times until it was sold to an actual buyer, and that upon his death, any art work that remained unsold would belong to and constitute an asset of his Estate. Furthermore, based on his discussions with the Decedent both before and after the execution of the Agreement, Attorney Riggi concludes in his Affidavit that the Decedent did not intend to create a trust that conveyed legal title to, or vested ultimate control over his art work to the Plaintiff as trustee.

Also, Attorney Riggi further confirms that the Decedent was fully aware of the terms of his Will and that his Will named the Defendant as the Executor and also as the sole beneficiary of his Estate. Attorney Riggi unequivocally states that it was the Decedent's understanding, intention and expectation that the right of cancellation contained in the Agreement "was mutual and would survive his death", and that it was never the Decedent's "intention or understanding that the Agreement would become irrevocable upon his death."

The Plaintiff contends that Attorney Riggi's Affidavit is barred by CPLR §4519, commonly referred to as "the Dead Man's Statute", precluding it from the Court's

consideration. The Plaintiff is mistaken. Attorney Riggi is a disinterested witness to these proceedings and neither the Defendant nor the Plaintiff derives his interest in these proceedings from or through Attorney Riggi simply by virtue of the fact that Attorney Riggi assisted the Decedent in drafting the Agreement. See, Johnson v. Cooney, 27 Misc.3d 1210(A); Matter of Hoffman, 2006 N.Y. Misc. LEXIS 6363. Attorney Riggi's Affidavit is in admissible form, and can be considered by the Court as long as his statements regarding his personal transactions and communications with the Decedent would not "tend to disgrace the memory of the Decedent", which they do not. See, CPLR §4503(b).

Next, the extrinsic evidence offered by the Plaintiff, on the other hand, in the form of informal letters allegedly written and exchanged between the Defendant and the Decedent after the Agreement was executed, and some of which are undated, unsigned and illegible, are not sworn to and therefore are not in admissible form. See, Krupp v. Aetna Life & Casualty Co., 103 A.D.2d 252. Even if the letters were in admissible form, and the letters authored by the Defendant were viewed as an admission against interest, the Defendant argues that they are automatically barred by the Dead Man's Statute since they are personal communications between the Defendant, a party having an interest in the outcome of this case, and the Decedent. While the Defendant is correct that these communications might be inadmissible at trial, they can be considered on a motion for summary judgment. See, Phillips v. Joseph Kantor & Co., 31 N.Y.2d 307.

With that being said, even if the Court were to consider these letters despite not being authenticated or in admissible form, they shed little to no light on the Decedent's intent and understanding regarding the nature of the Agreement and its legal effect after his death. The letters authored by the Defendant, who was not a party to the Agreement, simply reflect his thoughts and concerns about the Agreement, and his understanding and interpretation, as a layperson, of the legal effect of the Agreement. The letters allegedly written by the Decedent are just as ambiguous and unclear as the Agreement itself. The

fact that the Decedent wrote, "right off, I say the contract stands", simply reflects his decision not to change or terminate the Agreement at that time. Further, even if the Decedent wrote in another letter that he wanted to "endow" the Defendant's children "with the securities in our name and the house and whatever else excluding the sculpture", these words do not translate into an expression of intent to exclude his art work from his Estate and convey legal title to his art work to the Plaintiff through the Agreement. Similarly, the Decedent referring to the Plaintiff as his "agent" and "custodian of unsold work" does not equate to naming the Plaintiff as his "trustee" in the legal sense of the word. These letters offered by the Plaintiff as extrinsic evidence of the Decedent's intent are thus unhelpful, unpersuasive, and in large part irrelevant.

Accordingly, based on the above, the Court finds that the Decedent did not intend to create a trust when he entered into the Agreement with the Plaintiff. The words "trust", "trustee", "grantor", or "settlor" do not appear anywhere in the Agreement which would typically appear in a trust agreement. Despite the fact that the Agreement provides that it shall continue after the Artist's death, the Plaintiff is consistently referred to as an "agent". The Agreement is entitled, "Art Sales Agreement", not a trust agreement. The Agreement does not transfer the Decedent's ownership of the art work to a trust either before or after his death, but explicitly states that the art work shall remain the Decedent's property until sold.

Furthermore, it is clear from Attorney Riggi's Affidavit that the Decedent had legal counsel when he entered into this Agreement, given by the same attorney who had prepared the Decedent's Last Will and Testament that was executed eight (8) years earlier. The Will does not exclude the Decedent's art work, and names the Defendant as the Executor and the sole beneficiary of his Estate. The Agreement does not mention the Decedent's Will. The Decedent knew he had executed a Will and knew the provisions thereof. He never revoked his Will or executed a subsequent Will or a codicil to the Will.

If the Decedent had wanted to create a trust, fund it with his art work, and name the Plaintiff as a sole trustee with total authority and exclusive control over the disposition of the unsold art work after his death, and thereby exclude the art work from his Estate, the Decedent, who had legal counsel at the time, could have included such operative language in the Agreement or he could have executed the proper documents required by law in order for such an intended testamentary disposition to have the desired legal effect. The Decedent did neither, rendering the Plaintiff's desired disposition of the art work by way of a trust agreement untenable.

The Plaintiff further attempts to convince the Court that while ownership of the art work concededly may not have been transferred to the Plaintiff, legal title to the art work was conveyed to him through a statutory trust created under the Arts and Cultural Affairs Law §12.01, as it read in February, 2012 when the Agreement was executed. As a result, the Plaintiff maintains that the art work is excluded from the Decedent's Estate because the statute refers to such art work as "trust property". The Court does not share the same statutory interpretation.

This section of the Arts and Cultural Affairs Law, entitled "Artist-art merchant relationships", explicitly "establishes a consignor/consignee relationship" between the artist and the art merchant upon delivery to the art merchant of the artist's art work "for the purpose of exhibition and/or sale on a commission". The statute goes on to deem the consignee "the agent" of the consignor, and provides that even if the consignee "purchases" the art work from the consignor "for his own account", and the art work is thereafter "resold to a bona fide third party before the consignor has been paid in full", the art work "shall remain trust property in the hands of the consignee for the benefit of the consignor" until the consignor is paid in full. See, Arts and Cultural Affairs Law §12.01(1)(a)(I)-(iv).

It is undisputed that the majority of the Decedent's art work is physically located at

the Plaintiff's art gallery on Jay Street in Schenectady, New York, and that these pieces were delivered to the Plaintiff by the Decedent pursuant to the Agreement for the purpose of exhibition and/or sale. It is also undisputed that the Decedent signed Certificates of Authenticity and blank Bills of Sale for all of his art work and delivered these documents to the Plaintiff at some point prior to his death. The Plaintiff never purchased the art work from the Decedent and no money was exchanged when these documents were delivered to the Plaintiff. Thus, while there was a "delivery" of all of the art work to the Plaintiff, such delivery did not give the Plaintiff an inalienable right to legal title to the art work under the statute. It merely established a consignment relationship between the Decedent as the artist, and the Plaintiff as his agent. See also, Matter of Friedman, supra, at 82.

Once a consignment relationship is established, the statute serves to protect the artist's art work and any proceeds from its sale that come into the hands of the agent/consignee, until the artist/consignor is paid in full. An amendment to the statute in November, 2012 served to clarify this purpose by adding that the art work and/or any proceeds from the sale thereof shall not "become the property of the consignee or be subject or subordinate to any claims, liens or security interest of any kind or nature whatsoever of the consignee's creditors." See, Arts and Cultural Affairs Law §12.01(1)(a)(v). The statute, either before or after the amendment, does not serve to convey legal title to the artist/consignor's art work to the agent/consignee, and in fact with the amendment, it clearly states the opposite. Nor does the pre-amendment or post-amendment statute address what effect the death of the artist/consignor has on the consignment relationship or on the disposition of the "trust property" after the artist's death. The Plaintiff would like the Court to read into the statute and broadly interpret it as if there is a conveyance of legal title upon the creation of a consignment relationship, which would in turn create a type of irrevocable trust or testamentary substitute in favor of the agent/consignee upon the death of the artist/consignor. This interpretation, which would

result in the clawing of these assets from the Estate to this "trust", is not only unsupported and inconsistent with the actual wording of the statute and its clear purpose, but is also contrary to the Decedent's intention and understanding of the Agreement as previously determined herein.

All of the above findings necessarily lead the Court to the conclusion that the Agreement was not intended to be a trust agreement, but rather, was intended to be a consignment relationship which by its terms did not convey ownership or legal title to the Decedent's art work to the Plaintiff. Nor was the ownership or legal title to the art work conveyed to the Plaintiff by statute or any other provision of law or legal mechanism that would serve to exclude the Decedent's art work from his Estate. At the time of his death, the Decedent's art work remained titled to him as its sole owner and thus became an asset of his Estate by operation of law. Accordingly, the Defendant, in his capacity as the Executor of the Decedent's Estate, is a necessary party to this lawsuit which seeks to declare the rights to and obligations regarding the art work that now belongs to the Decedent's Estate.

While the Court finds that the Defendant as the Executor of the Decedent's Estate is a necessary party herein, it was not improper for the Plaintiff to sue the Defendant in his individual capacity since the Defendant took possession of the Decedent's remaining art pieces that are not located at the Plaintiff's art gallery. While the Plaintiff is currently seeking declaratory relief, he clearly is seeking to enforce, or intending to enforce if successful on his motion, the provision of the Agreement that entitles him to take possession of all of the art work after the Decedent's death. The Defendant is also named in his individual capacity in the Agreement as a third-party beneficiary. Moreover, the ownership of the Decedent's art work is now vested in the Defendant as the sole beneficiary of the Decedent' Estate. The Court thus finds that the Plaintiff should have named the Defendant in both of his capacities as an individual and as the Executor of the

Decedent's Estate.

In the interests of justice and judicial economy, and since the same attorney represents the Defendant in both of his capacities, the Court will *sua sponte* join the Defendant in his capacity as the Executor of the Decedent's Estate as a necessary party herein and amend the caption accordingly. However, the Court will not transfer this case to the Surrogate's Court since the Supreme Court is a court of general subject matter jurisdiction and has the authority to hear and determine this case. Moreover, all of the interested parties in the Estate proceeding are now parties before this Court and whose rights will be protected by this Court. Having thoroughly addressed the jurisdictional issues raised by the Defendant, the Court will now determine the ultimate disposition of this case on its merits.

The Court having established that the Agreement formed a consignment relationship between the Plaintiff and the Artist, the question remains as to the legal effect the Agreement has now that the Artist is deceased. The Agreement does explicitly state that it shall continue after the Artist's death, and goes on to provide how the proceeds from the artwork should be divided if sold after his demise. These provisions render the Agreement a contract to make a testamentary provision, invoking the provisions of EPTL §13-2.1.

EPTL §13-2.1 governs "contracts to make a testamentary provision of any kind" and only requires that they be in writing and subscribed by the party to be charged therewith, which the Agreement clearly was. <u>See</u>, EPTL §13-2.1(a)(2). However, pursuant to case law, it is well settled that in order for a contract to make a testamentary provision to be enforceable, it must not only be in writing and subscribed by the party to be charged with its performance as required by EPTL §13-2.1(a)(2), but that it "must further evince 'a clear and unambiguous manifestation of the testator's intention to renounce the future power of testamentary disposition'". <u>Aaron v. Aaron</u>, 64 A.D.3d 1103, 1104 [internal citations omitted], <u>lv denied</u>, 13 N.Y.3d 714. In other words, a contract to make a testamentary

disposition must include a clear and unambiguous agreement not to revoke it in order for it to be enforceable. See, The American Committee for the Weizmann Institute of Science v. Dunn, 10 N.Y.3d 82, 92; Matter of Argondizza, 2015 N.Y. Misc. LEXIS 613. See also, Matter of Attanasio, 52 Misc.3d 1216(A), affirmed by, 2018 NY Slip Op 01527.

A party seeking to enforce a contract to make a testamentary provision has a high burden to establish by clear and convincing evidence that the decedent "unequivocally" and "indisputably" renounced or surrendered his rights to freely revoke the agreement and later change his testamentary plan. Id. See also, Hamlin v. Stevens, 177 N.Y. 39, 48 ("contracts to make testamentary bequests should only be enforced 'when they have been established by evidence so strong and clear as to leave no doubt'"); Rubenstein v. Mueller, 19 N.Y.2d 228, 232 ("intention to not revoke must be manifested 'clearly and unambiguously'").

Applying this strict evidentiary standard to the Agreement in this case, the Court finds that the Plaintiff has failed to present indisputable evidence that the Decedent unequivocally intended to renounce his right to revoke the Agreement. The Agreement contains no provision stating that it is irrevocable. In fact, it contains a provision that gives him and the Plaintiff the absolute right to terminate the Agreement upon notice to the other party. The fact that there is no evidence that the Decedent actually terminated the Agreement prior to his death or attempted to do so, is not what controls its enforceability. The Decedent, even without revoking or terminating the Agreement, retained ownership and control over his art work and could have sold some or all of the pieces himself, gifted some or all of the pieces to someone else, or allowed someone other than the Plaintiff to try to sell his art work. The Agreement did not give the Plaintiff the exclusive, indefeasible right to sell the art work nor did it prohibit the Decedent from otherwise disposing of his art work as he in fact did through his Last Will and Testament.

Moreover, the extrinsic evidence in this case lends further support for the Court's

finding that the Decedent did not intend for the Agreement to be irrevocable. As set forth above, Attorney Riggi, who assisted the Decedent in reviewing and drafting the Agreement, unequivocally represents as an officer of this Court that the Decedent intended the right to terminate the Agreement to survive his death and that the Agreement would not become irrevocable upon his death. While it may have been the Decedent's desire or wish that the Agreement shall continue after his death, he did not make the Agreement irrevocable either during his lifetime or upon his death.

Since the Agreement is a contract to make a testamentary provision, and there is no evidence, let alone any clear and convincing evidence, that the Decedent unequivocally intended to surrender his rights to revoke the Agreement or to make the Agreement's testamentary provisions irrevocably binding on his Estate, the Court finds that as a matter of law, the Agreement is unenforceable by the Plaintiff against the Decedent's Estate and has no binding effect against the Decedent's Estate and certainly not against the Defendant in his individual capacity.

However, although the Agreement cannot bind the Estate beyond the Decedent's passing, this is not to say that the Agreement could not continue after the Decedent's death, if his Executor, now standing in the shoes of the Artist, chose to continue the Agreement. But the Plaintiff cannot force the Decedent's Estate to be bound by the Agreement, just as the Decedent's Estate could not force the Plaintiff, or the Plaintiff's Estate if he were to die, to be bound by the Agreement if the Plaintiff or his Estate elected to terminate the Agreement. It is clear that the Decedent intended the right to terminate the Agreement to be mutual and that this mutual right would continue after his death, giving the Executor of his Estate the option to either continue the Agreement or terminate it, just as he had the right to do during his lifetime and as the Plaintiff had and still has the right to do. Any other interpretation of the Agreement would result in a situation where the Plaintiff has the option to decide whether to perform under the Agreement or terminate it,

while the Executor of the Decedent's Estate, who now owns the art work, is irrevocably bound by the Agreement because the right to terminate expired with the Artist. In other words, the Plaintiff wants to obligate the Executor of the Decedent's Estate to perform under the Agreement, but take away his rights to terminate the Agreement. Such a unilateral contract, or contract of adhesion, is clearly inequitable, contrary to the Decedent's intention, and would force the Defendant, as Executor of the Decedent's Estate, to dispose of the Decedent's art work in a manner that is inconsistent with the terms of the Decedent's Will which he is bound as a fiduciary to follow.[1]

Accordingly, if the Agreement is treated as having survived the death of the Artist, then all of its provisions, including the mutual right to terminate the Agreement, must necessarily survive and inure to the benefit of the Decedent's Estate. Since the Defendant, in his capacity as the Executor of the Decedent's Estate, properly terminated the Agreement on notice to the Plaintiff pursuant to the termination clause, the Agreement is no longer valid and is not binding on the Decedent's Estate.

The Executor's right to terminate the Agreement is not only consistent with the Decedent's intent as determined above, but it is also supported by the principle of law that when a contract does not expressly contain a definite, fixed term of duration, the contract is "terminable at will." See, Better Living Now, Inc. v. Image Too, Inc., 67 A.D.3d 940, 941, citing, Double Fortune Prop. Investors Corp. v. Gordon, 55 A.D.3d 406, 407 ("The escrow agreement contained no definite term and therefore was terminable at will"), citing, Interweb, Inc. v. iPayment, Inc., 12 A.D.3d 164, 165 ("The agreement between the parties failed to contain a term certain for its duration. Thus, the agreement was terminable at will"). Since the Agreement does not contain any language regarding the length of time

---

1 See, Matter of Friedman, supra, at 82 ("[C]ourts 'will endeavor to give the construction most equitable to both parties instead of one which will give one of the parties an unfair or unreasonable advantage over the other'", quoting, Rush v. Rush, 19 A.D.2d 846).

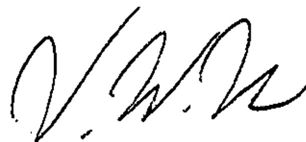
the Plaintiff would have to sell the art work or decide whether to donate the art work after the Decedent's death, the Decedent's Executor, now standing in the shoes of the Artist, is authorized to terminate the Agreement at will.[2]

Based on all of the foregoing, the Court hereby declares that the Agreement is no longer in full force and effect, and is unenforceable by the Plaintiff against the Artist, the Artist/Decedent's Estate, his Executor, or the Defendant in his individual capacity. The Plaintiff's Motion for Summary Judgment is hereby denied, and the Defendant's Cross-Motion for Summary Judgment is hereby granted. The Complaint, and all claims asserted therein, is hereby dismissed in its entirety, and upon searching the record, the Court *sua sponte* dismisses the Defendant's counterclaim for damages as lacking in merit.

The parties' remaining arguments, to the extent not specifically addressed herein, have been considered and found to be unavailing.

The foregoing shall constitute the Decision and Order of this Court.

Signed at Schenectady, New York, this 21st day of May, 2018.



HON. VINCENT W. VERSACI
Acting Supreme Court Justice

ENTER:

2 The termination of the Agreement is also consistent with the general rule that a consignor-consignee, or principal-agent relationship ordinarily terminates upon the death of either party. See, Matter of Friedman, supra, at 83. An exception to this general rule is when "an agency coupled with an interest" is created. Id. This exception does not apply here. The Plaintiff's agency created under the Agreement was not coupled with an interest since neither ownership nor legal title to the art work was conveyed to the Plaintiff at any time as determined herein.

906 N.Y.S.2d 796
15 N.Y.3d 179
933 N.E.2d 194

In the Matter of a Trust Created by Charlotte P. HYDE, Deceased. Glens Falls National Bank and Trust Company et al., as Trustees of a Trust Created by Charlotte P. Hyde, Deceased, Respondents; Carol J. Whitney, as Executor of Louis H. Whitney, Deceased, et al., Respondents,
and
Mary W. Renz et al., Appellants. (And Another Proceeding.).

Court of Appeals of New York.

June 29, 2010.

[906 N.Y.S.2d 797]

Nolan & Heller, LLP, Albany (David H. Wilder of counsel), for appellants.

Judge & Duffy, Glens Falls (H. Wayne Judge and Monica A. Duffy of counsel), for Carol J. Whitney and others, respondents.

Putney Twombly Hall & Hirson LLP, New York City (Christopher M. Houlihan of counsel), for Glens Falls National Bank and Trust Company, respondent.

McNamee, Lochner, Titus & Williams, PC, Albany (G. Kimball Williams of counsel), for Banknorth, N.A., respondent.

[906 N.Y.S.2d 798]

[933 N.E.2d 196]

OPINION OF THE COURT

Chief Judge LIPPMAN.

[15 N.Y.3d 182]

We hold that Surrogate's Court Procedure Act (SCPA) § 2110 grants the trial court discretion to allocate responsibility for payment of a fiduciary's attorney's fees for which the estate is obligated to pay-either from the estate as a whole or from shares of individual estate beneficiaries. In so doing, we overrule our holding in *Matter of Dillon,* 28 N.Y.2d 597, 319 N.Y.S.2d 850, 268 N.E.2d 646 (1971).

We consequently modify the order of the Appellate Division affirming the order of the Surrogate and remit to the Surrogate's Court for de novo consideration of allocation of the trustees' counsel fees.

I

This dispute developed out of a joint trial concerning intermediate accountings of two trusts. The first proceeding involved a testamentary trust created by Charlotte P. Hyde (Hyde Trust). At the outset of the trust accountings in 2001, Hyde's grandchildren, Mary Renz and her brother Louis H. Whitney, were the two life income beneficiaries of two equal shares of the Hyde Trust. Mary Renz's three children (Renz Children) and Louis H. Whitney's two children (Whitney Children) each possessed a presumptive one-fifth remainder interest in both the Mary Renz Share and the Louis H. Whitney Share that would vest upon the death of Mary Renz and Louis H. Whitney, respectively. Upon Louis H. Whitney's death in January 2008,[1] the Renz Children and the Whitney Children each received a one-fifth interest in the principal of the Louis H. Whitney Share of the Hyde Trust.

The second proceeding concerned an inter vivos trust created by Nell Pruyn Cunningham (Cunningham Trust). The Cunningham Trust term is measured by the lives of two of

[15 N.Y.3d 183]

Reprinted with permission.

Cunningham's grandnephews. In 2003, when the Cunningham accounting commenced, Mary Renz and Louis H. Whitney were each income beneficiaries and presumptive remaindermen of undivided one-sixth shares of the Cunningham Trust. The Mary Renz Share and the Louis H. Whitney Share were to pass to their living issue per stirpes upon the death of Mary Renz or Louis H. Whitney. Thus, upon Louis H. Whitney's death, the two Whitney children became the income beneficiaries and presumptive remaindermen of their father's undivided one-sixth share of the Cunningham Trust.

The two proceedings arose out of objections made to the Hyde trustees' accountings by Louis H. Whitney and the Whitney Children (the Whitneys) and objections made to the Cunningham trustees' accountings by Louis H. Whitney (and carried on by the Whitney Children and Louis H. Whitney's executor after his death). The Whitneys sought to deny the Hyde trustees and the Cunningham trustees their commissions and surcharge them on the basis of their alleged failure to diversify the Trusts' assets, among other objections.

Mary Renz and the Renz Children (the Renzes) did not participate in the Whitneys' objections to trustee conduct in either the Hyde or the Cunningham Trust accounting proceedings. Neither did any of the other income beneficiaries or remaindermen of the Cunningham Trust, aside from Louis H. Whitney (and later his executor and the Whitney Children), interpose

[933 N.E.2d 197, 906 N.Y.S.2d 799]

objections to the accounting of that Trust.

In advance of the joint trial on the Whitneys' objections, the Renzes filed an acknowledgment, attesting that they were non-objectors; and thus, under the Pro Tanto Rule,[2] they would not be entitled to share in any surcharges that might be imposed on the Hyde or Cunningham trustees. The Renzes simultaneously filed a cross motion seeking to require that all future trustees' counsel fees be deducted exclusively from the objecting beneficiaries' shares of the Hyde Trust and Cunningham Trust assets. The Renzes' cross motion also sought to reserve the right to seek reallocation of and reimbursement of the Hyde Trust for all counsel fees that had already been advanced from the Renzes' interests in the Hyde Trust.

[15 N.Y.3d 184]

Surrogate's Court dismissed all of the Whitneys' objections. As to the question of attorney's fees, the court acknowledged that the Pro Tanto Rule had applied, which meant that the non-objecting beneficiaries had not stood to gain from the success the Whitneys' objections might have had. Yet, the court stated it was constrained by *Dillon* to treat the trusts as single entities for purposes of trustee indemnification. Thus, regardless of potential unfairness to the Renz beneficiaries who abstained from the costly litigation, the Surrogate's Court ordered that the trustees' counsel fees be disbursed from the corpus of each trust generally. As a result, the Renzes' shares of the Hyde and Cunningham Trusts were held responsible for more than $700,000 in attorney's fees incurred by the trustees.

The Appellate Division affirmed, citing the construction of SCPA 2110 articulated in *Dillon* and finding no basis to distinguish this case (61 A.D.3d 1018, 876 N.Y.S.2d 196 [3d Dept.2009]).

II

SCPA 2110(2) provides: "The court may direct payment [for legal counsel rendered a fiduciary in connection with the performance of his or her fiduciary duties] from the estate generally or from the funds in the hands of the fiduciary belonging to any legatee, devisee, distributee or person interested." [3]

Reprinted with permission.

We first construed SCPA 2110(2) in our 1971 memorandum decision, *Matter of Dillon,* 28 N.Y.2d 597, 319 N.Y.S.2d 850, 268 N.E.2d 646 (1971). In *Dillon,* a legatee

[933 N.E.2d 198, 906 N.Y.S.2d 800]

under a testator's will that had been admitted to probate challenged probate of a subsequent will that increased the number of legatees who would inherit and thereby reduced the original legatee's portion of the testator's estate. The Surrogate's Court refused to vacate probate and charged the

[15 N.Y.3d 185]

objecting legatee's share of the estate with the executor's legal fees expended in defending probate of the later will. The legatee then appealed, asserting that legal fees should be allocated to the whole estate generally, not to the legacy of an individual party. Ultimately, this Court held that "SCPA 2110 does not authorize payment for legal services rendered a party to be charged against the share of other individual parties. Accordingly, although appellant lost in this litigation, the legal fees of the executor as her adversary were not chargeable to her personally" (*Dillon,* 28 N.Y.2d at 599, 319 N.Y.S.2d 850, 268 N.E.2d 646).

Although the decision in *Dillon* offers little rationale for its conclusion, the statutory interpretation requiring the corpus of the estate generally, and not the shares of individual beneficiaries, to pay for fiduciaries' counsel seems guided by the common-law American Rule. In brief, the American Rule requires all parties to a controversy-the victors and the vanquished-to pay their own "incidents of litigation" (*Chapel v. Mitchell,* 84 N.Y.2d 345, 349, 618 N.Y.S.2d 626, 642 N.E.2d 1082 [1994], quoting *Hooper Assoc. v. AGS Computers,* 74 N.Y.2d 487, 491, 549 N.Y.S.2d 365, 548 N.E.2d 903 [1989]). Thus, the unsuccessful objectant, under the American Rule, was required to pay only its own attorney's fee, not the executor's attorney's fees as well, which were paid for by the estate.

However, the *Dillon* decision, finding that SCPA 2110 required that the whole of the estate be charged with the executor's counsel fees, in spite of the fact that actions of the objecting party did not effect a benefit to the estate and bordered on the vexatious, seems to have ignored the plain meaning of the statute and departed from the earlier jurisprudence of this Court.

In interpreting SCPA 2110, we bear in mind that it is "presumed that no unjust or unreasonable result was intended and the statute must be construed consonant with that presumption" (*Zappone v. Home Ins. Co.,* 55 N.Y.2d 131, 137, 447 N.Y.S.2d 911, 432 N.E.2d 783 [1982], citing *Matter of Breen v. New York Fire Dept. Pension Fund,* 299 N.Y. 8, 19, 85 N.E.2d 161 [1949] and McKinney's Cons. Laws of N.Y., Book 1, Statutes § 143). The Legislature's intentions should normally be ascertained from a careful reading of the statute itself, especially where, as here, the language is unambiguous, and the legislative history reveals nothing that would counsel an alternative interpretation (see McKinney's Cons. Laws of N.Y., Book 1, Statutes § 92 [b]). On its face, the statute provides the trial court with discretion to disburse funds from any beneficiary's share in the estate-and not exclusively from "the estate generally."

[15 N.Y.3d 186]

In addition to departing from the plain meaning of the statute, *Dillon* did not focus on the considerations of fairness that guided *Matter of Ungrich,* 201 N.Y. 415, 94 N.E. 999 (1911) and its progeny (e.g. *Matter of Garvin,* 256 N.Y. 518, 177 N.E. 24 [1931]; *Matter of Bishop,* 277 App.Div. 108, 98 N.Y.S.2d 69 [1st Dept.1950]; *see also Matter of Burns,* 126 A.D.2d 809, 510 N.Y.S.2d 732 [3d Dept.1987]). In *Ungrich*, the plaintiff, a life tenant under a testamentary trust, brought an action for a

Reprinted with permission.

trust accounting and to remove the trustees for alleged misconduct. The Surrogate's Court there had dismissed the objectant's challenges. Regarding the question of attorney's fees, we determined as a matter of common law,

[933 N.E.2d 199, 906 N.Y.S.2d 801]

prior to any statute on the subject, that the court should have discretion to disburse fees from the estate generally or from individual shares, depending on the circumstances of each case. We stated that trustees should have "an opportunity to prove their expenses and the circumstances under which they were incurred," and at that point, "it would be for the court to determine on the facts of the case what part, if any, of such expenditures should be allowed to the [trustees] and charged against the life tenant and what part against the corpus of the estate" (*Ungrich,* 201 N.Y. at 420, 94 N.E. 999).

Because we find that this construction is more faithful to the statute, our precedents prior to *Dillon,* and fairness, we choose to restore the plain meaning of SCPA 2110(2): to place discretion in the hands of the trial courts to allocate expenses when ordering that fiduciaries be indemnified by an estate for attorney's fees.[4] The trial court's discretion extends to the timing and structure of deducting funds against the present and future interests of the beneficiaries.

In cases where a fiduciary is to be granted counsel fees under SCPA 2110(2), the Surrogate's Court should undertake a multi-factored assessment of the sources from which the fees are to be paid.[5] These factors, none of which should be determinative, may include: (1) whether the objecting beneficiary acted solely in his or her own interest or in the common interest of the estate; (2) the possible benefits to individual

[15 N.Y.3d 187]

beneficiaries from the outcome of the underlying proceeding; (3) the extent of an individual beneficiary's participation in the proceeding; (4) the good or bad faith of the objecting beneficiary; (5) whether there was justifiable doubt regarding the fiduciary's conduct; (6) the portions of interest in the estate held by the non-objecting beneficiaries relative to the objecting beneficiaries; and (7) the future interests that could be affected by reallocation of fees to individual beneficiaries instead of to the corpus of the estate generally (*see e.g. Matter of Greatsinger,* 67 N.Y.2d 177, 183-184, 501 N.Y.S.2d 623, 492 N.E.2d 751 [1986] [providing factors to guide courts in discretionary allocation of attorney's fees among multiple trusts in estate litigation]). Inasmuch as Surrogate's Court never exercised its discretion, we remit to allow it the opportunity to do so.

Accordingly, the order of the Appellate Division should be modified, with costs to appellants, by remitting to Surrogate's Court for further proceedings in accordance with the opinion herein and, as so modified, affirmed.

Order modified, etc.

Judges CIPARICK, GRAFFEO, READ, SMITH, PIGOTT and JONES concur.

[1] Following Louis H. Whitney's death, his widow and executor, respondent Carol J. Whitney, was substituted for him in both proceedings by order entered in April 2008. The Whitney Children were simultaneously joined as respondents in the second proceeding.

[2] The court-made Pro Tanto Rule dictates that beneficiaries who did not file objections to a fiduciary's conduct are not entitled to share in the surcharge that accrues to the estate or trust when other beneficiaries file successful objections. The rule sought to prevent non-objecting beneficiaries from

Reprinted with permission.

being rewarded for their quiescence while their co-beneficiaries defended the estate assets (*see Matter of Garvin,* 256 N.Y. 518, 177 N.E. 24 [1931]).

[3] The present SCPA 2110 was enacted in 1966 as part of a recodification of the Surrogate's Court Act. The original Surrogate's Court Act § 231-a, adopted in 1923, stated in relevant part, "The surrogate may direct payment therefor from the estate generally or from the funds in the hands of the representative belonging to any legatee, devisee, distributee or person interested therein." (L. 1923, ch. 526.) SCPA 2110, like Surrogate's Court Act § 231-a before it, provides for compensation out of estate funds for a fiduciary that accrues counsel fees in the course of fulfilling its fiduciary duties to the estate. Although the fiduciary conducts the litigation and may have all the hallmarks of a party to a suit (especially when the fiduciary is defending itself in a surcharge proceeding), the estate is ordinarily obligated to indemnify the fiduciary for attorney's and litigation fees (*see e.g. Wetmore v. Parker,* 52 N.Y. 450 [1873]; *cf. Matter of Wadsworth,* 275 N.Y. 590, 11 N.E.2d 769 [1937]). The rationale is that the actions of fiduciaries, absent misconduct, are undertaken to benefit the estate, and the estate should therefore be charged with the fiduciaries' costs.

[4] This holding does not involve or affect SCPA 2301(4), which provides for costs and allowances that may be made payable by any party *personally.*

[5] This holding does not involve or affect the Surrogate's discretion to make the underlying determination of whether or not the fiduciary is entitled to charge its counsel fees to the estate, or whether or not the amount of counsel fees is reasonable. In assessing the reasonableness of a fee award, the Surrogate should consider such factors as the extent of services provided, the amount of time spent on the matter, the level of sophistication required, and the size of the estate relative to the amount of fees.

Reprinted with permission.

32 Misc.3d 661
929 N.Y.S.2d 650
2011 N.Y. Slip Op. 21195

In the Matter of the INTERMEDIATE ACCOUNTING OF the GLENS FALLS NATIONAL BANK AND TRUST COMPANY and Samuel P. Hoopes, As Trustees under the Will of Charlotte P. Hyde, Deceased.

Surrogate's Court, Warren County, New York.

May 20, 2011.

[929 N.Y.S.2d 652]

Nolan & Heller, LLP (David H. Wilder of counsel), for Mary W. Renz and others.Judge & Duffy (H. Wayne Judge and Monica A. Duffy of counsel), for Louis H. Whitney and others.McPhillips, Fitzgerald & Cullum, LLP (James E. Cullum of counsel), for Byron Lapham.McNamee, Lochner, Titus & Williams (Richard D. Cirincione and G. Kimball Williams of counsel), for Banknorth.Bartlett, Pontiff, Stewart & Rhodes, P.C. (Benjamin R. Pratt of counsel), for Samuel Hoopes.Putney, Twombly, Hall & Hirson, LLP (Christopher M. Houlihan of counsel), for Glens Falls National Bank and Trust Company.**JOHN S. HALL, J.**

[32 Misc.3d 662] The Finch Pruyn Paper Company, Inc. (hereinafter referred to as “Finch Pruyn”) was, until recently, a large family-owned paper manufacturing company located in Glens Falls, New York. Through a series of successful innovations, including the development of a type of white, opaque paper requisite for making photocopies, the company flourished for more than a century. Unfortunately, the paper industry fell into a downturn [32 Misc.3d 663] during the 1990s when many paper mills were forced to close and the value of Finch Pruyn greatly diminished.

Charlotte Pruyn Hyde and Nell Pruyn Cunningham were the descendants of one of the founders of Finch Pruyn. During the time that the mill was flourishing, the sisters established several trusts which were funded primarily (and some, exclusively) with their shares of Finch Pruyn corporate stock. During the mid

[929 N.Y.S.2d 653]

2000s, after the decline in the paper market, Intermediate Accountings were filed by the trustees. These were followed by objections alleging, *inter alia,* that the investment portfolios of the trusts were not diversified and as a result, the trusts suffered a significant loss in value.

Prior to the trial, one family of beneficiaries, the Renz family, chose to withdraw their objections to the accounting and acknowledged in writing that they would not, and could not, share in any surcharge awarded against the trustees if the other objectants were successful, in accordance with a common law trust doctrine known as the *Pro Tanto* Rule. On the other hand, the Whitneys, the remaining family of beneficiaries, contended that the trustees should have sold 95% of the Finch Pruyn stock prior to 1995. As a result of their allegedly negligent failure to do so, the Whitneys contended that the trusts lost tens of millions of dollars in value.

In opposition to the Whitney's motion for summary judgment, the trustees maintained that Finch Pruyn had a unique capital structure preventing it's sale, that a fair price could not be obtained if they tried to liquidate the Finch Pruyn stock because there were no buyers for the stock, nor any public market in which to sell it. They argued that a sale of the Finch Pruyn stock would have been detrimental to the beneficiaries' interest who would suffer adverse tax consequences due to significant unrealized capital gains. Partial summary judgment was granted to the

Reprinted with permission.

objectants holding that the trusts were not diversified and that the governing trust instruments did not prohibit diversification. At a lengthy trial involving seventeen (17) days of testimony, the Court heard many witnesses including expert testimony by Professor Kenneth Joyce, one of the authors of the Prudent Investor Act, and Lawrence Griswold a Senior Trust Officer of the Lincoln Chase Bank, on behalf of the objectants. Following the trial this court issued a decision dated January 3, 2007 dismissing the objections. It held that a unique corporate stock arrangement prevented the sale of the Finch Pruyn stock and diversification of the trusts assets.

[32 Misc.3d 664] After the trial, the Renz family moved to have the attorney fees, in excess of $900,000, allocated to the objectants' interests in the trusts, not to the principal of the trusts which would diminish the value of their shares. Despite significant misgivings and strongly expressed doubts as to the fairness of requiring the Trusts to bear the entire costs of the litigation, this Court was constrained to follow *In re Dillon's Estate,* 28 N.Y.2d 597, 319 N.Y.S.2d 850, 268 N.E.2d 646 [1971], thus denying the motion for allocation of fees. The Appellate Division affirmed but the Court of Appeals granted leave to appeal and reversed. It overruled *In re Dillon's Estate* and remanded to this Court to allocate the attorney fees and expenses in it's discretion by applying several factors.

ISSUE PRESENTED

How to allocate litigation costs to balance the competing interests of the beneficiaries of a trust by protecting non-objecting beneficiaries from bearing the costs of litigation of a contested accounting matter they chose to not participate in, with the interests of the unsuccessful objecting beneficiaries who chose to litigate in good faith after being granted partial summary judgment.

THE TRUSTS

The **HYDE ARTICLE SEVENTH** trust is a testamentary trust established under Article SEVENTH of the Will of Charlotte P. Hyde. This trust was established solely for the benefit of Louis Whitney

[929 N.Y.S.2d 654]

and his children. The Renz family had no interest in this trust. Upon the death of the primary income beneficiary, Louis Whitney, the remainder was to go to his surviving children. As such, all expenses relative to the proceedings involving Article SEVENTH should be and has been borne by the Whitney children.

The **HYDE ARTICLE NINTH TRUST** is a testamentary trust established under Article NINTH of the Will of Charlotte P. Hyde. Upon the death of the primary income beneficiary, Mary VanNess Whitney, the principle of the Hyde Article NINTH Trust was divided into two separate and equal trusts to provide income for her children, Mary Renz and Louis H. Whitney. Upon each of their deaths, the principal of their respective trusts were to be distributed to the surviving great-grand children of Charlotte P. Hyde, or their issue surviving. Mary Renz has three children. Louis H. Whitney had two children. Thus, there are five great-[32 Misc.3d 665] grandchildren, each of whom possesses a presumptive one-fifth (1/ 5) remainder interest in both trusts. Neither Mary Renz nor Louis Whitney had a remainder interest in either of the trusts.

Objectant Louis Whitney died on January 16, 2008. Upon his death, the five surviving Renz and Whitney children received the principal of the Louis Whitney share of the Hyde Article NINTH Trust in equal five shares, subject to this Court's prior order, dated October 12, 2007, granting a stay of enforcement.

Reprinted with permission.

The **CUNNINGHAM TRUST** is an *inter vivos* trust established in 1935 for the benefit of Nell Pruyn Cunningham's husband, several friends and their descendants. Mary Renz and Louis Whitney are income beneficiaries and presumptive remaindermen of an undivided 1/6 share each. Upon Louis Whitney's death on January 16, 2008, his two children became the current income beneficiaries and presumptive remaindermen of that undivided 1/6 share of the Cunningham Trust (*i.e.* 1/12 each).

OBJECTIONS

Louis Whitney and his children filed objections to the accounting for the two Hyde Trusts. Significantly, only Louis Whitney filed objections to the Cunningham Trust Accounting.

During May of 2002, Mary Renz and her children filed objections to the intermediate accountings in Hyde but objected only to a portion of the attorneys fees which they believed were unreasonable. In the Cunningham accounting they objected to the lack of diversification of the trusts.

However, following the completion of discovery in 2006, they decided not to litigate their objections. They filed an Acknowledgment dated February 3, 2006 stating that they did not object to the accounts and acknowledged that “They are not entitled to share in any surcharges imposed against the Trustees in these proceedings”. They also filed a cross-motion opposing the Whitney's objections and requesting that all legal fees be paid from the Whitney's share of the trusts. This was denied as being premature.

On January 3, 2007 this court dismissed the Whitneys objections and the Renzes renewed their motion to require that legal expenses be paid by the Whitneys. By Order dated April 14, 2007, this Court held that while it appeared to be fair to allocate the attorneys fees to the Whitneys, it was constrained to follow the Court of Appeal's holding's in *Dillon's Estate*. The Court noted that the *Dillon* decision had been universally criticized by [32 Misc.3d 666] the leading commentators of the EPTL and that the outcome was harsh and unfair. However, established precedent required that attorney's fees be paid from the principal of the trusts to the detriment of the non-objecting beneficiaries, such as the Renz children.

[929 N.Y.S.2d 655]

COURT OF APPEALS

After the Appellate Division affirmed this Court's decision, the Court of Appeals granted leave to appeal and reversed. It overruled it's decision *In re Dillon's Estate (supra)* and restored discretion to the Surrogate when deciding issues of fee and expense allocation. It specifically held that SCPA 2110(2) gives the trial court discretion to allocate the payment of a fiduciary's attorney's fees either from the estate as a whole or from shares of individual estate beneficiaries, and that Surrogate's Court had discretion to charge individual trust beneficiaries' shares of trusts for counsel fees incurred by trustees in defense of beneficiaries' objection to an accounting.

PRO TANTO* RULE COMPARED TO THE RULE IN *HYDE

The *Pro Tanto* Rule is an equitable rule from the common law intended to protect fiduciaries by limiting their liability for negligent (but not egregious) conduct. Simply stated, a beneficiary who does not object to a fiduciary's conduct cannot share in the benefits obtained if an objecting party is successful. It is based on the concept that those who do not object to an account are deemed to have accepted it, and promotes the public policy of encouraging parties to take on the necessary and sometimes onerous duties of a fiduciary. Beneficiaries cannot await the

Reprinted with permission.

outcome of an attack on a fiduciary by other parties, then share in the surcharge without taking any of the risks or doing any of the work. (*See, Valente and Bochstein, Pro Tanto Rule: Sword or Shield,* N.Y.L.J.; pg. 3; Col. 1, 7/2/2010).

The Court of Appeals was presented with the inverse situation in Hyde. It held that a beneficiary who objects but is not successful can be held responsible, in whole or in part, for the litigation expenses incurred (see *Matter of Bishop,* 277 A.D. 108, 98 N.Y.S.2d 69 [1st Dept., 1950]). The *Pro Tanto* rule protects fiduciaries by limiting their liability wherein the *Hyde/Bishop* rule discourages frivolous litigation. The *Pro Tanto* Rule applies to the *receipt of benefits* resulting from *successful* objections. The *Hyde/Bishop* rule applies to the *payment of costs* resulting from *unsuccessful* objections.

[32 Misc.3d 667] MULTI–FACTORED ASSESSMENT

The Court of Appeals also held that:

"[I]n cases where a fiduciary is to be granted counsel fees under SCPA 2110(2), the Surrogate's Court should undertake a multi-factored assessment of the sources from which the fees are to be paid. These factors, none of which should be determinative, may include: 1) whether the objecting beneficiary acted solely in his or her own interest or in the common interest of the estate; 2) the possible benefits to individual beneficiaries from the outcome of the underlying proceeding; 3) the extent of an individual beneficiary's participation in the proceeding; 4) the good or bad faith of the objecting beneficiary; 5) whether there was justifiable doubt regarding the fiduciary's conduct; 6) the portions of interests in the estate held by the non-objecting beneficiaries relative to the objecting beneficiaries, and 7) the future interests that could be affected by reallocation of fees to individual beneficiaries instead to the corpus of the estate generally."

APPLYING THE FACTORS*HYDE ARTICLE NINTH TRUST*Factor 1 Whether the objecting beneficiary acted solely in his or her own interest or in the common interest of the estate.

The Whitneys objected that the trust portfolios were not diversified as required

[929 N.Y.S.2d 656]

by the Prudent Investor Act. At no time during this lengthy litigation did any party suggest that diversification was not in the best interests of the trusts. Partial summary judgment was granted to the Whitneys by Decision and Order dated September 8, 2005 which found that the trusts were not diversified as required and that the terms of the governing trust instruments did not prohibit diversification.

According to affidavits in related matters filed in this Court and as announced by Finch Pruyn & Company and widely reported by the media, the Finch Pruyn shareholders voted to approve the sale of the company to Finch Pruyn Holdings, LLC on April 24, 2007. The sale occurred in June of that year. The Court takes judicial notice of documents subsequently filed in Court that the portfolios of the trusts have now been liquidated and diversified. Although the Renzes chose to withdraw their [32 Misc.3d 668] objections and waived any claim for surcharges resulting from the Whitney objections, the Renzes nevertheless benefitted from that liquidation. While this diversification may have occurred had the Whitneys not filed objections, this development cannot be ignored as the trustees managed the trusts without diversifying the assets for decades.

***Factor 2* The possible benefits to individual beneficiaries from the outcome of the underlying proceeding.**

The Renz respondents filed an Acknowledgment on February 3, 2006 prior

Reprinted with permission.

to the trial that they did not join in the litigation and understood that they could not benefit in the event that surcharges were awarded. Consequently they contend that they stood to gain nothing from the objections. However, as noted above, the Trustees failed to comply with the Prudent Investor Act for decades (for unique and valid reasons), but achieved diversification shortly after this matter was decided.

Factor 3 **The extent of an individual beneficiary's participation in the proceeding.**

Following discovery, the Renzes withdrew their objections and did not participate in the trial. The Whitney children filed objections in the Hyde Accountings and participated in the joint trial. Significantly only Louis H. Whitney filed objections in the Cunningham accounting.

Factor 4 **The good or bad faith of the objecting beneficiary.**

The Court is all too familiar with disgruntled, vexatious estate litigants who are more (often exclusively) concerned with emotional rather than legal issues. Frequently they act without, or contrary to, the advice of counsel, often *pro se*. In contrast, the Whitneys consulted experienced counsel, who performed extensive investigation into the facts, the voluminous documents and records, the applicable law, and had a good faith belief in the necessity and validity of their proposed litigation.

Prior to filing their objections they correctly determined that failure to object to the intermediate accountings would prevent them from raising those objections in the future. They met with Buffalo Law School Professor Kenneth Joyce, one of the authors of the Prudent Investor Act, who confirmed that the Whitneys appeared to have a valid basis for objecting to the accountings. They also consulted with Lawrence Griswold, a retired senior trust officer at Lincoln Chase Bank in Rochester, who opined that the trustees were legally responsible for their failure to diversify the portfolios. Both experts offered to, and did, testify [32 Misc.3d 669] as a witness on behalf of the objectants. Finally, this Court granted partial summary judgment decision to the Whitneys and denied summary judgment to the Trustees finding

[929 N.Y.S.2d 657]

that there were no questions of fact that several elements of the Prudent Investor Act had been violated.

Where an account discloses possible mismanagement or a substantial loss, it

"in and of itself, does not imply negligence, imprudence or mismanagement on the part of the trustees, it does seem to imply a duty of explanation [by the trustees] to the beneficiaries and remaindermen" (*Matter of Penney,* 60 Misc.2d 334, 302 N.Y.S.2d 886 [1969]).

The Whitneys filed their objections in good faith, and they justifiably relied on the advice of numerous respected experts and experienced legal counsel.

Factor 5 **Whether there was justifiable doubt regarding the fiduciary's conduct.**

Unlike many objectants who base their claims on surmise, supposition or suspicion, the Whitneys had a plethora of proof of the Trustees' failure to diversify. Experienced counsel and several knowledgeable experts advised the objectants of the merits of the case. This Court's summary judgment decision established that their objections were justified and not a vehicle to retaliate against the trustees or family members.

Factor 6 **The portions of interests in the estate held by the non-objecting**

Reprinted with permission.

beneficiaries relative to the objecting beneficiaries.

This Court is well aware of litigation by beneficiaries of an inconsequential share in a trust or estate who appear to be, and often state, that they are motivated more by a desire to swamp the main beneficiaries in litigation costs rather than in succeeding. That is not a factor in the present matter. While the Renz children own a collective 3/5 (60%) remainder interest in the principal of the Hyde Article NINTH Trust, the Whitneys own the remaining presumptive 2/5ths (40%). The trust is worth several million dollars. The damages for failing to diversify could have exceeded several million dollars. Therefore, the Whitneys had a significant economic interest on the litigation.

***Factor 7* The future interests that could be affected by reallocation of fees to individual beneficiaries instead to the corpus of the estate generally.**

The Renz children own a collective 3/5 (60%) remainder interest in the principal of the Hyde Article NINTH Trust. Therefore, if the litigation fees are paid from the trust [32 Misc.3d 670] corpus and not reallocated to the Whitney share, the Renz beneficiaries who did not object and did not participate in the trial will bear a larger portion of the expenses than the actual objectants.

HYDE ARTICLE SEVENTH TRUST

The Hyde Article SEVENTH Trust was established solely for the benefit of Louis Whitney and his children. The Renz family had no interest in said trust. As such, all litigation expenses involving Article SEVENTH should be and have been paid from the Whitney grandchildren's interest.

CUNNINGHAM TRUST

Unlike the two HYDE trusts, neither of the Whitney children filed objections to the Cunningham accountings. Their father, Louis Whitney was the only objectant. In fact, the Whitney children were not added as parties to that proceeding until after their father died, and the trial had concluded. Consequently the Cunningham Trust presents an issue separate and distinct from the Hyde Article NINTH Trust: Whether non-objecting remaindermen should be responsible for litigation expenses incurred as the result of unsuccessful objections filed by their father.

[929 N.Y.S.2d 658]

Although this court previously held in its prior decision and order, dated April 29, 2008, that the Whitney children should be substituted in for their father as respondents, this was not because the Whitney children desired to litigate the Cunningham appeal on their own behalf, but because the court required a new party to finalize the litigation on behalf of their father. This does not, however, negate the fact that they never objected to the Cunningham accounting.

Since the Whitney children never objected to the intermediate accounting, they should not be penalized. They had no economic interest in the outcome. The *Pro Tanto* rule prohibits them from receiving any benefit. Any surcharge gained would have to be held in an earmarked fund specifically for the benefit of the life income beneficiary, their father (see *Matter of Hall,* 164 N.Y. 196, 58 N.E. 11 [1900]).

Litigation expenses resulting from an unsuccessful action against a trust should be paid, not by remaindermen who had no part in instituting the action and no interest in the outcome, but by an income beneficiary who instituted the action solely for his own benefit (*Matter of Ungrich,* 201 N.Y. 415, 94 N.E. 999 [1911]). In *Ungrich,* the remaindermen were charities and the objectants [32 Misc.3d 671] commenced litigation termed “unwarranted” by the court, thus perhaps making a more compelling case. However, in

Reprinted with permission.

balancing the equities, the Whitney remaindermen should not be treated differently than the other remaindermen, including the Renz children, who did not object to the accounting.

In *Matter of Bishop,* (*supra*) the Appellate Division held that where an income beneficiary instituted an unsuccessful action, the trust, not the remaindermen, should be responsible to pay litigation costs. The court found that the action was reckless and lacking merit, contrary to the facts here. However, where an account reflects mismanagement or a substantial loss to the estate or trust, it implies a duty of explanation by the trustees to the beneficiaries and remaindermen (*see Matter of Penney, supra*).

Where such as here a...

"court cannot say that [issues raised in litigation] ... were so lacking in substance as to constitute proof of ... malice on the part of the income beneficiaries ... [the court] will follow the usual practice and will charge the attorneys' fees **wholly to principal** ..." (*In re Bishop's Estate,* 79 N.Y.S.2d 220) (emphasis supplied).

The remaindermen should not have to pay for the action of their father, especially since he acted in good faith. The Court of Appeal's decision in this matter reiterates that parties who do not object to an accounting should not be required to bear to costs of the litigation. While the practical effect of having the litigation expenses paid from the corpus of the trust will result in the non-objecting Renz family bearing some of the costs of the litigation, the Renz remaindermen hold only a 1/12 interest. Therefore their liability will be *de minimus.*

ADDITIONAL FACTORS

The list of factors set forth by the Court of Appeals in the *Matter of Hyde* is not exhaustive. Rather, the decision states "these factors, none of which should be determinative *may* include ..." the seven factors set forth above (see *Matter of Hyde,* 15 N.Y.3d 179, 906 N.Y.S.2d 796, 933 N.E.2d 194, *at* 186) (emphasis added). There are additional factors unique to these proceedings that must be considered.

First, the Renz beneficiaries filed objections to the Hyde accounting dated May

[929 N.Y.S.2d 659]

16, 2002 and to the Cunningham accounting dated June 4, 2003. In Hyde, the objectants complained of a specific, relatively small payment of attorneys fees. In the Cunningham accounting the objections were broader; they objected to the lack of diversification of the trust assets. Thereafter they [32 Misc.3d 672] engaged in discovery from 2003 until 2006, then withdrew their objections to both accounts by filing the Acknowledgment dated February 3, 2006. They did not, participate in the trial. Therefore, a small portion of the attorney's fees charged in this matter were incurred as a result of the Renz's participation in the discovery process. It is likely that some of the discovery occurred simultaneously to discovery conducted by the Whitneys.

Second, Louis Whitney, who died January 16, 2008, filed objections to the Cunningham account. However, his children did not. The Hyde and the Cunningham objections were tried jointly. This created some unique issues. The Whitney children were present and participated in the trial regarding the Hyde objections. Although they lacked standing to participate in Cunningham, they were present while issues regarding the Cunningham Trust were heard. Although they should not be responsible to pay litigation expenses involved in the Cunningham Trust, it is impossible to determine precisely what litigation expenses pertained to which trust. For instance, when the Attorneys for the Whitney Trust

Reprinted with permission.

presented testimony that the trust could not diversify the trust assets due to the unique structure of its corporate stock, that testimony also established the validity of the Cunningham Trust's account. When the Hyde Trust lawyers cross examined the objectant's experts, the points raised also benefitted the Cunningham Trust. There is no exact method of dividing the litigation expenses by number of questions asked, time spent, or whether any particular witness or question benefitted the Hyde Trust, the Cunningham Trust, both or neither.

In preparing for trial, the parties agreed to share the expert witness fees equally. Although respondent Renz subsequently asked the court to overrule that agreement and allocate the payment of said expert witness fees based on the number of shares that each respective trust controls, this court denied said request. By decision and order dated August 16, 2007, this court directed that the expert witness fees be shared equally as originally agreed upon.

Consequently, the only practical method of allocating the Cunningham Trust's litigation expenses is to order that they be paid from the trust principal, even though it is apparent that at least some of those expenses were incurred because objections were filed in the Hyde Trust, and that some of the Whitney objectants were present in the courtroom while issues involving the Cunningham Trust were litigated. As a result, the Renz family's [32 Misc.3d 673] share will be reduced despite the fact that they, like the Whitney children, did not object or participate in the litigation.

Finally, the size of the litigation expenses, in excess of $1,000,000 must be considered in light of the substantial assets being held in trust. Each trust is believed to be currently worth approximately $2,500,000.

Following the trial, on July 14, 2008, this court awarded attorneys fees in the amount of $966,087.90 and disbursements of $54,819.06, to the Law Firm of Putney, Twombly, Hall & Hirson LLP. It directed that those expenses be shared equally by the parties and that they be paid from the principal of the Hyde Article NINTH Trust for the benefit of Mary W. Renz and Louis H. Whitney. The Court also awarded attorneys fees in the amount of

[929 N.Y.S.2d 660]

$104,549.90, and disbursements of $4,028.02 to the law firm of Bartlett, Pontiff, Stewart & Rhodes. It ordered that those expenses be shared equally by the parties and paid from the principal of the Hyde Article NINTH trust.

Based on the foregoing, it is hereby

ORDERED, all litigation expenses incurred by the trustees of the Hyde Article SEVENTH Trust, which was established exclusively for the benefit of the Whitneys, be paid from principal from the corpus of the trust, as directed in this court's July 14, 2008 Decision and Order, and it is further

ORDERED, that all litigation expenses incurred by the Hyde Article NINTH accountings ***before*** February 3, 2006 shall be paid from the corpus of the trust. All litigation expenses incurred by the Hyde Article NINTH accountings ***after*** February 3, 2006, shall be paid as follows:

(1)one-half (1/2) shall be paid from the shares of the objectants, Louis H. Whitney, Charlotte Whitney and Louis Whitney, II, **and**

(2)the remaining one-half (1/2) of said expenses shall be paid from the trust corpus, and it is further

ORDERED, that the trustees of the Hyde Article NINTH Trust reallocate the litigation expenses that were previously paid

Reprinted with permission.

from the Article NINTH Trust so as to comply with this decision and order.

ORDERED the Renz counterclaim is granted to the extent that one-half (1/2) of all future litigation expenses incurred by the Hyde Article NINTH Trustees in defending this accounting proceeding be paid from the Whitney share, one-half (1/2) from trust corpus and it is further

ORDERED, all litigation expenses of Cunningham accounting, shall be paid from the principal of the trust without reallocation.

Reprinted with permission.

[* 1]

SURROGATE'S COURT : NEW YORK COUNTY

New York County Surrogate's Court

Date: June 28, 2016

---------------------------------------X

Reformation Proceeding in the Estate of

CHARLES SUKENIK,

Deceased.

---------------------------------------X

File No. 2014-20/A

A N D E R S O N, S.

Petitioner, the wife of decedent Charles Sukenik, asks the court to reform an inter vivos trust he established, as well as the IRA beneficiary designation form he executed in which he left his IRA to petitioner. The purpose of the reformation is to remedy "inefficient estate and income tax planning" which, absent the requested reformation, will result in petitioner's incurring an income tax liability of approximately $1.6 million.

Decedent died on August 17, 2013. Under his will, executed on November 4, 2004, decedent left his tangible personal property and cooperative apartment to petitioner and left his residuary estate to The Charles and Vivian Sukenik Philanthropic Fund, Inc. (the "Foundation"). Under the trust, established on August 21, 1996, and amended and restated the same day as the will's execution, decedent provided that, upon his death, petitioner would receive certain real property in Columbia County, New York, with the balance of the trust remainder to be distributed to the Foundation. The will was admitted to probate and letters testamentary issued to the nominated executor, a cousin, who is also the sole trustee of the trust. The IRA beneficiary

designation form at issue was executed by decedent on July 29, 2009, almost five years after the will and trust, and it names petitioner as the recipient of decedent's IRA at UBS Financial Services, Inc.

Petitioner asks the court to reform the trust to add a pecuniary bequest to petitioner in a sum equal to the value of the IRA (about $3.2 million) and to reform the IRA beneficiary designation form to name the Foundation the beneficiary instead of petitioner. If such relief were granted, petitioner would avoid receipt of an asset (the IRA) on which income tax would be due. According to petitioner, decedent intended to benefit the Foundation and his spouse, but his estate plan "could have been structured in a more tax efficient manner ...." By "swap[ping]" assets, petitioner notes that decedent's intent to benefit her and charity, *i.e.*, the Foundation, will be carried out "more tax efficiently." Neither the Foundation nor the Attorney General of the State of New York has opposed the application.

Courts have the power to reform an instrument, *i.e.*, to add, excise, change or transpose language, if doing so would effectuate a decedent's intent (*see e.g. Matter of Snide*, 52 NY2d 193 [1981]). As a general rule, courts will rarely reform a testamentary or trust instrument to correct a mistake (*see e.g. id.; Matter of Dickinson,* 273 AD2d 89 [1st Dept 2000]) unless the reformation is required to rescue the instrument from a

circumstance that threatens to subvert the intent of the testator or grantor to maximize available tax exemptions or deductions (*see e.g. Matter of Martin*, 146 Misc 2d 144 [Sur Ct, New York County 1989]; *Matter of Choate*, 141 Misc 2d 489 [Sur Ct, New York County 1988]; *Matter of Lepore*, 128 Misc 2d 250 [Sur Ct, Kings County 1985). These tax-related reformations are normally sought to cure an instrument's failure to meet the technical requirements of the Internal Revenue Code ("IRC") because of a drafting error (*see e.g. Matter of Gottfried,* NYLJ, Apr. 11, 1997, at 46, col 4 [Sur Ct, New York County 1997]) or because of a subsequent change in law (*see e.g. Matter of Choate*, 141 Misc 2d 489, *supra*).

By contrast, the reformation requested here is prompted by neither a drafting error nor a subsequent change in law. Several years after executing his will and trust, decedent himself thwarted the tax efficiency of his own estate plan by making petitioner the beneficiary of the IRA. There is nothing in the record indicating why, after executing these estate planning instruments, decedent chose to leave additional assets to his wife in this manner or why, in the four years before his death, he did not take steps to cure the unfavorable tax consequences of

his choice of IRA beneficiary.[1]

Petitioner relies on the general presumption that those executing testamentary instruments intend to minimize taxes (*see e.g. Matter of Lepore*, 128 Misc 2d 250, *supra*). However, that presumption has been applied to support tax-related reformations where there was a drafting error or a change in law and the intent of the testator to secure the specific tax advantages sought through reformation/construction was clear (*see e.g. Matter of Choate*, 141 Misc 2d 489, *supra; Matter of Marino*, NYLJ, Nov. 5, 2007, at 43, col 4 [Sur Ct, Suffolk County 2007]; *cf. Matter of Kaskel*, 146 Misc 2d 278 [Sur Ct, New York County 1989] [will executed years before enactment of first generation skipping transfer tax ("GST") reformed to preserve the surviving spouse's GST tax exemption because, among other things, language of will indicated testator intended to minimize/postpone taxes related to grandchildren). Thus, in *Matter of Dunlop* (162 Misc 2d 329 [Sur Ct, Hamilton County 1994], the court refused to reform an instrument to secure GST exemptions for decedent and his spouse where testator expressed an intent to maximize only the marital deduction and was silent as to the GST, which had been in

[1] According to petitioner, at some unspecified time, decedent's estate planning attorney (who post-deceased decedent) had suggested that decedent leave the IRA to charity and leave certain non-IRA accounts to petitioner rather than to charity, but shortly thereafter - a characterization that leaves too much to conjecture - grantor became too ill to make the necessary changes.

existence when the will was drafted.

Petitioner has offered no authority to support the reformation of a clear and unambiguous instrument in order to remedy the adverse tax consequences of poor estate planning. Although the court is sympathetic to petitioner's regret that grantor's decision to leave her additional assets left her with an additional tax burden as well, nothing in the trust or the will indicates that decedent intended to minimize the income tax consequences of distributions to any beneficiary. Indeed, in both instruments, decedent indicated that he was neutral as to the tax consequences of distributions by giving his fiduciaries the power to distribute assets without regard to "income tax basis." The IRA beneficiary designation is, of course, silent on this issue.

To reform instruments such as those at issue here based only upon the presumption that one who executes testamentary instruments intends to minimize taxes would expand the reformation doctrine beyond recognition and would open the flood gates to reformation proceedings aimed at curing any and all kinds of inefficient tax planning (*see Matter of Manville*, 112 Misc 2d 355 [Sur Ct, Westchester County 1982]; *see also Matter of Rubin*, 4 Misc 3d 634, 640 [Sur Ct, New York County 2004] [rejecting argument that presumption applied in reformation case where the instrument did not contain "technical drafting errors"]). As the Appellate Division, First Department, stated in

Matter of Dickinson (273 AD2d 89, 90, *supra*), a case in which the court affirmed dismissal of a reformation proceeding:

> "'When the purpose of the testator is reasonably clear by reading his words in their natural and common sense, the courts have not the right to annul or pervert that purpose upon the ground that a consequence of it might not have been thought of or intended by him (*Matter of Tamargo*, 220 NY 225, 228 [1917].'"

Based upon the foregoing, the petition is denied.

This decision constitutes the order of the court.

Dated: June 28, 2016

S U R R O G A T E

162 A.D.3d 564
75 N.Y.S.3d 422 (Mem)

IN RE Charles SUKENIK, Deceased.

Vivian J. Sukenik, Petitioner–Appellant.

6949
6950
File 20A/14

Supreme Court, Appellate Division, First Department, New York.

ENTERED: JUNE 21, 2018

Farrell Fritz, P.C., Uniondale (Eric W. Penzer of counsel), for appellant.

Richter, J.P., Tom, Mazzarelli, Gesmer, Moulton, JJ.

Decree, Surrogate's Court, New York County (Nora S. Anderson, S.), entered November 16, 2016, pursuant to an order, same court and Surrogate, entered June 28, 2016, which denied the petition to reform an inter vivos trust and designation on an IRA beneficiary form, unanimously reversed, on the law, and the petition granted, without costs. Appeal from above order unanimously dismissed, without costs, as subsumed in the appeal from the decree.

The petition should have been granted. Decedent's intent to minimize taxes and provide for his wife of 39 years was apparent in the donative instruments. The Will and Trust agreements demonstrated his intent to take full advantage of all deductions and exemptions provided by law. For example, Article One, paragraph C of the Trust agreement specifically stated that the Trust funds could be transferred to the philanthropic fund only if it was a tax exempt entity, and Article Three authorized the trustee to sell assets in order to minimize taxes payable by beneficiaries. Article Eleventh of the Will also permitted the executor to make certain elections in order to reduce taxes. Furthermore, the presumption that testators intend to take full advantage of tax deductions and exemptions, the lack of opposition, including by the State of New York, and the presumption in favor of widows, all favor petitioner's requested reformation (*see e.g. Matter of Berger,* 57 A.D.2d 591, 393 N.Y.S.2d 600 [2d Dept. 1977] ; *Matter of Hicks,* 10 Misc.3d 1078[A], 2006 N.Y. Slip Op. 50118[U], 2006 WL 250508 [Sur. Ct., Nassau County 2006] ; *Matter of Lepore,* 128 Misc.2d 250, 492 N.Y.S.2d 689 [Sur. Ct., Kings County 1985]).

Reprinted with permission.

151 A.D.3d 662
Supreme Court, Appellate Division, First Department, New York.

In re FRENCH–AMERICAN AID FOR FILE CHILDREN, INC., et al., Petitioners–Respondents,
Joerg Klebe, Objectant–Appellant,
Eric T. Schneiderman, Attorney General, Respondent–Respondent.

June 29, 2017.

Attorneys and Law Firms

John A. Barone, Bronx, for appellant.

***851** Greenfield Stein & Senior, LLP, New York (Gary B. Freidman of counsel), for French–American Aid for Children, Inc., respondent.

Eric T. Schneiderman, Attorney General, New York (Seth M. Rokosky of counsel), for Attorney General, respondent.

Opinion

Decree, Surrogate's Court, New York County (Rita Mella, S.), entered June 9, 2016, inter alia, adjudging that petitioner's revocation of a trust of which objectant is a trustee was valid, unanimously affirmed, without costs.

Objectant's contention that petitioner did not properly revoke the trust because it used Estates, Powers and Trusts Law (EPTL) § 7–1.9(a) instead of § 8–1.1.(c)(2) is unavailing. Before 1985, cases held that a charitable trust could use the predecessor of EPTL 7–1.9(a) (*see e.g. Hanover Bank v. United Brethren's Church on Staten Is.,* 134 N.Y.S.2d 356, 361–362 [Sup.Ct., N.Y. County 1954]). In 1985, EPTL 7–1.9 was amended to add subsection c, which provided that "[a] trust ... wholly benefitting one or more charitable beneficiaries *may* be terminated as provided for by" EPTL 8–1.1(c)(2) (emphasis added). Nothing in either the text of EPTL 7–1.9(c) or the legislative history thereof indicates that charitable trusts were restricted to EPTL 8–1.1(c)(2) after 1985 (*see generally Allstate Ins. Co. v. Belt Parkway Imaging, P.C.,* 78 A.D.3d 592, 914 N.Y.S.2d 5 [1st Dept.2010]). Moreover, post-amendment cases indicate that charitable trusts may still use EPTL 7–1.9(a) (*see e.g. Board of Trustees of Museum of Am. Indian, Heye Found. v. Board of Trustees of Huntington Free Lib. & Reading Room,* 197 A.D.2d 64, 85–86, 610 N.Y.S.2d 488 [1st Dept.1994], *lv. denied* 86 N.Y.2d 702, 631 N.Y.S.2d 606, 655 N.E.2d 703 [1995]; *Matter of Forester,* NYLJ, Dec. 3, 2001, at 17, col. 3 [Sur.Ct., N.Y. County 2001]).

SWEENY, J.P., RENWICK, ANDRIAS, KAPNICK, KAHN, JJ., concur.

All Citations

151 A.D.3d 662, 54 N.Y.S.3d 850 (Mem), 2017 N.Y. Slip Op. 05324

End of Document

© 2019 Thomson Reuters. No claim to original U.S. Government Works.

Reprinted with Permission.

Avoiding Conflicts Among Trust Clients

Hon. Teresa B. Whelan
Suffolk County Surrogate's Court, Riverhead

Eric W. Penzer, Esq.
Farrell Fritz, P.C., Uniondale

Fact Pattern/Questions

In 2010, Robert,[1] then 85 years of age, executed a pour-over Last Will & Testament along with a Revocable Trust. Both instruments were drafted by Natalia,[2] Robert's close friend and trusted attorney for many years. The trust provides that during Robert's lifetime, and that of his (second) wife, Jennifer,[3] the trustees – Robert and his son and daughter from his previous marriage, Laurence and Jill[4] -- have absolute discretion to distribute income and/or principal to Robert and/or Jennifer, as they may determine in their sole and absolute discretion or as Robert may direct in writing.

The trust agreement provides that, upon Robert's death, the assets of the trust are to be held in a continuing marital trust for Jennifer's lifetime benefit. Laurence and Jill are the nominated trustees. The marital trust provides for the payment of all income, and discretionary distributions of principal, to Jennifer. Upon Jennifer's death, the trust principal is payable in equal shares to Laurence's daughter, Ilene, and Jill's son, Ron; Jill's other son, Phillip, is currently incarcerated in connection with a non-violent felony and the trust contains no provision for his benefit.[5]

Shortly after its creation, Robert funded the trust with all of his assets, or so he thought. Robert, Laurence, and Jill administered the trust until Robert's death in 2015, after which Laurence and Jill administered the marital trust. At all times, Natalia provided legal counsel to the trustees.

Since Robert's death, Jill, a non-practicing lawyer and investment advisor, has been the laboring oar in the administration of the trust; Laurence has been passive. Jill has managed the investment of trust assets and fielded Jennifer's frequent requests for distributions of principal. Jill invested the trust assets conservatively, with the goal of providing a generous stream of income for Jennifer. She granted the majority of Jennifer's distribution requests, without regard for her other assets. As a result, the trust has significantly decreased in value over its term. In connection with the principal invasions, Jill did not consult with Laurence before agreeing to Jennifer's requests

---

[1] Not to be confused with the Section Chair, Robert M. Harper, Esq.
[2] No relation to the Section's Immediate Past Chair, Natalia Murphy, Esq.
[3] Definitely not our Secretary, Jennifer Hillman, Esq.
[4] Not our Section's Chairperson-Elect Jill Beier, Esq., or Treasurer Laurence Kaiser, Esq.
[5] Neither Ilene nor Ron have ever served as Chairs of the Section, unlike Ilene Cooper, Esq., and Ronald Weiss, Esq. Moreover, our Past Chair Phillip Burke has, to our knowledge, never been incarcerated.

Jennifer has now died. Laurence's estranged daughter, Ilene, through her counsel Marion,[6] brought a Surrogate's Court proceeding seeking to compel Jill and Laurence to account for their proceedings as trustees of the trust. It is anticipated, based on preliminary discussions with her counsel, that Ilene will object to the accounting. She is of the opinion that the investment of trust assets was improper as the trustees disregarded the interests of the remainder beneficiaries. She also believes that the trustees abused their discretion in making excessive principal distributions to Jennifer, who had sufficient assets of her own and died with a substantial estate (which largely benefits her son from a prior marriage, Carl[7]). Ron does not share Ilene's opinions concerning the administration of the trust and seeks to support his mother and uncle.

[6] No relation to Past Chair Marion Fish, Esq.
[7] Carl, unlike our Past Chair Carl Baker, Esq., is an actor/waiter in Hollywood.

Questions

1. After an initial meeting, Jill seeks to retain you to represent her and Laurence, as well as Ron (Jill's son and remainder beneficiary of the marital trust), in the accounting proceeding. Can you take on the joint representation of all three prospective clients?

2. A conflict check has revealed that in the mid-1990's, your law partner, Meg,[8] represented Ilene and her husband, Gary.[9] After speaking with Meg, you learn that she represented them in the purchase of their home and also drafted their wills. Does Meg's prior representation of Ilene and Gary preclude you from undertaking representation of Jill and Laurence, adverse to Ilene, in the trust proceeding?

3. You have appeared in the proceeding on behalf of Jill and Laurence. In conference with the Court-Attorney Referee on the return date of citation, you learn from Ilene's counsel, Marion, that before Ilene hired her, Ilene discussed this matter with her friend, Betsy,[10] who is an employment law partner in your law firm, over a social lunch at the country club that they both belong to, disclosing her thoughts, strategies, and objectives. Separately, Ilene consulted, but did not hire, your law partner Ira. According to Marion, Ilene had several telephone conversations with Ira and met with him once. During that meeting, she showed him various documents concerning the matter and disclosed her thoughts, strategies, and objectives. She ultimately decided not to hire Ira and retained Marion instead. Marion has demanded that you withdraw as Jill and Laurence's counsel of record, threatening a disqualification motion if you refuse. Is there merit to Marion's position?

4. Jill and Laurence recently discovered a relatively small, but still substantial, bank account owned by Robert and never retitled to his trust. Accordingly, they hired Natalia to commence a proceeding on their behalf to probate Robert's will. Phillip (who was cited in the probate proceeding by reason of a bequest to him of Robert's valuable collection of duck decoys in a prior will), having served his prison sentence, appeared on the return date of citation though counsel, who requested examinations pursuant to SCPA §

[8] Meg is not related to our Past Chair Magdalen Gaynor, Esq.
[9] A genealogist has concluded that Gary is, coincidentally, a distant relative of Past Chair Gary Freidman, Esq. The two have never met.
[10] Not our Past Chair Elizabeth Hartnett, Esq.

1404 and made clear in conference Phillip's intention to object to probate and, additionally, to commence a proceeding to invalidate the trust. Counsel objects to Natalia's continued representation of Jill and Laurence in the probate proceeding, arguing that she is disqualified because she drafted the will and supervised its execution, and by reason of her representation of the trustees of the trust.

RULES OF PROFESSIONAL CONDUCT

RULE 1.7:
CONFLICT OF INTEREST: CURRENT CLIENTS

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:

(1) the representation will involve the lawyer in representing differing interests; or

(2) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

RULE 1.9:
DUTIES TO FORMER CLIENTS

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

(b) Unless the former client gives informed consent, confirmed in writing, a lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client:

(1) whose interests are materially adverse to that person; and

(2) about whom the lawyer had acquired information protected by Rules 1.6 or paragraph (c) of this Rule that is material to the matter.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) use confidential information of the former client protected by Rule 1.6 to the disadvantage of the former client, except as these Rules would permit or require with respect to a current client or when the information has become generally known; or

(2) reveal confidential information of the former client protected by Rule 1.6 except as these Rules would permit or require with respect to a current client.

RULE 1.18:
DUTIES TO PROSPECTIVE CLIENTS

(a) A person who discusses with a lawyer the possibility of forming a client-lawyer relationship with respect to a matter is a "prospective client."

(b) Even when no client-lawyer relationship ensues, a lawyer who has had discussions with a prospective client shall not use or reveal information learned in the consultation, except as Rule 1.9 would permit with respect to information of a former client.

(c) A lawyer subject to paragraph (b) shall not represent a client with interests materially adverse to those of a prospective client in the same or a substantially related matter if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter, except as provided in paragraph (d). If a lawyer is disqualified from representation under this paragraph, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter, except as provided in paragraph (d).

(d) When the lawyer has received disqualifying information as defined in paragraph (c), representation is permissible if:

(1) both the affected client and the prospective client have given informed consent, confirmed in writing; or

(2) the lawyer who received the information took reasonable measures to avoid exposure to more disqualifying information than was reasonably necessary to determine whether to represent the prospective client; and

(i) the firm acts promptly and reasonably to notify, as appropriate, lawyers and nonlawyer personnel within the firm that the personally disqualified lawyer is prohibited from participating in the representation of the current client;

(ii) the firm implements effective screening procedures to prevent the flow of information about the matter between the disqualified lawyer and the others in the firm;

(iii) the disqualified lawyer is apportioned no part of the fee therefrom; and

(iv) written notice is promptly given to the prospective client; and

(3) a reasonable lawyer would conclude that the law firm will be able to provide competent and diligent representation in the matter.

(e) A person who:

(1) communicates information unilaterally to a lawyer, without any reasonable expectation that the lawyer is willing to discuss the possibility of forming a client-lawyer relationship; or

(2) communicates with a lawyer for the purpose of disqualifying the lawyer from handling a materially adverse representation on the same or a substantially related matter, is not a prospective client with the meaning of paragraph (a).

RULE 3.7:
LAWYER AS WITNESS

(a) A lawyer shall not act as advocate before a tribunal in a matter in which the lawyer is likely to be a witness on a significant issue of fact unless:

(1) the testimony relates solely to an uncontested issue;

(2) the testimony relates solely to the nature and value of legal services rendered in the matter;

(3) disqualification of the lawyer would work substantial hardship on the client;

(4) the testimony will relate solely to a matter of formality, and there is no reason to believe that substantial evidence will be offered in opposition to the testimony; or

(5) the testimony is authorized by the tribunal.

(b) A lawyer may not act as advocate before a tribunal in a matter if:

(1) another lawyer in the lawyer's firm is likely to be called as a witness on a significant issue other than on behalf of the client, and it is apparent that the testimony may be prejudicial to the client; or

(2) the lawyer is precluded from doing so by Rule 1.7 or Rule 1.9.

CASE LAW

46 Misc.3d 1207(A)
Unreported Disposition
(The decision is referenced in
the New York Supplement.)
Supreme Court, New York County, New York.

GEM HOLDCO, LLC, Gem Ventures, Ltd., Global Emerging Markets North America, Inc., Christopher Brown, Edward Tobin, and Demetrios Diakolios, Plaintiffs,
v.
CHANGING WORLD TECHNOLOGIES, L.P., CWT Canada II Limited Partnership, Resource Recovery Corporation, Jean Noelting, Ridgeline Energy Services, Inc., Dennis Danzik, Bruce A. MacFarlane, Tony Ker, Richard Carrigan, Douglas Johnson, and Kelly Sledz,, Defendants.

No. 650841/2013.
|
Jan. 9, 2015.

Attorneys and Law Firms

Greenberg Traurig LLP, for the Ridgeline Defendants.

Schlam Stone & Dolan LLP, for the CWT Defendants.

Opinion

SHIRLEY WERNER KORNREICH, J.

***1** Motion sequence numbers 008 and 009 are consolidated for disposition.

Defendants Changing World Technologies, L.P. (CWT), Ridgeline Energy Services, Inc. (Ridgeline) and Dennis Danzik (the Ridgeline Defendants) move to disqualify Schlam Stone & Dolan LLP (Schlam Stone) from serving as counsel for defendants CWT Canada II Limited Partnership (CWT Canada), Resource Recovery Corporation (RRC), and Jean Noelting (the CWT Defendants). Seq. 008.[1] The CWT Defendants oppose and move to supplement the record on the disqualification motion. Seq. 009. The motions are denied for the reasons that follow.

Background & Procedural History

The court assumes familiarly with its decisions on the motions to dismiss the first and third amended complaints (respectively, the FAC and the TAC), which set forth the allegations in this case. *See* Dkt. 120 & 201. When this action was originally commenced on March 11, 2013, the only alleged wrongdoers named as defendants were CWT Canada and RRC. CWT also was named as a defendant because plaintiff GEM Holdco, LLC (GEM) sought to enjoin the CWT Defendants from selling CWT to the Ridgeline Defendants.[2] Schlam Stone was retained and appeared on behalf of those originally named defendants. Bruce A. MacFarlane, RRC's director, chose to retain Schlam Stone because of his decade-long satisfaction with the legal services of its lead counsel, Jeffrey M. Eilender, Esq.

On April 29, 2013, GEM filed the FAC, asserting claims against the Ridgeline Defendants. Under the UPI (discussed in the prior decisions), the CWT Defendants have to pay for the Ridgeline Defendants' legal costs in this action. MacFarlane, therefore, suggested to Danzik, Ridgeline's principal, that Schlam Stone represent all defendants in this litigation. At the time, GEM's claims against both sets of defendants concerned the same issues (the subscription requests) and, hence, their incentives in this litigation appeared aligned.

After meeting with Mr. Eilender, Danzik signed a retainer letter dated May 2, 2013 (the Retainer Letter). *See* Dkt. 212. The Retainer Letter expressly and extensively contemplates future conflicts between the CWT Defendants and the Ridgeline Defendants:

> At the present time, based upon the facts known to us, including those supplied to us by you, we do not perceive any actual conflict of interest among CWT, RRC, CWT Canada, Ridgeline, you personally, and Mr. Noelting. We understand, of course, that in this case of joint representation, **there is a possibility that RRC, CWT Canada's and Mr. Noelting's status as ongoing clients of our firm could be perceived as adversely affecting our ability to represent you, Ridgeline, and CWT with complete loyalty and exercise**

> **of independent judgment. Certainly, joint representation can result in shared and divided loyalty.** Although we are not currently aware of any actual or reasonably foreseeable adverse effects of such shared or divided loyalty because everyone's interests appear to be aligned, **it is possible that issues may arise as to which our representation of you, Ridgeline, or CWT may be materially limited by our representation of RRC, CWT Canada, or Mr. Noelting.** We bring this possibility to your attention **so that you can decide for yourself whether you are sufficiently concerned with this possibility that you do not wish joint representation.** We also believe that there are significant advantages of joint representation. These include economy, efficiency, and the presentation of a united front based on the common interests of everyone in vigorously defending against GEM's claims.

***2** Dkt. 212 at 3 (emphasis added). The Retainer Letter continues:

> We anticipate that **if a conflict or dispute were to arise or if for any other reason joint representation does not continue, we would continue to represent RRC, CWT Canada, and Mr. Noelting.** Accordingly, we are now asking you, Ridgeline, and CWT to consent to our continued and future representation of RRC, CWT Canada, and Mr. Noelting, and to **agree not to assert any such conflict of interest or seek to disqualify us from representing RRC, CWT, and Mr. Noelting in this or any other matter, notwithstanding any adversity or litigation that may exist or develop.** By signing and returning to us the agreement and consent set forth at the end of this letter, you, Ridgeline, and CWT **are consenting to such an arrangement and waive any conflicts regarding that arrangement.**

Id. (emphasis added).

The Retainer Letter further clarifies what would happen if Schlam Stone withdrew from representing the Ridgeline Defendants:

> Notwithstanding such waiver and consent, depending on the circumstances, there remains some degree of risk that we would be disqualified from representing anyone, including RRC, CWT Canada, and Mr. Noelting, in the event of a dispute.
>
> In the event of our withdrawal from representation of you, Ridgeline, or CWT in this matter, you, Ridgeline, or CWT would likely be required to retain new counsel who might not be as familiar with the case as our firm would be, and substantial expense may be involved as such new counsel familiarizes him/herself with the case.

Id. at 4. The Retainer Letter discloses that the Ridgeline Defendants' confidential, attorney-client communications would be shared with the CWT Defendants. *Id.*

Immediately thereafter, Schalm Stone began representing the Ridgeline Defendants. On June 10, 2013, Schalm Stone filed a motion to dismiss the FAC, which the court decided in an order dated December 24, 2013. At a February 6, 2014 preliminary conference, a discovery schedule was ordered, which set a June 30, 2014 deadline for the production of ESI and a compliance conference for July 31, 2014. *See* Dkt. 135. Three weeks before that conference, on July 10, 2014, the parties called the court with ESI disputes. *See* Dkt. 182. Apparently, among other issues, defendants did not produce their ESI by the June 30 deadline. Following the court's instructions, on July 29, 2014, the parties filed a joint letter outlining their disputes. *See* Dkt. 192. Additionally, as directed by the court, Mr. Eilender filed an affirmation explaining why certain defendant custodians' ESI was not produced. *See* Dkt. 189. Mr. Eilender explained that he did not produce any ESI from the Ridgeline Defendants because his relationship with them had broken down, leading Mr.

 © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Eilender to file a motion to withdraw on July 25, 2014. Mr. Eilender continues to represent the CWT Defendants.

After the letter and affirmation were filed, the parties (plaintiffs' counsel, Mr. Eilender, and Mr. Danzik, who participated *pro se*) called the court to discuss adjourning the motion to withdraw and the July 31 conference. The court adjourned the motion until August, but it was agreed that plaintiffs and the CWT Defendants would appear on July 31 to discuss their ESI, but all disputes concerning the Ridgeline Defendants' ESI would be resolved at a September 11, 2014 conference, at which time new counsel for the Ridgeline Defendants had to be ready to discuss such matters. *See* Dkt. 193. The July 31 conference was held. Two weeks later, the parties resolved Mr. Eilender's withdrawal motion by stipulation dated August 12, 2014, pursuant to which Greenberg Traurig LLP appeared as new counsel on behalf of the Ridgeline Defendants. *See* Dkt. 196. Additionally, in an order dated August 28, 2014, the court decided the pending motion to dismiss the TAC.

***3** On September 10, 2014, the parties submitted another joint discovery letter in advance of the September 11 conference. *See* Dkt. 204. In that letter, the parties informed the court that plaintiffs and the Ridgeline Defendants had reached a settlement. At the September 11 conference, many of the discovery disputes were resolved, and further production deadlines were agreed to in a stipulation filed the following day. *See* Dkt. 207. However, at that conference, counsel for the Ridgeline Defendants discussed moving to disqualify Schalm Stone from representing the CWT Defendants, even though the Ridgeline Defendants had already settled with plaintiffs. A continuing conflict supposedly still existed due to forthcoming cross-claims by the CWT Defendants against the Ridgeline Defendants and recently commenced Canadian litigation between the parties, in which the Ridgeline Defendants allege they were fraudulently induced to enter into the UPI because they were supposedly lied to about CWT's plant producing renewable diesel fuel (even though Danzik was running the company and likely was in a position to conduct due diligence to ensure that the plant was producing the right kind of fuel). That lawsuit was commenced in Canada pursuant to the UPI's forum selection clause.

The Ridgeline Defendants filed the instant motion to disqualify on September 19, 2014. On September 22, 2014, Schlam Stone, on behalf of the CWT Defendants, filed an answer and third-party complaint, asserting counterclaims, cross-claims, and third-party claims. *See* Dkt. 217 & 219. The CWT Defendants opposed the instant motion on October 14, and the Ridgeline Defendants replied on October 22. Oral argument was scheduled for October 28.

However, two days before oral argument, on October 26, 2014, the CWT Defendants filed a sur-reply [Dkt. 251–257], which the court has not considered. After oral argument on October 28, the court reserved decision on the instant motion, and expressly denied Mr. Eilender's request to consider his sur-reply papers. *See* Dkt. 277 (10/28/14 Tr. at 16–17). To ensure an appeal of right under CPLR 5701(a)(2), [3] on November 4, 2014, Mr. Eilender filed a motion for leave to consider his sur-rely, which the court is now denying, with one caveat. As discussed below, the court has considered the case of *Zador Corp. v. Kwan,* 31 CalApp4th 1285 (1995) as persuasive authority; it was discussed at oral argument. [4] All other arguments made in the sur-reply have not been considered and, in any event, are irrelevant because the motion is, as explained below, decided in the CWT Defendants' favor based on arguments made in the original briefing.

Discussion

It is well established that the right to be represented by counsel of one's choice is "a valued right [and] any restrictions must be carefully scrutinized." *Ullmann–Schneider v. Lacher & Lovell–Taylor PC,* 110 AD3d 469, 469–70 (1st Dept 2013), quoting *S & S Hotel Ventures Ltd. Partnership v. 777 S.H. Corp.,* 69 N.Y.2d 437, 443 (1987). Moreover, "in the context of an ongoing lawsuit, disqualification ... can [create a] strategic advantage of one party over another." *Id.* "[M]otions to disqualify are frequently used as an offensive tactic, inflicting hardship on the current client and delay upon the courts Such motions result in a loss of time and money, even if they are eventually denied. This Court and others have expressed concern that such disqualification motions may be used frivolously as a litigation tactic when there is no real concern that a confidence has been abused." *Solow v. W.R. Grace & Co.,* 83 N.Y.2d 303, 310 (1994); *see Mayers v. Stone Castle Partners, LLC,* 2015 WL 94652, at *3 (1st Dept Jan. 8, 2015) (disqualification motions made for "tactical purposes" should be denied, even if confidential information was transmitted). For these reasons, "movant

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

must meet a heavy burden of showing that disqualification is warranted." *Ullmann–Schneider,* 110 AD3d at 470, citing *Broadwhite Assocs. v. Truong,* 237 A.D.2d 162 (1st Dept 1997).

***4** As the Second Department recently explained:

> The disqualification of an attorney is a matter which rests within the sound discretion of the court. A party's entitlement to be represented in ongoing litigation by counsel of his or her own choosing is a valued right which should not be abridged absent a clear showing that disqualification is warranted, and the movant bears the burden on the motion. [It is improvident] to disqualify [a law firm when the former clients/current defendants executed a waiver in which they] specifically waived any conflict of interest that might arise from [the law firm's] representation of the plaintiff [if t]he waiver fully informed [ ] defendants of the potential conflict of interest[. B]y executing the waiver, [ ] defendants consented to have [the law firm] represent [plaintiff] notwithstanding that conflict.

Grovick Props., LLC v. 83–10 Astoria Blvd., LLC, 120 AD3d 471, 473–74 (2d Dept 2014) (citations and quotation marks omitted).

The Ridgeline Defendants argue that Schlam Stone may not represent the CWT Defendants because doing so would run afoul of Rules 1.7 and 1.9 of the New York Rules of Professional Conduct. *See* 22 NYCRR 1200. As the CWT Defendants correctly aver, Rule 1.7 governs conflicts of interest between current clients and, hence, is inapplicable because the instant motion concerns conflicts between current and former clients.[5] The Ridgeline Defendants concede this point. Rule 1.9, however, is applicable, since it governs duties to former clients. Rule 1.9 provides:

> (a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.
>
> (b) Unless the former client gives informed consent, confirmed in writing, a lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client:
>
> (1) whose interests are materially adverse to that person; and
>
> (2) about whom the lawyer had acquired information protected by Rules 1.6 or paragraph (c) of this Rule that is material to the matter.
>
> (c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:
>
> (1) use confidential information of the former client protected by Rule 1.6 to the disadvantage of the former client, except as these Rules would permit or require with respect to a current client or when the information has become generally known; or
>
> (2) reveal confidential information of the former client protected by Rule 1.6 except as these Rules would permit or require with respect to a current client.

It is undisputed that Rule 1.9 applies. It is further undisputed that, in the absence of a conflict waiver, Rule 1.9 would prohibit Schlam Stone from further representing the CWT Defendants in this action.

***5** The issue here is whether the conflict wavier in the Retainer Letter permits Schlam Stone to continue representing the CWT Defendants. The Ridgeline Defendants aver that the sort of confidential information shared with an attorney in a joint representation inherently gives rise to the very unfair advantages that Rule 1.9 seeks to prohibit. This concern, they argue, warrants disqualification. In opposition, the CWT

Defendants rightly explain that the Ridgeline Defendants have it backwards for reasons best articulated in *Zador:*

> [W]hen the prior representation involves joint clients, and the subsequent action relates to the same matter, the substantial relationship test adds nothing to disqualification analysis. This is because a substantial relationship between the former representation and the subsequent action is inherent in such situations. In other words, clients A and B are jointly represented by C until C discovers a conflict between the legal position of A and B. Client B retains separate counsel. Client A then sues Client B. In these circumstances, a substantial relationship will always exist between C's prior representation of B and the litigation between A and B In addition, although the substantial relationship test determines whether confidences were likely disclosed, in a joint client situation, confidences are necessarily disclosed. In fact, the joint client relationship is an exception to the attorney-client privilege.

Zador, 31 CalApp4th at 1294 (emphasis added).

Though the parties dispute whether confidential information was transmitted, this is both unremarkable and irrelevant for the reasons set forth in *Zador.* If the transmission of confidential information in a joint representation vitiated the validity of conflict waiver, notwithstanding the Retainer Letter's disclaimers to the contrary, virtually all conflict waivers would be ineffectual.

Unsurprisingly, as a result, New York courts have recognized that, where a valid conflict wavier exists, the traditional concerns about confidential information are inapposite. *See St. Barnabas Hosp. v. New York City Health & Hosps. Corp.,* 7 AD3d 83, 90 (1st Dept 2004). [6]

Indeed, the validity of conflict waivers is well established. *See Centennial Ins. Co. v. Apple Bldrs. & Renovators, Inc.,* 60 AD3d 506 (1st Dept 2009), citing *St. Barnabas,* 7 AD3d at 91; *see also Grovick,* 120 AD3d at 604. For a conflict waiver to be valid, the former client must provide informed consent. *St. Barnabas,* 7 AD3d at 9, citing *Schneider v. Saiber Schlesinger Satz & Goldstein, LLC,* 260 A.D.2d 321 (1st Dept 1999) and *Yasuda Trust & Banking Co., v. 250 Church Assocs.,* 206 A.D.2d 259 (1st Dept 1994); *see Snyder v. Snyder,* 57 AD3d 1528 (4th Dept 2008); *see also Ferolito v. Vultaggio,* 99 AD3d 19, 27 (1st Dept 2012) ("an attorney may represent such clients where a disinterested lawyer would believe that the lawyer can competently represent the interest of each client and that each consents to the representation after full disclosure of the implications of simultaneous representation as well as the advantages and risks involved").

***6** The Ridgeline Defendants further argue that the alleged fraud at issue in the new Canadian lawsuit merits deeming the conflict waiver unenforceable. [7] The Ridgeline Defendants maintain that at the time Danzik signed the conflict waiver, he was not in a position to provide informed consent because he assumed the interests of both sets of defendants were aligned. This, however, does not matter. Aside from the questionable nature of the fraud claim, [8] the very point of a conflict waiver is that some future, unforeseen conflict may arise, misaligning the incentives underlying the joint defense. That was made clear in the Retainer Letter.

Indeed, if the conflict was expected, it is unlikely a joint defense agreement would have been entered into. It is to no avail to allege that the other defendant secretly knew about a conflict, since if that mere allegation warranted disqualification, disqualification would be a *fait accompli.* Prior knowledge of the conflict is inherently intertwined with the merits of the claim giving rise to it, making it virtually impossible to adjudicate on a disqualification motion. Since, as here, it is premature to reach the merits on a disqualification motion, there is no way to rebut the alleged conflict. Ergo, if a claim of knowledge of the conflict were enough to warrant disqualification, disqualification would almost always result.

The Ridgeline Defendants, nonetheless, argue this does not matter and that equity militates in favor of disqualification in this case. The court disagrees. As the CWT Defendants persuasively argue, if disqualification

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

were warranted in this case, it would follow that virtually all conflict waivers would be unenforceable, a result which is at odds with this state's legal policy. Such a result would significantly impair the ability of co-defendants to mount a joint defense, leading to significant litigation inefficiencies and increased legal costs for litigants, who would unnecessarily have to hire more lawyers to perform duplicative and expensive work.

A review of the portion of the Retainer Letter cited earlier makes clear that Danzik provided informed consent. In fact, the Ridgeline Defendants do not meaningfully quibble with the general sufficiency of the waiver language in the Retainer Letter. Rather, they argue, disqualification is warranted because "[t]he facts here are extreme." *See* Dkt. 249 at 6. Simply put, they contend the joint defense agreement was predicated on the litigation being about a non-payment dispute with plaintiffs, not a fraudulent inducement case between defendants. *See id.* at 6–7 ("Had Danzik known the underlying transaction was a complete sham he would never have signed the [Retainer Letter] and agreed to a joint defense."). [9]

Leaving aside the merits of the fraud claim (which, additionally, may well have a reasonable reliance problem since Danzik was running the very company with the alleged bad diesel fuel for approximately 4 months before the UPI was executed and 6 months before agreeing to a joint defense), it is of no moment that the specifics of the conflict may not have been foreseen. The Retainer Agreement expressly contemplated unforeseen conflicts. *See* Dkt. 212 at 3 ("joint representation can result in shared and divided loyalty. Although we are not currently aware [10] of any actual or reasonably foreseeable [conflicts], it is possible that issues may arise as to which our representation of you may be materially limited by our representation of [the CWT Defendants] **We bring this possibility to your attention so that you can decide for yourself whether you are sufficiently concerned with this possibility that you do not wish joint representation.**") (emphasis added).

***7** Even though the specific nature of the conflict (i.e. dispute over the fuel) may not have been expressly foreseen, it was quite foreseeable a dispute may arise under the UPI. The UPI contains approximately 15 pages of robust representations and warranties, pre-closing covenants, and conditions precedent to closing. *See* Dkt. 241 at 21–35. The UPI also contains extensive provisions concerning disputes arising under the UPI, including choice of law and forum selection clauses. *See id.* at 35–42. Conflicts arising from the sale of a company are not rare occurrences, and Danzik knows that. After all, Danzik, aside from being a sophisticated businessman, represents himself to be both a lawyer and a scientist. *See* Dkt. 234 at 8 (Danzik told MacFarlane that he is a scientist and "an experienced litigator").

Of course, at the time of sale, one cannot predict every possible permutation of conflict that may lead to litigation. If such foresight were required, conflict waivers would be ineffectual. There is no rule that the specific details of a conflict be itemized in a waiver for it to be valid. Rather, the rule of informed consent simply requires the client to be in a position to make an informed decision about whether a potential conflict is a risk worth taking on for the benefits of joint representation. Here, a dispute over the sale was not unforeseeable, and therefore, the wavier covers it. For these reasons, regardless of the existence of a conflict between the CWT Defendants and the Ridgeline Defendants and regardless of the fact that Schlam Stone may be privy to the Ridgeline Defendants' confidential information, by signing the Retainer Letter, Danzik waived his right to seek Schlam Stone's disqualification. "To fail to give effect to [Danzik's] consent under these circumstances would constitute an unwarranted interference with [the CWT Defendants'] right to retain counsel of [their] choice, and with [Mr. Eilender's] ability to retain a longstanding client." *See St. Barnabas,* 7 AD3d at 84. Accordingly, it is

ORDERED that the motion by defendants Changing World Technologies, L.P., Ridgeline Energy Services, Inc., and Dennis Danzik to disqualify Schlam Stone & Dolan LLP from serving as counsel for defendants CWT Canada II Limited Partnership, Resource Recovery Corporation, and Jean Noelting is denied; and it is further

ORDERED that a status conference will be held on January 29, 2015 after oral argument on Motion 10, before which the parties must meet and confer about all outstanding discovery disputes, which will be resolved at the conference.

All Citations

46 Misc.3d 1207(A), 7 N.Y.S.3d 242 (Table), 2015 WL 120843, 2015 N.Y. Slip Op. 50014(U)

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Footnotes

1 Former defendants Tony Ker and Richard Carrigan were part of this motion, but since there are no longer any outstanding claims against them, they have withdrawn from the motion without prejudice. *See* Dkt. 249 at 7 n. 2.

2 The court denied GEM's injunction motion in an order dated March 13, 2013. *See* Dkt. 53.

3 *See 1471 Second Corp. v. Nat of N.Y. Corp.,* 2014 WL 7372925 (2d Dept Dec. 30, 2014), citing *Serradilla v. Lords Corp.,* 12 AD3d 279, 280 (1st Dept 2004).

4 Though *Zador* is a California case decided under California law, New York law is similar. More importantly, as set forth below, *Zador,* which involved similar circumstances and a virtually identical conflict waiver, contains an excellent discussion of how to approach conflicts arising during a joint representation. It should be noted that *Zador,* decided in 1995, continues to be widely cited by California state and federal courts. *See, eg., S.E .C. v. Tang,* 831 FSupp2d 1130, 1140 (ND Cal 2011) (noting that *Zador* is the leading California case on joint representations); *see also Sharp v. Next Entm't, Inc.,* 163 CalApp4th 410, 429–30 (2008).

5 *See Anderson & Anderson LLP–Guangzhou v. N. Am. Foreign Trading Corp.,* 45 Misc.3d 1210(A), at *3 (Sup Ct, N.Y. County 2014) (noting that the Rule covers, *inter alia,* conflicts between the lawyer and the client).

6 Therefore, the Ridgeline Defendants' policy based arguments, such as preventing "the appearance of impropriety" [*see Solow,* 83 N.Y.2d at 309], are also irrelevant. *See Develop Don't Destroy Brooklyn v. Empire State Dev. Corp.,* 31 AD3d 144, 153 (1st Dept 2006) ("the motion court erred in finding that the appearance of impropriety' warranted disqualification of [ ] counsel. In doing so, the court ignored three basic principles of law on this subject: that if the representation does not violate another ethical or disciplinary rule, there can be no appearance of impropriety") (emphasis added); *see also Mayers,* 2015 WL 94652.

7 They also argue that the CWT's Defendants' cross-claims, which, *inter alia,* also concern alleged breaches of the UPI, warrant disqualification. However, as discussed herein, disputes under the UPI were foreseeable and, thus, are not grounds for disqualification.

8 Section 3.6 of the UPI states that, except as otherwise warranted in the contract, the buyer is accepting the assets as is, with no warranty as to their condition or suitability for any purpose. *See* Dkt. 241 at 24.

9 It should be noted that the Ridgeline Defendants cite no authority supporting the arguments that the date the conflict arose or that it involved related litigation are bases for disqualification. To the contrary, such arguments have been rejected by the First Department. *See St. Barnabas,* 7 AD3d at 92 (rejecting argument "that the retention letter waives only those future conflicts that might arise from the employment matters, for which St. Barnabas retained the Rosenman firm at the time the letter was executed, and not conflicts arising from the SMS matter, for which St. Barnabas did not retain the Rosenman firm until two years later").

10 Mr. Eilender, in a sworn affirmation, represents that he did not know about the fuel issue at the time. *See* Dkt. 240 at 17. The court takes him at his word, since there is no reason to believe that Mr. Eilender would risk his reputation or license by lying. Additionally, in reply, Danzik protests that Mr. Eilender never discussed the express terms of the Retainer Letter with him. However, Danzik, who is quite sophisticated, is not legally entitled to maintain ignorance of the express terms of the Retainer Agreement and the conflict waiver contained therein. *See Golden Stone Trading, Inc. v. Wayne Electro Sys., Inc.,* 67 AD3d 731, 732 (2d Dept 2009) ("A party who executes a contract is presumed to know its contents and to assent to them"), accord *Metzger v. Aetna Ins. Co.,* 227 N.Y. 411, 416 (1920); *see also Holcomb v. TWR Express, Inc.,* 11 AD3d 513, 514 (2d Dept 2004) (even those illiterate in English are not excused from understanding the contract). This is particularly true here given Danzik's sophistication, education and law degree. Moreover, all Rule 1.9 requires is written consent. *See Grovick,* 120 AD3d at 604 ("The waiver fully informed the Astoria defendants of the potential conflict of interest and, by executing the waiver, the Astoria defendants consented to have Brooks represent them notwithstanding that conflict"). In other words, it is the content of the writing and the client's signature that matters. An inquiry into what was discussed between the attorney and the client would be burdensome, intrusive, and utterly irrelevant. Rule 1.9, like most writing requirements (e.g., the statute of frauds), obviates the need to test the veracity of alleged subsequent or contemporaneous oral representations that contradict the writing.

End of Document

© 2019 Thomson Reuters. No claim to original U.S. Government Works.

Reprinted with Permission

130 A.D.3d 506, 14 N.Y.S.3d 14, 2015 N.Y. Slip Op. 06040

****1** Gem Holdco, LLC, et al., Plaintiffs
v
Ridgeline Energy Services, Inc., et al., Appellants-Respondents, and CWT Canada II Limited Partnership et al., Respondents-Appellants, et al., Defendants. (And a Third-Party Action.)

Supreme Court, Appellate Division,
First Department, New York
15694N, 650841/13
July 9, 2015

CITE TITLE AS: Gem Holdco, LLC v Ridgeline Energy Servs., Inc.

HEADNOTE

Attorney and Client
Disqualification
Waiver of Conflict of Interest

Greenberg Traurig, LLP, New York (William C. Silverman of counsel), for appellants-respondents.
Schlam, Stone & Dolan LLP, New York (Jeffrey M. Eilender of counsel), for respondents-appellants.

Order, Supreme Court, New York County (Shirley Werner Kornreich, J.), entered January 9, 2015, which denied defendants Changing World Technologies, L.P., Ridgeline Energy Services, Inc. and Dennis Danzik's (the Ridgeline defendants) motion to disqualify Schlam Stone & Dolan LLP from representing defendants CWT Canada II Limited Partnership, Resource Recovery Corporation, and Jean Noelting (the CWT defendants), and denied the CWT defendants' motion to supplement the record, unanimously affirmed as to the motion to disqualify, and the appeal therefrom otherwise dismissed, without costs, as moot.

The motion court properly denied the Ridgeline defendants' motion to disqualify Schlam Stone & Dolan LLP from representing the CWT defendants, since in their retainer agreement with Schlam Stone & Dolan LLP, the Ridgeline defendants specifically waived any conflict of interest that might arise from the firm's representation of both them and the CWT defendants (*see St. Barnabas Hosp. v New York City Health & Hosps. Corp.*, 7 AD3d 83 [1st Dept 2004]). The Ridgeline defendants' contention that they did not give informed consent to the firm's asserting claims against them in this litigation is belied by the clear language of the retainer agreement and the unit purchase agreement. They “cannot now compel the disqualification of . . . counsel simply because the representation to which [they] consented has since devolved into litigation” (*see id.* at 92 [internal quotation marks omitted]).

Nor does the fact that the firm obtained confidential information from the Ridgeline defendants warrant disqualification ***507** since the Ridgeline defendants knowingly and expressly agreed in the retainer agreement to the firm's use of their confidential information and the disclosure of that information to the CWT defendants (*see id.* at 90).

****2** We have considered the Ridgeline defendants' remaining contentions and find them unavailing. Concur—Mazzarelli, J.P., Sweeny, Saxe, Richter and Manzanet-Daniels, JJ.

Copr. (C) 2019, Secretary of State, State of New York

End of Document © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Reprinted with Permission.

Unreported Disposition
40 Misc.3d 1234(A), 980 N.Y.S.2d 276 (Table), 2013 WL 4605989 (N.Y.Sur.), 2013 N.Y. Slip Op. 51420(U)

This opinion is uncorrected and will not be published in the printed Official Reports.

*1 In the Matter of the Application of Allen M. Kaufman, M.D., As Co-Executor of the Estate of
v.
Ruth Kaufman, Deceased, and Co-Trustee of the Trust Created Under Article Third (B) of the Last will and Testament of Ruth Kaufman, To Revoke the Letters Testamentary and Letters of Trusteeship Issued to Kenneth Kaufman, as Co-Executor and Co-Trustee. In the Matter of the Application of Allen M. Kaufman, M.D., As Co-Executor of the Estate of RUTH KAUFMAN, Deceased, and Co-Trustee of the Trust Created Under Article Third (B) of the Last will and Testament of Ruth Kaufman, To Revoke the Letters Testamentary and Letters of Trusteeship Issued to Kenneth Kaufman, as Co-Executor and Co-Trustee. In the Matter of the Application of Allen M. Kaufman, M.D., As Co-Executor of the Estate of HYMAN KAUFMAN, Deceased, To Revoke the Letters Testamentary Issued to Kenneth Kaufman, as Co-Executor.

355054/H
Sur Ct, Nassau County
Decided on August 28, 2013

CITE TITLE AS: Matter of Kaufman

ABSTRACT

Attorney and Client
Disqualification

Kaufman, Matter of, 2013 NY Slip Op 51420(U). Attorney and Client—Disqualification. (Sur Ct, Nassau County, Aug. 28, 2013, McCarty III, J.)

APPEARANCES OF COUNSEL

John R. Morken, Esq. (co-counsel for petitioner)
Farrell Fritz, P.C. 1320 RXR Plaza
Uniondale, NY 11556
Henry Klosowski, Esq. (for respondent)
Moritt Hock & Hamroff, LLP
400 Garden City Plaza
Garden City, NY 11530
Howard Meyers, Esq. (for Merrill Lynch, interested party)
Meyers Meyers & Tonachio
48 Wall St.
11th Floor
New York, NY 10005
Pamela Corey, Esq. (co-counsel for petitioner)
Law Offices of John Lang
60 East 42nd Street, Ste. 4600
New York, NY 10165

OPINION OF THE COURT

Edward W. McCarty III, J.

This is a motion for an order disqualifying the law firm of Farrell Fritz, P.C. as counsel for Allen M. Kaufman, the executor of the estate of Ruth Kaufman and the estate of Hyman Kaufman and the trustee of the Trust Created under Article Third (B) of the last will and testament of Ruth Kaufman.

FACTS:

Allen M. Kaufman (hereinafter “Allen”), and his brother, Kenneth Kaufman (hereinafter “Ken”), are co-executors, co-trustees and the sole beneficiaries of the estates of their parents, Ruth Kaufman and Hyman Kaufman. On May 15, 2013, Ken filed a notice of motion to disqualify Farrell Fritz, P.C., as attorneys for Allen, on the grounds that Ken had met with two Farrell Fritz, P.C. (hereinafter “Farrell Fritz”) attorneys, Michael Stafford and Frank Santoro (hereinafter “Stafford” and “Santoro”), on October 6, 2011. The meeting was for the purpose of Ken retaining Farrell Fritz to represent him in his litigation against Allen in connection with his parents' estates.

Prior to the meeting with Stafford and Santoro, Ken had several telephone conversations with Stafford and sent Stafford six emails with attached documents relating to Ken's parents' estates and trusts. Ken's emails also addressed what he was “most concerned about” regarding

the litigation. Stafford responded to Ken's emails by stating, “thanks for the six emails containing the background of your matter. Frank Santoro, Esq. and [I] will review the material before our meeting on Thursday.” At the meeting, Ken provided Stafford and Santoro with “four tote bags full of documents” concerning his parents' estates, which were reviewed by Stafford and Santoro. Additionally, at the meeting Ken “disclosed his inner most fears and concerns relating to the pending litigation.” After the meeting, Ken emailed Santoro asking for advice about a particular issue and ***2** Santoro responded that he will “talk to John about it” [1] to determine what would be a “sore for Allen to pick at” regarding the litigation. Ultimately however, Ken did not retain Farrell Fritz. Therefore, Farrell Fritz did not open a new file, bill Ken for the firm's time, prepare memoranda or retain any documents other than the documents Ken sent to Stafford via email.

In February 2013, Allen retained Farrell Fritz to represent him in the ongoing litigation against Ken in connection with his parents' estates. John R. Morken, (hereinafter “Morken”) the lead attorney on the matter, performed a conflict check at Farrell Fritz upon his retention. The conflict check did not yield any results because Farrell Fritz had not opened a new file for Ken. For over two months, Farrell Fritz represented Allen and participated in conferences and a mediation session. Ken was unaware that Morken was from the same firm as Stafford and Santoro and therefore did not object to Farrell Fritz's representation of Allen during this time period.

Once Ken was advised that Morken worked with Stafford and Santoro, Ken requested that Farrell Fritz voluntarily withdraw from representing Allen. Farrell Fritz declined to withdraw as counsel, on the grounds that the meeting with Ken was held 16 months prior, Stafford and Santoro did not recall the details of their meeting or the documents that they had reviewed, and they had never discussed the meeting with any other Farrell Fritz attorney. Additionally, once Farrell Fritz became aware of the conflict they proceeded with screening measures and erected a “Chinese Wall” [2] around Stafford and Santoro. Farrell Fritz advised Stafford and Santoro not to work on Allen's matter or discuss their earlier meeting with Ken with any member of Farrell Fritz's trust and estates department. The members of Farrell Fritz's trust and estates department were also instructed not to discuss Allen's case with Stafford and Santoro. Ken, however, unsatisfied with these measures, proceeded with this motion.

ANALYSIS:

According to Ken, “ the Court must disqualify Farrell Fritz from representing Allen against Ken Farrell Fritz clearly has a conflict of interest which warrants its immediate ***3** disqualification.” Although “the Court takes the issue of a potential conflict of interest very seriously” (*Susan K. v Thomas C.* 25 Misc 3d 1207(A) 2 [Fam Ct, Monroe County 2009]), the assertion that a consultation between an attorney and a prospective client can lead to per se disqualification is erroneous.

Lawyers have an ongoing duty of loyalty and confidentiality to former clients, thus “lawyers may not represent a client in a matter and thereafter represent another client with interests materially adverse to interests of the former client in the same or a substantially related matter” (*Kassis v Teacher's Ins. & Annuity Assoc.,* 93 NY2d 611, 615-16 [1999]). Therefore, if a party can establish 1) the existence of a prior attorney-client relationship and 2) that the former and current representations are both adverse and substantially related, then such party can seek to disqualify the attorney (*Solow v Grace & Co.,* 83 NY2d 303, 308 [1994]). Moreover, the conflict may be imputed to the entire firm, because there is a presumption of shared confidences across a law firm (*Solow v Grace & Co.,* 83 NY2d 303, 309 [1994]).

However, the Court of Appeals in *Solow v Grace* made it clear that such a presumption is rebuttable and that the entire law firm is not subject to a “per se disqualification” as it “is unnecessarily preclusive as it disqualifies all members of a law firm indiscriminately, whether or not they share knowledge of former client's [sic] confidences and secrets” (*Solow v Grace & Co.,* 83 NY2d 303, 309 [1994]). Therefore, a law firm can rebut the presumption as long as it can establish that any information acquired by the disqualified lawyer is “unlikely to be significant or material in the litigation” (*Kassis v Teacher's Ins. & Annuity Assoc.,* 93 NY2d 611, 678 [1999]). If the presumption is rebutted, then a “Chinese Wall” must be erected around the disqualified lawyer in order to avoid firm disqualification (*Kassis v Teacher's Ins. & Annuity Assoc.,* 93 NY2d 611, 678 [1999]).

Here, an attorney-client relationship was established between Ken and Farrell Fritz because an initial

 © 2019 Thomson Reuters. No claim to original U.S. Government Works.

consultation creates an attorney-client relationship even if the lawyer is not subsequently retained (*Burton v Burton,* 39 AD2d 554 [2d Dept 1988]). Moreover, a substantial relationship is defined as matters that are "essentially the same" (*Sgromo v St. Joseph's Hosp. Health Ctr.*, 245 AD2d 1096, 1097 [4th Dept 1997]). Farrell Fritz's representation of Allen and the prior meeting between Ken and the two Farrell Fritz attorneys concerned the same matter. Furthermore, it is undisputed that Ken and Allen's interests are adverse, thus satisfying the second prong of the analysis. However, although Ken has been able to meet his burden for disqualifying Stafford and Santoro, individually, Farrell Fritz is not thereby automatically disqualified (*Kassis v Teacher's Ins. & Annuity Assoc.,* 93 NY2d 611, 677 [1999]). Instead, Farrell Fritz has the burden of rebutting the presumption that the entire firm should be disqualified based on Stafford and Santoro's disqualification. Therefore, the court must determine if Farrell Fritz can rebut the presumption by establishing that the information acquired by Stafford and Santoro is not significant or material to the current litigation (*Kassis v Teacher's Ins. & Annuity Assoc.,* 93 NY2d 611, 618 [1999]).

Farrell Fritz has submitted affirmations, which reflect that Stafford and Santoro do not recall the details of the meeting with Ken or their review of any of his documents. Therefore, Farrell Fritz asserts that the lack of recollection renders the information immaterial or insignificant. However, lack of recall is not an indication that the material learned is insignificant or immaterial. In a case similar to the present matter, the defendant met with two attorneys from the same firm for an initial ***4** consultation that lasted an hour and twenty minutes but did not culminate in retention. When the opposing plaintiff retained this same firm, mid-proceeding, the defendant moved to disqualify the firm. The firm, however, believed that disqualification was not necessary because the attorneys were unable to recall the meeting and what was discussed. The court held that because the defendant had met with two attorneys it "doubles the likelihood" that a memory can be triggered, as "one never knows what event will stimulate one's memory and bring recollections to the surface." Therefore, lack of recall was not a persuasive argument to avoid firm disqualification. (*I Heng Ngan v Wei Su,* 13 Misc 3d 1229(A) [Sup Ct, Queens County 2006]).

Moreover, although Farrell Fritz asserts that it is not clear what details were discussed during the consultation "it is reasonable to infer that, during the course of the interview with the defendant [the attorney] obtained confidential or strategically valuable information about the parties ..." (*Burton v Burton,* 39 AD2d 554, 555 [2d Dept 1988]). In the present case, Ken provided "four tote bags full of documents" necessary for the litigation proceeding and Ken's emails addressed his utmost concerns about the litigation. Under *Kassis* "all a movant must show is a risk that client confidences were acquired" (*Rodeo Family Enterprises, LLC v Matte*, 31 Misc 3d 1227(A), 4 [Sup Ct, Nassau County 2011]). Here however, Ken has unequivocally established that the material obtained by Stafford and Santoro was confidential and strategically valuable.

Furthermore, Farrell Fritz relies heavily on *Cummin v Cummin*, 264 AD2d 637 [1st Dept 1999], believing it to be particularly instructive in this matter. However, even if the court were to apply *Cummin,* the facts in the instant case are essentially different. In *Cummin,* an attorney retained by the plaintiff discovered that the firm's managing partner had a consultation with the defendant six years earlier that did not culminate in retention. Although the firm billed the defendant, a new file was not opened and the firm did not have any notes or memoranda on the matter. The court found that because the firm did not have any notes or memoranda regarding the consultation, and there was no indication that the conflicted attorney shared any information with his colleagues, the presumption of shared confidences was rebutted. However, Ken's consultation with Farrell Fritz took place only 16 months prior to Allen's retention of Farrell Fritz and, unlike the attorney in *Cummin*, Santoro actually retained documents relating to the consultation. Additionally, whereas in *Cummin* it was clear that no confidences were shared, in this case Santoro did advise Ken that he "will speak to John" [3] about Ken's matter. Although Santoro avers in his affirmation that he did not share this information with John it is certainly not sufficient to "free [Ken] from apprehension and certainty that [his] interests will not be prejudiced" (*Cardinale v Golinello,* 43 NY2d 288, 296 [1977]).

Based on the foregoing, the court cannot conclude that Farrell Fritz has established that the material acquired by Stafford and Santoro is unlikely to be significant or material in the current litigation. Farrell Fritz is unable

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

to rebut the presumption of disqualification; accordingly the court does not need to discuss the erection of the "Chinese Wall" or an adequate screen. Based on all the facts presented here and because "doubts as to the existence of a conflict of interest must be resolved in favor of disqualification" (*Sperr v. Gordon L. Seaman, Inc.,* 284 AD2d 449, 457 [2d Dept 2001]), the motion to disqualify Farrell Fritz, P.C., is granted.

Dated: August 28, 2013 ***5**

EDWARD W. McCARTY III

Judge of the

Surrogate's Court

FOOTNOTES

Copr. (C) 2019, Secretary of State, State of New York

Footnotes

1 The reference to "John" is apparently a reference to John R. Morken, a Farrell Fritz partner who is a member of the firm's trust and estates department.

2 A "Chinese Wall" is a screening device that separates a disqualified attorney from a conflicting case and enables the other attorneys in the firm to proceed with the representation; "These procedures aim to isolate the disqualification to the lawyer or lawyers infected with the privileged information that is the source of the ethical problem, and thereby to allow other attorneys in the firm to carry on the questioned representation free of any taint of misuse of confidences. Typical walling procedures include prohibiting the tainted attorney(s) from having any connection with the case or receiving any share of the fees attributable to it, banning relevant discussions with or the transfer of relevant documents to or from the tainted attorney(s), restricting access to files, educating all members of the firm as to the importance of the wall, and separating, both organizationally and physically, groups of attorneys working on conflicting matters."(The Chinese Wall Defense to Law-Firm Disqualification, 128 U. PA. L. REV.
677, 678 [1980]).

3 Farrell Fritz does not concede that this reference to "John" was a reference to John R. Morken, who currently represents Allen.

End of Document © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Reprinted with Permission

44 Misc.3d 1216(A)
Unreported Disposition
(The decision is referenced in
the New York Supplement.)
Surrogate's Court, County.

In the Matter of the ESTATE OF
Hyman KAUFMAN, Deceased.

No. 2011–368209/C.
|
July 30, 2014.

Attorneys and Law Firms

Damianos Markou, Esq., Moritt Hock & Hamroff, LLP, Garden City, NY, for respondent, Kenneth Kaufman.

Howard Meyers, Esq., Meyers Meyers & Tonachio, LLP, New York, NY, for respondent, Merrill Lynch.

James M. Wicks, Esq., Farrell & Fritz, P.C., Uniondale, NY, for petitioner, Allen M. Kaufman.

Donald Novick, Esq., Novick & Associates, Huntington, NY, co-counsel for Allen Kaufman.

Opinion

EDWARD W. McCARTY III, J.

***1** In these proceedings concerning the estate of Hyman Kaufman, the motion to renew and reargue is granted and upon reargument the court confirms its prior decision (40 Misc.3d 1234[A] [2013]), which granted a motion to disqualify counsel.

These proceedings involve disputes between Kenneth Kaufman and Allen Kaufman executors/beneficiaries of the estate of their father Hyman Kaufman. In its prior decision, the court granted the motion of Kenneth Kaufman to disqualify the firm of Farrell Fritz, P.C., on the grounds that he had previously consulted with the firm and thereafter the firm represented his adversary, Allen Kaufman. In the decision, the court concluded that Kenneth Kaufman was a prior client who communicated significant confidential information to the firm. The motion to disqualify Farrell Fritz was granted, pursuant to Rule 1.9 of the New York Rules of Professional Conduct (22 NYCRR 1200.0 et seq).

The applicable rule, however, is Rule 1.18 pertaining to prospective clients, as there was never a formal attorney-client relationship between Farrell Fritz and Kenneth Kaufman.

In October 2011, two attorneys from Farrell Fritz, Michael Stafford and Frank Santoro met with Kenneth Kaufman. It is undisputed that the subject of the consultation related to the administration of the estate of Hyman Kaufman. Kenneth Kaufman delivered documents (which were returned) and exchanged e-mails with counsel. There was a subsequent meeting on October 6, 2011. The firm was not retained by Kenneth Kaufman and no file was opened. In February 2013, Farrell Fritz attorney John Morken met with Allen Kaufman, an engagement letter was signed and the firm commenced representation in connection with a petition to revoke letters testamentary which had been issued to Kenneth Kaufman. A conflicts check performed by Farrell Fritz was negative, as no file had been opened after the consultation with Kenneth. On May 6, 2013, Henry Klosowski, attorney for Kenneth Kaufman, informed Morken of the prior consultation with Farrell Fritz and Kenneth Kaufman then made this motion to disqualify. Morken states and it is undisputed that he was previously unaware of the consultation as it was never entered into the firm's computer. Kenneth Kaufman alleges that in the first months after the petition was filed, he did not realize that Morken was associated with the same firm as Stafford and Santoro.

Rule 1.18 was promulgated, in part, in response to the practice of consulting an attorney for the purpose of disqualifying the attorney from representing an adversary. The rule limits the protection afforded a prospective client as opposed to a former client (Restatement [Third] of the Law Governing Lawyers, sec 15, Comment [1][b]). Rule 1.18 provides in part:

> "(a) A person who discusses with a lawyer the possibility of forming a client-lawyer relationship with respect to a matter is a "prospective client."

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Even when no client-lawyer relationship ensues, a lawyer who has had discussions with a prospective client shall not use or reveal information learned in the consultation, except as Rule 1.9 would permit with respect to information of a former client.

***2** A lawyer subject to paragraph (b) shall not represent a client with interests materially adverse to those of a prospective client in the same or a substantially related matter if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter, except as provided in paragraph (d). If a lawyer is disqualified from representation under this paragraph, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter, except as provided in paragraph (d)."

(d) When the lawyer has received disqualifying information as defined in paragraph (c), representation is permissible if: (1) both the affected client and the prospective client have given informed consent, confirmed in writing; or (2) the lawyer who received the information took reasonable measures to avoid exposure to more disqualifying information than was reasonably necessary to determine whether to represent the prospective client; and (i) the firm acts promptly and reasonably to notify, as appropriate, lawyers and nonlawyer personnel within the firm that the personally disqualified lawyer is prohibited from participating in the representation of the current client; (ii) the firm implements effective screening procedures to prevent the flow of information about the matter between the disqualified lawyer and the others in the firm; (iii) the disqualified lawyer is apportioned no part of the fee therefrom; and (iv) written notice is promptly given to the prospective client; and (3) a reasonable lawyer would conclude that the law firm will be able to provide competent and diligent representation in the matter, (e) A person who: (1) communicates information unilaterally to a lawyer, without any reasonable expectation that the lawyer is willing to discuss the possibility of forming a client—lawyer relationship; or (2) communicates with a lawyer for the purpose of disqualifying the lawyer from handling a materially adverse representation on the same or a substantially related matter, is not a prospective client with the meaning of paragraph (a).

Under Rule 1.18 the threshold for disqualification is raised. In circumstances involving a former client, the standard is whether the information conveyed is significant or material (*Town of Oyster Bay v. 55 Motor Ave. Co., LLC,* 109 AD3d 549 [2d Dept 2013]). Under Rule 1.18, disqualification is required only where the information is significantly harmful. Where the information is significantly harmful, the conflict affecting the participating attorney is imputed to other lawyers in the firm (Rule 1.18[c]).

The description of the initial consultation with Kenneth Kaufman, coupled with the production of documents and exchange of e-mails which contained confidential information, gives rise to a reasonable inference that the information conveyed was significantly harmful (*Zalewski v. Shelroc Homes, LLC,* 856 F Supp 2d 426 [NDNY 2012]).

***3** Rule 1.18[c] provides for the imputation of knowledge to other attorneys in the firm. Allen Kaufman attempts to overcome the presumption by the submission of the affidavits of Santoro and Stafford which state that they did not communicate confidential information. In addition, the "non-consulting" attorneys have provided affidavits stating that they did not receive information concerning the estate.

Allen Kaufman challenges the accuracy of the affidavits. In particular, there is a vigorous dispute as to whether a discussion of "John" in an e-mail refers to a member of Farrell Fritz or another firm.

In *Arista Records LLC v. Lime Group LLC* (2011WL 672254 [SDNY]), there was a delay in implementing a formal screen around an attorney who possessed confidential information acquired at his previous employment. The attorney's affidavit stated that confidential information was not disclosed to attorneys in the current firm. The motion to disqualify was denied, primarily on the grounds that the affidavit was not disputed. Here, where the affidavits are disputed, they cannot be accepted as conclusive proof that Santoro and Stafford were the only attorneys who received confidential information.

Rule 1.18 requires that the knowledge of the client's confidences be imputed to the other attorneys in the firm unless effective screening procedures were implemented, as provided in subdivision [d][2][ii]. These procedures are

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

generally referred to as a "Chinese wall." The effectiveness of the screen is customarily determined without a hearing.

Among the factors to be considered in determining the effectiveness of a Chinese wall are the frequency of communications between attorneys and access to records § NYC Eth. Op.2013–1 [2013]).

A Chinese wall is intended to be pre-emptive. Therefore, timeliness is the pre-dominant factor in determining its effectiveness (*Decora, Inc. v. DW Wallcovering, Inc.,* 899 F Supp 132 [SDNY1995]; *Papanuicolaou v. Chase Manhattan Bank, N.A.,* 720 F Supp 1080 [SDNY1989]).

Ideally, a screen should be erected when the firm accepts a case which presents an ethical problem (*LaSalle Nat. Bank v. Lake County,* 703 F.2d 252 [7th Cir.1983]).

In this case, the failure of the conflicts check to reveal the first consultation resulted in the representation of Allen Kaufman without any checks in place. It appears that the firm made a serious attempt to construct a screen immediately upon learning of the conflict. However, a screen must foreclose the possibility of disclosures. In March 2013, when the screen was constructed, the opportunity for the dissemination of information had already been extant for approximately two and a half years.

In addition, between February 2013, when Farrell Fritz was retained, and May 2013, when the prior consultation was revealed, the attorneys in the firm were not forewarned to avoid discussion of the Kaufman estate. During this period, none of the attorneys in the firm, including Santoro and Stafford, were aware of the impending conflict and there was no impediment to the free disclosure of information.

***4** In assessing the effectiveness of a screen, consideration is given to the size and structure of the firm. It is expected that attorneys in a small firm are likely to exchange confidences and ideas about pending cases (see *Kassis v. Teacher's Ins. and Annuity Assn.,* 93 N.Y.2d 611 [1999]; *Solow v. W.R. Grace & Co.,* 83 N.Y.2d 303 [1994]). Here, it is not the size of the firm as a whole, which is relevant. The initial consultation and subsequent representation involved attorneys within a single department, thus increasing the likelihood of communications concerning the estate.

In this case, all of the attorneys had the opportunity to access the e-mails, prior to the construction of the screen (*Poma v. Ipek,* 27 Misc.3d 1206[A] [Sup. Ct, New York County 2010]). In addition, the effectiveness of the screen was undermined by the transfer of the emails to general counsel. The information necessary to defend the motion to disqualify should have been extracted and then forwarded.

Further, the fact that the e-mails continued between the attorneys and the prospective client suggest that the initial consultation was not limited in its scope, as required by Rule 1.18

A former prospective client is entitled to freedom of apprehension and to certainty that his interests will not be prejudiced by disclosure of confidential information (*Nationwide Associates, Inc. v. Targee Street Internal Medicine, P.C,* 303 A.D.2d 728 [2d Dept 2003]); *P.C. Forest Park Associates Ltd. Partnership v. Kraus,* 175 A.D.2d 60 [1st Dept 1991]).

For the foregoing reasons, the court adheres to its original conclusion.

This is the decision and order of the court.

All Citations

44 Misc.3d 1216(A), 997 N.Y.S.2d 99 (Table), 2014 WL 3739575, 2014 N.Y. Slip Op. 51133(U)

End of Document

© 2019 Thomson Reuters. No claim to original U.S. Government Works.

Reprinted with Permission

126 A.D.3d 1
Supreme Court, Appellate Division,
First Department, New York.

Matthew R. MAYERS, Plaintiff–Respondent,
v.
STONE CASTLE PARTNERS, LLC,
et al., Defendants–Appellants.
Stone Castle Partners, LLC, Plaintiff–Appellant,
v.
Matthew R. Mayers, et al.,
Defendants–Respondents.

Jan. 8, 2015.

Synopsis
Background: In two joined lawsuits, employee commenced action against company alleging that he was wrongfully terminated without cause, and seeking injunctive and declaratory relief, as well as damages, and company commenced action against employee asserting for engaging in numerous illegal schemes while employed there. The Supreme Court, New York County, Shirley Werner Kornreich, J., 2014 WL 1258259, granted employee's motion to disqualify employer's counsel. Employer appealed.

Holdings: The Supreme Court, Appellate Division, Saxe, J., held that:

[1] telephone interview involved confidential information, but

[2] disqualification of employer's counsel was not warranted under the circumstances.

Reversed.

West Headnotes (5)

[1] **Attorney and Client**
Disqualification proceedings;standing

Movant seeking disqualification of opponent's counsel bears heavy burden.

4 Cases that cite this headnote

[2] **Attorney and Client**
Disqualification in general

Party has right to be represented by counsel of its choice, and any restrictions on that right must be carefully scrutinized. U.S.C.A. Const.Amend. 6.

3 Cases that cite this headnote

[3] **Attorney and Client**
Interests of former clients

Where prospective client consults attorney who ultimately represents party adverse to prospective client in matters that are substantially related to the consultation, prospective client is entitled to obtain attorney's disqualification only if it is shown that the information related in the consultation could be significantly harmful to him or her in the same or substantially related matter. Rules of Prof.Conduct, Rule 1.18, N.Y.Ct.Rules, § 1200.0.

5 Cases that cite this headnote

[4] **Attorney and Client**
Labor relations

Telephone interview between employee and attorney for law firm which represented company more than a year and a half later in litigation against that employee involved confidential information, for purposes of employee's motion to disqualify company's counsel; employee made call to attorney for firm after employer's prospective sale of collateralized debt obligation investment had fallen through, and in call employee allegedly informed attorney that he was calling in his personal capacity and not in connection with his employment or association with his employer and of his company's present ownership of preferred shares in that investment and his future

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

plans regarding preferred shares, and asked if attorney would represent his company against bank based on trustee's failure to follow instructions in Direction to Sell.

1 Cases that cite this headnote

[5] **Attorney and Client**
Labor relations

Disqualification of employer's counsel was not warranted in two joined actions; conveyed information did not have potential to be significantly harmful to employee in matter from which he sought to disqualify counsel. Rules of Prof.Conduct, Rule 1.18, N.Y.Ct.Rules, § 1200.0.

3 Cases that cite this headnote

Attorneys and Law Firms

****59** Quinn Emanuel Urquhart & Sullivan, LLP, New York (Sanford I. Weisburst, Kevin S. Reed and David M. Cooper of counsel), and Morrison Cohen LLP, New York (Danielle C. Lesser of counsel), for appellants.

Jaffe & Asher, LLP, New York (Marshall T. Potashner and Michael L. Ihrig, II of counsel), for respondents.

DAVID FRIEDMAN, J.P., ROLANDO T. ACOSTA, DAVID B. SAXE, SALLIE MANZANET–DANIELS, and JUDITH J. GISCHE, JJ.

Opinion

SAXE, J.

***3** Stone Castle Partners, LLC (SCP) and its affiliates challenge a ruling disqualifying their chosen counsel. We hold that counsel's disqualification was not required under these circumstances.

SCP, defendant in Action # 1 and plaintiff in Action # 2, manages more than $5 billion in assets. Matthew R. Mayers, plaintiff in Action # 1 and defendant in Action # 2, as well as George Shilowitz and Joshua S. Siegel, defendants in Action # 1, were members and "Management Investors" with SCP; their rights and obligations were defined under SCP's Fifth Amended and Restated Limited Liability Company Agreement (LLC Agreement). In 2009, through a subsidiary, SCP acquired a supermajority position in the preferred shares of Tropic CDO IV (Tropic IV), a collateralized debt obligation investment. Under Tropic IV's governing documents, the owner of a supermajority of its preferred shares was entitled to direct the CDO's trustee to sell the underlying collateral. Relying on that authority, SCP attempted to bring about the sale of Tropic IV's collateral at deeply discounted prices in exchange for a "consent payment," so called because it is paid to holders of the preferred shares by the collateral buyers in exchange for their consenting to the collateral's sale. However, Tropic IV's other investors, including Hildene Capital Management, a holder of Tropic IV notes and a client of SCP, protested that SCP's actions constituted a scheme to defraud them by stripping Tropic IV's collateral in exchange for a bribe. The trustee, Wells Fargo, when presented with SCP's directive to sell and the other investors' objections to the sale, commenced a federal ****60** interpleader action on November 2, 2009 to resolve the issue. SCP caused its subsidiaries to withdraw their consent to the buyer's offer for the ***4** Tropic IV collateral, and the prospective buyer eventually withdrew its offer.

By the fall of 2010, SCP had decided to avoid the expressed concerns of antagonized investors and important clients by arranging for its subsidiaries to divest themselves of their holdings of Tropic IV preferred shares, which totaled 2 million preferred shares. In an auction conducted by the SCP subsidiaries in November 2010, Mayers, through his wholly owned entity RRWT, purchased those 2 million preferred shares of Tropic IV.

While it is Mayers's position that SCP must have known that he was the shares' purchaser, it is SCP's position that the purchase was made secretly and without its knowledge, that, having given up its involvement with Tropic IV equity in the interest of maintaining its investors' trust, it would not knowingly have permitted one of its managers to engage in the very conduct that had undermined the investors' trust.

Thereafter, Mayers continued to purchase Tropic IV preferred shares in order to acquire a supermajority. In early 2011 he formed TP Investments LLC to hold those Tropic IV preferred shares, and by June 2012 he had acquired control of a supermajority of Tropic IV preferred

shares, allowing him to carry out the plan that SCP had attempted and then abandoned.

In November 2012, through RRWT and TP Investments and under the assumed name "Kricket Hound," Mayers solicited a $750,000 consent payment from a prospective purchaser of certain securities held by Tropic IV as collateral, and sent a "Direction to Sell" letter to the trustee. Although this communication did not contain Mayers's name, it included his personal telephone number. The Direction to Sell was provided by the trustee to interested parties, including holders of Tropic IV notes, one of whom forwarded it to Joshua Siegel of SCP, with an inquiry regarding whether SCP was connected to the Direction to Sell.

By December 5, 2012, having learned of Mayers's attempt to arrange the sale of Tropic IV collateral in exchange for a $750,000 consent payment, SCP retained Quinn Emanuel Urquhart & Sullivan, LLP, which it had used in other legal matters, to represent SCP against Mayers.

By letter dated January 22, 2013, SCP demanded that Mayers sell his interests in Tropic IV preferred shares, and Mayers complied within three weeks, allegedly without gain. Nevertheless, ***5** on January 29, 2013, SCP terminated Mayers for cause on the grounds that he had personally engaged in transactions adverse to SCP's interests, had concealed those activities from SCP, and had failed to answer honestly SCP's questions about his disputed activities.

Mayers commenced an action on February 6, 2013, alleging that he was wrongfully terminated without cause, and seeking injunctive and declaratory relief, as well as damages. On November 25, 2013, SCP, represented by Quinn Emanuel, commenced an action against Mayers, claiming that Mayers engaged in illegal schemes while employed at SCP.

Mayers's motion to disqualify Quinn Emanuel as counsel for SCP arose out of a telephone call Mayers made to Quinn Emanuel attorney Jonathan Pickhardt in May 2011, after SCP's prospective sale of Tropic IV collateral had fallen through, in which Mayers allegedly informed Pickhardt that he was calling in his personal capacity and not in connection with his ****61** employment or association with SCP. According to Mayers's complaint, he informed Pickhardt of his company's present ownership of Tropic IV preferred shares and his future plans regarding the CDO's preferred shares, and asked if Pickhardt would represent RRWT against Wells Fargo based on the trustee's failure to follow the instructions in the Direction to Sell.

It is undisputed that Pickhardt declined the representation. However, Pickhardt admittedly discussed the Mayers telephone call with Quinn Emanuel attorney Kevin S. Reed, who was lead counsel for SCP.

In seeking Quinn Emanuel's disqualification, Mayers claimed that Pickhardt had received confidential information from him during their consultation and that, after SCP retained the firm, the firm used that information in SCP's action against him. Mayers argued that the disclosure of his communications to Pickhardt regarding his purpose in the Tropic IV investment went to the heart of the SCP's counter-suit asserting that Mayers had breached his duties under the LLC Agreement, since the communication divulged a scenario that Mayers "was trying to go around the back of [SCP]." Mayers also contended that without the information in his communications to Pickhardt, Quinn Emanuel might not have come up with the strategy, in SCP's action against him, of subpoenaing for deposition certain people that he dealt with.

[1] **[2]** A movant seeking disqualification of an opponent's counsel bears a heavy burden (*Ullmann–Schneider v. Lacher & Lovell–* ***6** *Taylor PC,* 110 A.D.3d 469, 973 N.Y.S.2d 57 [1st Dept.2013]). A party has a right to be represented by counsel of its choice, and any restrictions on that right "must be carefully scrutinized" (*id.* at 469–470, 973 N.Y.S.2d 57, *quoting S & S Hotel Ventures Ltd. Partnership v. 777 S.H. Corp.,* 69 N.Y.2d 437, 443, 515 N.Y.S.2d 735, 508 N.E.2d 647 [1987]). This right is to be balanced against a potential client's right to have confidential disclosures made to a prospective attorney subject to the protections afforded by an attorney's fiduciary obligation to keep confidential information secret (*see* New York Rules of Professional Conduct [22 NYCRR 1200.0] rule 1.18; *see also Jamaica Pub. Serv. Co. v. AIU Ins. Co.,* 92 N.Y.2d 631, 637, 684 N.Y.S.2d 459, 707 N.E.2d 414 [1998]; *Sullivan v. Cangelosi,* 84 A.D.3d 1486, 923 N.Y.S.2d 737 [3d Dept.2011]). Courts should also examine whether a motion to disqualify, made during ongoing litigation, is made for tactical purposes, such as to delay litigation and

deprive an opponent of quality representation (*see e.g. Solow v. Grace & Co.,* 83 N.Y.2d 303, 310, 610 N.Y.S.2d 128, 632 N.E.2d 437 [1994]). The decision of whether to grant a motion to disqualify rests in the discretion of the motion court (*see Macy's Inc. v. J.C. Penny Corp., Inc.,* 107 A.D.3d 616, 968 N.Y.S.2d 64 [1st Dept.2013]).

Issues relating to the prospective client relationship based on events that occurred after April 2009 are governed by Rule 1.18 of the Rules of Professional Conduct (22 NYCRR 1200.0), rather than the repealed DR 5–108 (22 NYCRR 1200.27). Cases from this Court addressing conduct that occurred prior to the April 2009 enactment of the new rules are not controlling here (*see e.g. Justinian Capital SPC v. WestLB AG, N.Y. Branch,* 90 A.D.3d 585, 934 N.Y.S.2d 807 [1st Dept.2011]; *Bank Hapoalim B.M. v. WestLB AG,* 82 A.D.3d 433, 918 N.Y.S.2d 49 [1st Dept.2011]).

[3] The former Code of Professional Responsibility did not have a specific rule that governed disclosures during a prospective client consultation. Rule 1.18 of the Rules of Professional Conduct fills that void. It provides:

> ****62** "(a) A person who discusses with a lawyer the possibility of forming a client-lawyer relationship with respect to a matter is a 'prospective client.'
>
> "(b) Even when no client-lawyer relationship ensues, a lawyer who has had discussions with a prospective client shall not use or reveal information learned in the consultation, except as Rule 1.9 would permit with respect to information of a former client.
>
> ***7** "(c) A lawyer subject to paragraph (b) shall not represent a client with interests materially adverse to those of a prospective client in the same or substantially related matter *if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter,* except as provided in paragraph (d). If a lawyer is disqualified from representation under this paragraph, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter, except as provided in paragraph (d)" (emphasis added).

Thus, where a prospective client consults an attorney who ultimately represents a party adverse to the prospective client in matters that are substantially related to the consultation, the prospective client is entitled to obtain the attorney's disqualification only if it is shown that the information related in the consultation "could be significantly harmful" to him or her in the same or substantially related matter (*id.,* Rule 1.18[c]).

[4] Initially, we reject the contention of SCP and its affiliates that the May 2011 telephone interview did not involve confidential information. Rule 1.6(a) of the new Rules of Professional Conduct (22 NYCRR 1200.0) defines "[c]onfidential information" as "information gained during or relating to the representation of a client, whatever its source, that is (a) protected by the attorney-client privilege, (b) likely to be embarrassing or detrimental to the client if disclosed, or (c) information that the client has requested be kept confidential." Notwithstanding SCP's observation that Mayers ultimately disclosed the same information in his June 2013 complaint, the telephone communication between Mayers and Pickhardt at least fits within subdivision (b), since the information imparted was likely to be detrimental to Mayers.

[5] Nevertheless, disqualification is not warranted because the conveyed information did not have the potential to be significantly harmful to Mayers in the matter from which he seeks to disqualify counsel. The affidavits and the parties' respective pleadings establish that Mayers's plans with regard to the Tropic IV investment had been made generally known, and Mayers even attests that SCP, Siegel and Shilowitz were cognizant of his Tropic IV investment purchase via his wholly owned entity (at the SCP auction of Tropic IV preferred shares), that they knew of his investment strategy, and that he had offered ***8** them an opportunity to participate in the investment. Mayers did not meet the heavy burden he bore as a prospective client seeking to disqualify Quinn Emanuel, a year into the litigation, from representing the SCP parties.

Accordingly, the order of the Supreme Court, New York County (Shirley Werner Kornreich, J.), entered on or about March 28, 2014, which granted Matthew R. Mayers's motion to disqualify Quinn Emanuel Urquhart & Sullivan, LLP as counsel for the SCP parties should be reversed, on the law and the facts, without costs, and the motion denied. The appeal from the order, same court and Justice, entered on or about April 24, 2014, which denied the motion of the SCP parties for reargument,

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

****63** should be dismissed, without costs, as taken from a nonappealable order.

Order, Supreme Court, New York County (Shirley Werner Kornreich, J.), entered on or about March 28, 2014, reversed, on the law and the facts, without costs, and the motion denied. Appeal from order, same court and Justice, entered on or about April 24, 2014, dismissed, without costs.

All concur.

All Citations

126 A.D.3d 1, 1 N.Y.S.3d 58, 2015 N.Y. Slip Op. 00295

End of Document © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Reprinted with Permission

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF KINGS

Probate Proceeding, Will of **SOPHIE DZIUBKOWSKI,** Deceased.	:	File No.: 2016-1114 **DECISION and ORDER**

LÓPEZ TORRES, S.

The following submissions were considered on this motion:

Papers	Number
Notice of Motion by proponent dated August 10, 2016, Affirmation of Edwin I. Gorski, Esq., dated August 10, 2016, and Exhibits	1, 2, 3
Affirmation of Richard B. Feldman, Esq., in Opposition and Exhibits	4, 5
Affirmation of Edwin I. Gorski, Esq., in Reply dated September 20, 2016	6
Notice of Motion by objectant dated September 28, 2016 Affirmation of Richard B. Feldman, Esq., in Opposition and Exhibits	7, 8, 9
Objectant's Memorandum of Law dated September 28, 2016	10
Affirmation of Edwin I. Gorski, Esq., in Opposition dated October 17, 2016	11
Affidavit of Lucius Tyrasinski dated October 14, 2016	12

Before the court is the motion of the proponent, Lucius Tyrasinski (proponent), for an order disqualifying Rosenberg Feldman Smith LLP (Rosenberg) from serving as counsel to the objectant, Barbara Hunter (objectant), and to dismiss her objections.

Also before the court is the motion of objectant which seeks the continuation of the depositions of the proponent and the attorney-drafter, now counsel for the proponent (attorney-drafter), and the production of documents pursuant to a Demand For Inspection and Production, dated April 22, 2016 (the demand), and two subpoenas served on the attorney-drafter dated June 29, 2016 and August 2, 2016 (subpoenas).

Background

The proponent filed a petition seeking to admit to probate an instrument purporting to be the last will and testament of Sophie Dziubkowski (decedent) dated April 16, 2013 (the propounded instrument) that names proponent as executor and Our Lady of Czestochowa (beneficiary), a religious institution, as the sole beneficiary. The objectant, who is the decedent's sole distributee, is not a beneficiary.

The objectant appeared by Rosenberg and filed objections verified on May 13, 2016, which were amended on May 25, 2016, to the propounded instrument.[1] The proponent was issued preliminary letters testamentary pending the probate contest.

On April 22, 2016, the objectant served the demand seeking pre-objection disclosure pursuant to SCPA 1404. SCPA 1404 examinations of two of the subscribing witnesses were conducted on May 12, 2016, despite the proponent's failure to produce the demanded documents with his initial response dated May 13, 2016. Thereafter, the attorney-drafter was served with a subpoena, on June 29, 2016, to take his deposition. The subpoena also called for the production at the deposition of certain documents contained in an annexed Schedule A. On August 2, 2016, a second subpoena was served on the attorney-drafter requesting essentially the same documents. [2]

The attorney-drafter neither appeared to be deposed nor provided documents demanded by the subpoenas. Thereafter on August 31, 2016, the proponent served an amended response to the demand (amended response), which amended the proponent's answers to his initial response. For

---

[1] Initially, Rosenberg had appeared and filed objections for both the objectant and Suzanne Williams, a niece of the decedent. Rosenberg later amended the objections to name only the objectant, and not Williams, who is not a distributee, and therefore, has no standing to pursue objections .

[2] The documents requested in the subpoenas and the demand are virtually identical, except that the final subpoena also requests the decedent's medical records.

example, when asked to supply "all drafts of the April 16, 2013 will," the initial response provides "no drafts of the last will and testament of the decedent of April 16, 2013 are in custody or possession." In contrast, the amended response states that the attorney-client privilege and the attorney-work product rule set forth under CPLR 3101(b) and (c) preclude such production.

As the parties' disclosure dispute continued, on August 10, 2016, the proponent moved for an order seeking the disqualification of Rosenberg as counsel to the objectant and for the dismissal of objections. Despite the pending motion to disqualify Rosenberg, the parties finally scheduled the deposition of the attorney-drafter on September 7, 2016. During the deposition, the attorney-drafter declined to answer and objected to most of the questions posed.

As a result, the objectant filed a separate motion seeking an order compelling the proponent and the attorney-drafter to comply with the subpoenas and the demand and to continue their depositions.

The proponent's motion to disqualify Rosenberg and to dismiss objections was heard on October 4, 2016. The proponent relies upon the affirmation of counsel, the pleadings, disclosure demands and responses, subpoenas, a partial deposition transcript of a subscribing witness to the propounded instrument, portions of the propounded instrument, and other sundry documents. The objectant relies on his counsel's affirmation, and various disclosure demands and responses.

The objectant's motion to compel disclosure was heard on October 18, 2016. The objectant relies upon the affirmation of counsel, disclosure demands and responses, subpoenas, and deposition transcripts. The proponent relies on proponent's affidavit and the attorney-drafter's affirmation.

The two motions are now consolidated for decision.

Proponent's Motion for Disqualification

The proponent seeks the disqualification of the objectant's counsel. The proponent states that while no actual conflict exists between the proponent and objectant's counsel, he is concerned about a purported "conflict" between the objectant and Suzanne Williams (Williams), both, it is asserted, are represented by Rosenberg. Williams, a niece of the decedent, is not a distributee in this proceeding, and therefore is not an interested party in this litigation. Nonetheless, Rosenberg had initially filed objections on behalf of both the objectant and Williams, which were thereafter amended to remove Williams as an "objectant." The proponent asserts that

despite the amendment, Rosenberg is still acting as counsel for both the objectant and Williams in this proceeding. The proponent avers that this constitutes a "conflict" between the objectant and Williams, because Williams' standing to inherit would only take effect if objectant's interest was eliminated. The proponent also alleges that Williams is financing the litigation on the objectant's behalf. The objectant avers that there has never been an attorney-client relationship between the proponent and the objectant's counsel, and therefore, no basis for disqualification rests.

A party seeking to disqualify an attorney based on conflict of interest must establish (1) the existence of a prior attorney-client relationship between the moving party and opposing counsel, (2) that the matters involved in both representations are substantially related, and (3) that the interests of the former client and current client are materially adverse. *Scafuri v DeMaso*, 71 A.D. 3d 755 (2nd Dep't 2010). Here, it is undisputed that no attorney-client relationship exists or existed between the proponent, as movant, and opposing counsel. The proponent's sole basis for disqualification is that opposing counsel may have a conflict with his own client, an allegation that does not form a basis for the relief sought. Accordingly, since the proponent has filed to satisfy even the first prong of this three part test, the branch of proponent's motion to disqualify Rosenberg is denied.

Proponent's Motion To Dismiss Objections

The branch of proponent's motion for an order dismissing objections is also denied.

First, the proponent states that objectant has failed to respond to its document demand dated June 20, 2016. As it appears that the objectant has now responded to the disclosure demands, the proponent's motion to dismiss based on the failure of the objectant to comply with disclosure is denied as moot.

Next, the proponent avers that the objectant has not stated a case of actual fraud. Generally, an objection is a responsive pleading that must be in writing and verified and must conform to all the requirements of responsive pleadings. SCPA 302(1)(a). Such pleadings must be sufficiently particular to give the court and parties notice of what is intended to be proved. SCPA 302(2). *See, Matter of Dixon,* 7 Misc. 2d 812 (Surr. Ct. Westchester County 1956), *order aff'd*, 2 A.D. 2d 987 (2nd Dep't 1956); *Matter of Payson*, 5/20/86 N.Y.L.J. 14, col. 4 (Surr. Ct. Nassau County); *see also, Matter of Schneider*, 64 Misc. 2d 299 (Surr. Ct. Westchester County 1970). Here, the objection for fraud is sufficiently plead, and the proponent is not precluded from

demanding a bill of a particulars for an amplification of the pleadings. Therefore, the proponent's motion to dismiss the fraud objection due to a failure to state "actual fraud" is denied.

Finally, the proponent avers that dismissal is warranted because he has established the due execution of the propounded instrument by a preponderance of the evidence. Although the proponent has not expressly set forth the statutory basis for the relief that he seeks, the court surmises that proponent seeks summary judgment under CPLR 3212. In opposition, the objectant avers that the proponent's entire motion is premature, because discovery is ongoing. She avers that significant document disclosure is outstanding, and that the attorney-drafter has been extremely uncooperative in her efforts to obtain disclosure necessary for the prosecution of objections.

Summary judgment may be premature as disclosure has not been concluded, and thus a further analysis is unecessary. *Aurora Loan Services, LLC v. LaMattina & Associates, Inc.*, 59 A.D.3d 578 (2nd Dep't 2009) ("A party should be afforded a reasonable opportunity to conduct discovery prior to the determination of a motion for summary judgment.") Accordingly, the proponent's motion to dismiss objections on this basis is denied.

Objectant's Motion for Disclosure and Continued Depositions

The objectant alleges that the proponent has failed to adequately respond to the demand and the subpoenas, specifically, the attorney-drafter has failed to provide the demanded documents, has raised invalid objections during depositions, and has deliberately and purposefully refused to answer questions during his deposition. For instance, objectant alleges that the attorney-drafter refused to answer:

> [a]ny questions regarding his relationship to the Decedent, the Petitioner or the Shrine. In fact he became agitated when certain questions were asked. He repeatedly interrupted the questioning and stonewalled certain obviously relevant areas of inquiry.

Therefore, the objectant seeks an order directing compliance with the demand and subpoenas and granting the objectant an opportunity to continue the depositions of both the proponent and the attorney-drafter after the documents sought are produced.

The proponent asserts that the attorney-client privilege and attorney-work product under CPLR 3010 (b) and (c) precludes the disclosure sought by the objectant.

Post-objection disclosure is governed by the CPLR, which provides that there shall be "full disclosure of all matter material and necessary in the prosecution or defense of an action." CPLR 3101(a). Supervision of disclosure is generally left to the sound discretion of the trial court.

Argumedo v 303 Tenants Corp., 246 A.D. 2d 616 (2nd Dep't 1998). Generally, the language "material and necessary" is "interpreted liberally to require disclosure, upon request, of any facts bearing on the controversy which will assist preparation for trial by sharpening the issues and reducing delay and prolixity. The test is one of usefulness and reason." *Allen v Crowell-Collier Publ. Co.*, 21 N.Y. 2d 403, 406 (1968), *Matter of Beryl*, 1118 A.D. 2d 705 (2nd Dep't 1986). It has been interpreted as nothing more or less than relevant. *See*, Connors, Practice Commentaries, McKinney's Cons. Laws of NY, Book 7B, CPLR C3101:5.

In will contests, relevant matters are those which may be the basis of objections to the probate of the propounded instrument. *Matter of Delisle*, 149 A.D. 2d 793 (3rd Dep't 1989), *Matter of Ettinger*, 7 Misc. 3d 316 (Surr. Ct. Nassau County 2005) (both examination and discovery permitted under SCPA 1404 are broad), 2 *Harris N.Y. Estates: Probate Admin. & Litigation* § 24:144 (6th ed.). Documents obtained may include, but are not limited to, the attorney-drafter's copies of prior wills, billings, federal and state tax returns, inventories, and the decedent's financial documents. *Matter of Delisle, supra.* Since requests for documents contained in the disclosure demand and the two subpoenas are nearly identical, the court will examine 14 document requests sought to be compelled in Schedule A of the objectant's subpoena.

Requests Numbered 1, 2, 5, and 7
Prior Testamentary Instruments and Drafts of the
Propounded Instrument and Related Documents

The objectant may seek disclosure of prior testamentary instruments and drafts of the propounded instrument. A will can be compelled from any person under SCPA 1401 regardless of its date. Further, prior testamentary instruments should be discoverable unless there is some other basis for issuing a protective order. *Matter of Manoogian*, 2014 W.L. 726923 (Surr. Ct. New York County 2014). Moreover, the production of drafts of the propounded instrument are permissible and relevant, and are not privileged as claimed by the proponent. Indeed, pursuant to CLPR 4503 (b):

> In any action involving the probate, validity or construction of a will or, after the grantor's death, a revocable trust, an attorney or his employee shall be required to disclose information as to the preparation, execution or revocation of any will, revocable trust, or other relevant instrument, but he shall not be allowed to disclose any communication privileged under subdivision (a) which would tend to disgrace the memory of the decedent.

Pursuant to this statute, production of the requested documents is permissible and clearly not shielded by the attorney-client privilege. Further, assuming such disclosure would tend to

disgrace the memory of the decedent, the party asserting privilege bears the burden of establishing the application of privilege. *People v. Mitchell*, 58 N.Y.2d 368, 373 (1983). Aside from the conclusory allegation of preclusion by virtue of the attorney-client privilege, proponent offers no other assertion justifying the failure to respond to this request. Moreover, drafts of the propounded instrument, and notes taken by the attorney-drafter concerning the propounded instrument clearly fall under "preparation" of any will. Likewise, any communications between the attorney-drafter and the decedent are also relevant and material to the objections of the propounded instrument. Accordingly, the proponent and attorney-drafter shall produce copies of all drafts of the propounded instrument and all prior wills and codicils prepared for and/or executed by the decedent, and all documents as enumerated in Schedule A of the subpoena numbered 1, 2, 5, and 7, if any, within 30 days of service of this decision and order with notice of entry.

Requests Numbered 3, 4, 10, 11, and 12
Retainer Agreements and Invoices

Production of a copy of the retainer agreement, invoices and evidence of payments between the decedent and the attorney-drafter are relevant and material. Further, payments from the proponent and the residuary beneficiary under the propounded instrument to the attorney-drafter are entirely discoverable. *Matter of Delisle*, *supra*. Accordingly, the proponent and attorney-drafter shall produce a copy of documents requested in Schedule A of the subpoena numbered 3, 4, 10, 11, and 12, if any, within 30 days of service of this decision and order with notice of entry.

Requests Numbered 6, 8, and 9
Documents pertaining to conversations between the attorney-drafter, the proponent and the beneficiary under the propounded instrument concerning the decedent.

The proponent has not established that these requests, which pertain to conversations that the attorney-drafter may have had with the proponent and the beneficiary about the decedent, are properly shielded by the attorney-client privilege in light of the provisions of CPLR 4503(b) and in light of the fact that the attorney-drafter represented the decedent concerning her estate plan. *Matter of Mitchell*, *supra*. Accordingly, the proponent and attorney-drafter shall produce a copy of documents requested in Schedule A of the subpoena numbered 6, 8 and 9, if any, within 30 days of service of this decision and order with notice of entry.

Request Numbered 13
Financial Records

The proponent shall produce a copy of the financial records in Request 13 of Schedule A within 30 days of service of this decision and order with notice of entry. *See Matter of Delisle, supra*. If the proponent is not in possession of such records, he shall provide properly executed authorizations to the objectant in compliance with 22 NYCRR 207.27 within 30 days of service of this decision and order with notice of entry.

Medical Records

The decedent's medical records during the period permitted by 22 NYCRR 207.27 are entirely discoverable. If the proponent is in possession of such medical records, copies of same shall be provided within 30 days from the notice of entry of this decision and order. If the proponent is not in possession of such records, he shall provide properly executed HIPAA authorizations to the objectant in compliance with 22 NYCRR 207.27 within 30 days of service of this decision and order with notice of entry.

Responses to Disclosure and Depositions

With respect to all disclosure demands set forth above, if a request has been complied with, or if there are no such documents, the court directs proponent to provide a sworn statement to the effect that there are no other documents in his possession or within his control that would satisfy a particular request within 30 days of service of this decision and order with notice of entry. If the proponent is not in possession of documents, but has control of same by virtue of his having been appointed preliminary executor, he shall provide objectant with appropriately executed authorizations so that objectant may obtain such documents within 30 days of service of this decision and order with notice of entry.

The depositions of the attorney-drafter and the proponent shall continue within 30 days after the aforementioned documents, including financial and medical records, if any, are received by the objectant.

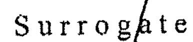
Conclusion

For all the foregoing reasons, the proponent's motion is denied and the objectant's motion is granted to the extent set forth herein.

This constitutes the decision and order of the court.

Dated: December 20, 2016

HON. MARGARITA LÓPEZ TORRES



Surrogate

124 A.D.3d 1266
Supreme Court, Appellate Division,
Fourth Department, New York.

In the Matter of the ESTATE OF
David C. PETERS, Deceased.

Jan. 2, 2015.

Synopsis

Background: Daughter of testator brought action seeking to prohibit Surrogate's Court from exercising jurisdiction over any real property situated within Native American reservation territory that was bequeathed to her in testator's will. The Surrogate's Court, Genesee County, Robert C. Noonan, S., denied motion by testator's mother, who challenged probate of testator's will, to disqualify attorney of testator's daughter. Mother appealed.

[Holding:] The Supreme Court, Appellate Division, held that testator's mother waived her objection to opposing counsel's representation of testator's daughter.

Affirmed.

West Headnotes (8)

[1] **Evidence**
Records and decisions in other actions or proceedings

On motion by testator's mother to disqualify attorney of testator's daughter during probate proceedings, Appellate Division would take judicial notice of records submitted to Appellate Division in related appeals.

Cases that cite this headnote

[2] **Attorney and Client**
Interests of former clients

Attorney and Client
Disqualification proceedings;standing

A party seeking disqualification of its adversary's lawyer must prove that there was an attorney-client relationship between the moving party and opposing counsel, that the matters involved in both representations are substantially related, and that the interests of the present client and former client are materially adverse; only where the movant satisfies all three inquiries does the irrebuttable presumption of disqualification arise.

3 Cases that cite this headnote

[3] **Attorney and Client**
Disqualification in general

Inasmuch as the right to counsel of choice, while not absolute, is a valued right, any restrictions thereon must be carefully scrutinized.

Cases that cite this headnote

[4] **Attorney and Client**
Disqualification in general

A court reviewing a party's motion to disqualify its adversary's lawyer must balance the vital interest in avoiding even the appearance of impropriety with a party's right to representation by counsel of choice and the danger that such motions can become tactical derailment weapons for strategic advantage in litigation.

Cases that cite this headnote

[5] **Attorney and Client**
Disclosure, waiver, or consent

In determining whether a party has waived any objection to opposing counsel's conflict of interest, courts consider when the challenged interests became materially adverse to determine if the party could have moved for disqualification at an earlier time.

Cases that cite this headnote

[6] **Attorney and Client**

 © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Disclosure, waiver, or consent

If a party moving for disqualification of opposing counsel was aware or should have been aware of the facts underlying an alleged conflict of interest for an extended period of time before bringing the motion, that party may be found to have waived any objection to the other party's representation.

1 Cases that cite this headnote

[7] **Attorney and Client**

Disclosure, waiver, or consent

Where a party's motion to disqualify opposing counsel is made in the midst of litigation where the moving party knew of the alleged conflict of interest well before making the motion, it can be inferred that the motion was made merely to secure a tactical advantage.

1 Cases that cite this headnote

[8] **Attorney and Client**

Disclosure, waiver, or consent

Testator's mother waived her objection to opposing counsel's representation of testator's daughter during probate proceedings; daughter's interests were materially adverse to mother's interests inasmuch as mother had consistently maintained that, pursuant to tribal law, she was entitled to all real property and businesses located within Native American tribal territory that were to pass to daughter under testator's will, and, although mother was not named party in any proceeding, she and her attorney actively participated in litigation for over one year before filing motion to disqualify, with full knowledge of potential conflict of interest involving daughter's attorney.

Cases that cite this headnote

Attorneys and Law Firms

****606** Colucci & Gallaher, P.C., Buffalo (Paul G. Joyce of Counsel), for Respondent–Appellant.

Law Offices of John P. Bartolomei & Associates, Niagara Falls (John P. Bartolomei of Counsel), for Petitioner–Respondent.

PRESENT: SCUDDER, P.J., SMITH, PERADOTTO, CARNI, AND SCONIERS, JJ.

Opinion

MEMORANDUM:

***1266** Respondent appeals from an order denying her motion seeking, inter alia, to disqualify petitioner's attorney and his law firm from representing petitioner. We conclude that Surrogate's Court properly denied that motion.

[1] In support of her motion, respondent contended that petitioner's attorney had once represented her and her son, David C. Peters (decedent), in an action related to ownership of one of the pieces of real property at issue in this proceeding. That real property is situated within the borders of the Tonawanda Seneca Nation Territory (Territory), and was purportedly owned by decedent when he died. Through his will, which was offered for ***1267** probate in September 2011, decedent sought to devise and bequeath that same piece of real property, as well as businesses situated thereon, to his brother and petitioner, who is decedent's daughter. Respondent is decedent's mother, and she challenged various provisions of decedent's will, contending that she had a superior right of ownership over all of the real property situated on the Territory based on “matriarchal tribal law.” Since decedent's death, there has been ongoing litigation related to decedent's estate and the Surrogate's authority to preside over that litigation (*see e.g. Peters v. Noonan,* 871 F.Supp.2d 218; *Matter of Tonawanda Seneca Nation v. Noonan,* 122 A.D.3d 1334, 996 N.Y.S.2d 446), and we take judicial notice of the records submitted to this Court in related appeals (*see Edgewater Constr. Co., Inc. v. 81 & 3 of Watertown, Inc.* [Appeal No. 2], 24 A.D3.d 1229, 1231, 806 N.Y.S.2d 817). In the midst of that litigation, respondent filed the instant motion to disqualify petitioner's attorney.

[2] “The Code of Professional Responsibility does not in all circumstances bar attorneys from representing parties in litigation against former clients. Rather, DR 5–108 sets out two prohibitions on attorney conduct relating to former clients. First, an attorney may not represent ‘another person in the same or a substantially related

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

matter in which that person's interests are materially adverse to the interests of the former client' ... Second, an attorney may not use 'any confidences or secrets of the former client except as permitted by DR 4–101(C) or when the confidence or secret has become generally known' " (*Jamaica Pub. Serv. Co. v. AIU Ins. Co.,* 92 N.Y.2d 631, 636, 684 N.Y.S.2d 459, 707 N.E.2d 414). "A party seeking disqualification of its adversary's lawyer pursuant to DR 5–108(A)(1) must prove that there was an attorney-client relationship between the moving party and opposing counsel, that the matters involved in both representations are substantially related, and that the interests of the present client and former client are materially adverse. Only 'where the movant satisfies all three inquiries does the irrebuttable presumption of disqualification arise' " (*id.*).

****607** **[3]** **[4]** Of particular concern to the courts, however, is the fact that "motions to disqualify are frequently used as an offensive tactic, inflicting hardship on the current client and delay upon the courts by forcing disqualification even though the client's attorney is ignorant of any confidences of the prior client. Such motions result in a loss of time and money, even if they are eventually denied. [The Court of Appeals] and others have expressed concern that such disqualification motions may be used frivolously as a litigation tactic when there is no real concern that a confidence has been abused" (*Solow v. Grace &* ***1268** *Co.,* 83 N.Y.2d 303, 310, 610 N.Y.S.2d 128, 632 N.E.2d 437). Inasmuch as the right to counsel of choice, while not absolute, "is a valued right[,] ... any restrictions [thereon] must be carefully scrutinized" (*S & S Hotel Ventures Ltd. Partnership v. 777 S.H. Corp.,* 69 N.Y.2d 437, 443, 515 N.Y.S.2d 735, 508 N.E.2d 647). We must therefore balance "the vital interest in avoiding even the appearance of impropriety [with] a party's right to representation by counsel of choice and [the] danger that such motions can become tactical 'derailment' weapons for strategic advantage in litigation" (*Jamaica Pub. Serv. Co.,* 92 N.Y.2d at 638, 684 N.Y.S.2d 459, 707 N.E.2d 414).

Contrary to petitioner's contention, respondent established that she had a prior attorney-client relationship with petitioner's attorney, that the issues in the two litigations are substantially related, each involving ownership of the same parcel of property, and that her interests are adverse to those of petitioner (*see id.* at 636, 684 N.Y.S.2d 459, 707 N.E.2d 414; *Tekni–Plex, Inc. v. Meyner & Landis,* 89 N.Y.2d 123, 132, 651 N.Y.S.2d 954, 674 N.E.2d 663, *rearg. denied* 89 N.Y.2d 917, 653 N.Y.S.2d 921, 676 N.E.2d 503; *Solow,* 83 N.Y.2d at 313, 610 N.Y.S.2d 128, 632 N.E.2d 437). Usually, that would create an "irrebuttable presumption of disqualification" (*Tekni–Plex,* 89 N.Y.2d at 132, 651 N.Y.S.2d 954, 674 N.E.2d 663; *see Jamaica Pub. Serv. Co.,* 92 N.Y.2d at 636, 684 N.Y.S.2d 459, 707 N.E.2d 414), but many courts have nevertheless denied disqualification upon finding that a party has waived any objection to the purported conflict of interest (*see e.g. Hele Asset, LLC v. S.E.E. Realty Assoc.,* 106 A.D.3d 692, 693–694, 964 N.Y.S.2d 570; *Gustafson v. Dippert,* 68 A.D.3d 1678, 1679, 891 N.Y.S.2d 842; *Lake v. Kaleida Health,* 60 A.D.3d 1469, 1470, 876 N.Y.S.2d 800).

[5] **[6]** **[7]** In determining whether a party has waived any objection to a conflict of interest, "courts consider when the challenged interests became materially adverse to determine if the party could have moved [for disqualification] at an earlier time ... If a party moving for disqualification was aware or should have been aware of the facts underlying an alleged conflict of interest for an extended period of time before bringing the motion, that party may be found to have waived any objection to the other party's representation ... Further, where a motion to disqualify is made in the midst of litigation where the moving party knew of the alleged conflict of interest well before making the motion, it can be inferred that the motion was made merely to secure a tactical advantage" (*Hele Asset, LLC,* 106 A.D.3d at 694, 964 N.Y.S.2d 570; *see Gustafson,* 68 A.D.3d at 1679, 891 N.Y.S.2d 842; *Lake,* 60 A.D.3d at 1470, 876 N.Y.S.2d 800).

[8] Under the circumstances of this case, we conclude that respondent waived her objection to the attorney's representation of petitioner. Respondent "was aware ... of the facts underlying [the] alleged conflict of interest for an extended period of time before bringing the motion" (*Hele Asset, LLC,* 106 A.D.3d at 694, 964 N.Y.S.2d 570). Decedent passed away in August 2011, and the will was ***1269** offered for ****608** probate in September 2011. The executors appointed by the will refused to transfer to petitioner any of the real or personal property located within the Territory that was devised and bequeathed to her because respondent was asserting a superior right to all of the real property located within the Territory as well as the businesses situated thereon under the claimed authority of tribal law. In December

WESTLAW © 2019 Thomson Reuters. No claim to original U.S. Government Works.

2011, petitioner sought, inter alia, a hearing to determine whether respondent had lost any bequests pursuant to the in terrorem clause of decedent's will.

Respondent "made a 'special appearance' " in the probate proceeding on January 17, 2012 to assert her claims that the real property and businesses located within the Territory were not decedent's property to distribute. She claimed title and ownership of the property and the business interests "pursuant to matriarchal tribal law and clan interests." The Surrogate noted, however, that despite her assertions, respondent was refusing to submit to the jurisdiction of Surrogate's Court.

On January 30, 2012, respondent's attorney again appeared in court, at which time he was advised that respondent needed to file an intervenor pleading and pay a filing fee. Respondent refused to do so and, in March 2012, the Surrogate warned that the continued failure to do so would result in the Surrogate finding her in default on her attempted intervention. "Rather than intervene, on March 22, 2012, [respondent] filed a Federal lawsuit against [the Surrogate]." In the context of that federal action, respondent moved for a temporary restraining order prohibiting the Surrogate from probating decedent's will. That motion was denied on May 18, 2012 (*see Peters,* 871 F.Supp.2d at 220).

In August 2012, the Surrogate removed the coexecutors based on their refusal to comply with orders issued by the Surrogate, and he appointed petitioner as administratrix C.T.A. In December 2012, petitioner filed a petition seeking disgorgement and forfeiture of any and all bequests, devised properties and gifts under the will received by respondent. One month later, in January 2013, respondent filed the instant motion to disqualify petitioner's attorney and his law firm from representing petitioner.

Petitioner's attorney has represented petitioner in this matter since November 2011. At all times, petitioner's interests have been materially adverse to respondent's interests inasmuch as respondent has consistently maintained that, pursuant to matriarchal tribal law, she is entitled to all of the real property and businesses located within the Territory that were to pass to ***1270** petitioner under the will. Although respondent was technically not a named "party" in any proceeding, she and her attorney actively participated in the litigation for over one year with full knowledge of the identity of petitioner's attorney and the potential conflict of interest involving that attorney. Given the complexity of the litigation, the hardship that would be inflicted on petitioner and the estate, and the one-year delay in bringing the motion, we conclude that this motion was made "as an offensive tactic" (*Solow,* 83 N.Y.2d at 310, 610 N.Y.S.2d 128, 632 N.E.2d 437), i.e., for the purpose of "secur[ing] a tactical advantage" in the proceeding (*Hele Asset, LLC,* 106 A.D.3d at 694, 964 N.Y.S.2d 570), and that "there is no real concern that a confidence has been abused" (*Solow,* 83 N.Y.2d at 310, 610 N.Y.S.2d 128, 632 N.E.2d 437).

It is hereby ORDERED that the order so appealed from is unanimously affirmed without costs.

All Citations

124 A.D.3d 1266, 1 N.Y.S.3d 604, 2015 N.Y. Slip Op. 00042

End of Document © 2019 Thomson Reuters. No claim to original U.S. Government Works.

Reprinted with Permission

Neutral
As of: May 2, 2019 2:06 PM Z

Matter of Milbauer

Surrogate's Court of New York, Nassau County

April 6, 2015, Decided

351171/A

Reporter
2015 N.Y. Misc. LEXIS 2675 *; 2015 NY Slip Op 31300(U) **

[1]** Probate Proceeding, Will of JEANETTE MILBAUER, Deceased.Probate Proceeding, Will of JEANETTE MILBAUER, Deceased.In the Matter of the Petition of Joan Husserl to Compel an Accounting of Karen Silverman as Preliminary Executor of the Estate of JEANETTE MILBAUER, Deceased.Miscellaneous Proceeding, Estate of JEANETTE MILBAUER, Deceased.Accounting by Karen Silverman as Preliminary Executor of the Estate of JEANETTE MILBAUER, Deceased.Accounting by Karen Silverman as Preliminary Executor of the Estate of JEANETTE MILBAUER, Deceased. **[**2]** Accounting by Karen Silverman as Preliminary Executor of the Estate of JEANETTE MILBAUER, Deceased.Accounting by Karen Silverman as Preliminary Executor of the Estate of JEANETTE MILBAUER, Deceased.Miscellaneous Proceeding Pursuant to SCPA 2103 by Joan Husserl, as Limited Administrator, for Discovery and Turnover of Assets Belonging to the Estate of JEANETTE MILBAUER, Deceased.In the Matter of the Petition of Joan Husserl and Kenneth Husserl to Compel Accounting of Karen Silverman, as Preliminary Executor of the Estate of Jeanette Milbauer, Successor Trustee of the Trust dated November 1, 2000 Made by HAZEL R. FLICKER, Deceased.In the Matter of the Petition of Joan Husserl to Compel Accounting of Karen Silverman, as Preliminary Executor of the Estate of Jeanette Milbauer, First Successor Trustee of the Trust July 1, 1995 Made by HAZEL R. FLICKER, Deceased. **[**3]** Miscellaneous Proceeding - Supreme Court Action of Karen Milbauer Silverman, individually as Beneficiary and Trustee of the HAZEL R. FLICKER IRREVOCABLE TRUST, July 1, 1995, -against- Kenneth Husserl, individually, Kenneth Husserl, as the Pretexted and Successor Trustee in the Purported Document "named" the Irrevocable Trust made by Hazel R. Flicker (Trustor) and Stanley Milbauer (Trustee) dated November 1, 2000.In the Matter of the Petition of Joan Husserl to Compel Accounting of Karen Silverman, as Preliminary Executor of the Estate of Jeanette Milbauer, First Successor Trustee of the Trust dated July 1, 1995, made by HAZEL R. FLICKER, Deceased.In the Matter of the Petition of Joan Husserl to Compel Accounting of Karen Silverman, as Preliminary Executor of the Estate of Jeanette Milbauer, Successor Trustee of the Trust dated November 1, 2000, made by HAZEL R. FLICKER, Deceased.In the Matter of the Petition of Joan Husserl and Kenneth Husserl to Compel Accounting of Karen Silverman, as Preliminary Executor of the Estate of Jeanette Milbauer, Successor Trustee of the Trust dated November 1, 2000, made by HAZEL R. FLICKER, Deceased.

Prior History: *Matter of Milbauer, 40 Misc. 3d 1202(A), 972 N.Y.S.2d 144, 2013 N.Y. Misc. LEXIS 2637 (2013)*

Core Terms

disqualify, disqualification, movant, proceedings, matters, conflicting interest, participated, recusal, argues, law law law, parties, disqualification motion, rule rule rule, promptly, waived, attorney-referee, conferences, involvement, third-party, arbitrator, settlement, knowingly, mediator, opposing, letters, probate, courts, circumstances, transferred, attorneys

Judges: **[*1]** EDWARD W. McCARTY III, Judge of the Surrogate's Court.

Opinion by: EDWARD W. McCARTY III

Opinion

[4]** In connection with multiple proceedings filed in connection with the Estate of Jeanette Milbauer and trusts created by Hazel R. Flicker, an order to show cause has been filed on behalf of Karen Silverman seeking:

1. An order disqualifying Sally Donahue and the

firm of Jaspan Schlesinger, LLP as attorneys for Kenneth Husserl and Joan Husserl;

2. An order of recusal by Surrogate Edward W. McCarty III;
3. An order of judicial disqualification of Surrogate Edward W. McCarty III; and
4. An order transferring all pending matters to Judge Thomas A. Adams, the Administrative Judge for the Tenth Judicial District Supreme Court, Nassau County; and
5. A stay of all proceedings pending a determination of the application.

In addition, Karen Silverman filed a petition for an extension of preliminary letters issued to her in the estate of Jeanette Milbauer.

Opposition to all of the relief requested has been filed on behalf of Joan Husserl and Kenneth Husserl.

BACKGROUND

The complete background and history of these proceedings are recited in the prior decisions and orders of this court and are incorporated into this decision by reference. **[*2]** Briefly, the court notes that Jeanette Milbauer died on February 18, 2008, survived by her two daughters, Karen Silverman and Joan Husserl. Joan Husserl is married to Kenneth Husserl. Hazel R. Flicker is the aunt of Ms. Silverman and Ms. Husserl. The decedent, Jeanette Milbauer, served as a trustee of two trusts created by Hazel Flicker. Ms. Silverman offered an instrument for probate, dated December 20, 2007, as the will of the decedent, in which Ms. Silverman is nominated as the executor. Ms. Husserl objected to probate. Preliminary letters testamentary issued to Ms. **[**5]** Silverman on April 6, 2010 and were subsequently extended, despite objections filed by Ms. Husserl.

ANALYSIS

1. Disqualification of Sally Donahue and Jaspan Schlesinger, LLP

The disqualification of Sally Donahue and Jaspan Schlesinger, LLP (Jaspan) as counsel for Kenneth Husserl and Joan Husserl is sought pursuant to New York State Unified Court Systems Part 1200 Rules of Professional Conduct, Rules 1.10, imputation of conflict of interest; Rule 1.11, special conflicts of interest for former and current government offices and employees; and Rule 1.12, specific conflicts of interest from former judges, arbitrators, mediators or other third-party neutrals. **[*3]** The basis for the requested relief is Ms. Donahue's prior professional position as a court attorney-referee with this court (the Court), in which capacity she worked on an earlier proceeding brought in connection with the estate of Jeanette Milbauer, including supervising discovery and conducting conferences.

Ms. Donahue argues that there is no legitimate reason to grant this relief. She further maintains that Ms. Silverman waived any rights she might have in connection with the requested disqualification of Ms. Donahue and Jaspan by waiting until two years after Ms. Donahue began representing Joan Husserl and Kenneth Husserl.

While Ms. Donahue concedes that she was employed at the Court as a court attorney-referee from November 2006 until June 1, 2011, she argues that she had only ministerial involvement with the sole Jeanette Milbauer proceeding ongoing at that time, which was the probate petition filed by Ms. Silverman and contested by Ms. Husserl. All parties agree that in Ms. Donahue's position as a court attorney-referee, she conducted several conferences regarding the Jeanette Milbauer estate which counsel for Ms. Silverman, G. Ronald Hoffman, appeared on behalf of Ms. Silverman. **[*4]**

[6]** In December 2012, Ms. Donahue began working for Jaspan. In that capacity, she appeared on behalf of Joan Husserl and Kenneth Husserl in opposition to Mr. Hoffman at multiple conferences at the Court. As counsel for the Husserls, Ms. Donahue communicated with Mr. Hoffman and with the Court in writing and by telephone, and participated with Mr. Hoffman in settlement conferences, both at Jaspan and at Mr. Hoffman's law firm. Ms. Donahue states that at the start of her representation of Joan and Kenneth Husserl, she disclosed to Mr. Hoffman the extent of her involvement in the Milbauer probate proceeding while she was a court employee, a contention which Mr. Hoffman does not expressly refute. She argues that it is only now, two years later, after mutual attempts at settlement were unsuccessful, that Mr. Hoffman brought the order to show cause to disqualify her and Jaspan, and thus deny Joan and Kenneth Husserl the counsel of their choice.

In connection with the Hazel Flicker proceedings pending in the Court, Ms. Donahue argues that none of these proceedings were pending during her tenure at the Court, and that there are therefore no grounds for disqualifying her or Jaspan in connection **[*5]** with these matters. She argues further that since Ms. Silverman waited two years to argue for the

disqualification of Ms. Donahue and Jaspan in the Hazel Flicker matters, the delay amounts to Ms. Silverman's waiver of this relief.

There is no disagreement among the parties that the applicable standard for disqualification of a court attorney-referee based on these present facts is whether the attorney personally and substantially participated in the matter before the Court. Rule 1.11 provides, in relevant part:

> "Rule 1.11 Special conflicts of interest for former and current government officers and employees.
>
> (a) Except as law may otherwise expressly provide, a lawyer who has formerly **[**7]** served as a public officer or employee of the government:
> (1) shall comply with Rule 1.9(c); and
> (2) shall not represent a client in connection with a matter in which the lawyer participated personally and substantially as a public officer or employee, unless the appropriate government agency gives its informed consent, confirmed in writing, to the representation. This provision shall not apply to matters governed by Rule 1.12(a).
>
> (b) When a lawyer is disqualified from representation under paragraph (a), no lawyer in a firm with which that lawyer is associated may knowingly **[*6]** undertake or continue representation in such a matter unless:
> (1) the firm acts promptly and reasonably to:
> (i) notify, as appropriate, lawyers and nonlawyer personnel within the firm that the personally disqualified lawyer is prohibited from participating in the representation of the current client;
> (ii) implement effective screening procedures to prevent the flow of information about the matter between the personally disqualified lawyer and the others in the firm;
> (iii) ensure that the disqualified lawyer is apportioned no part of the fee therefrom; and
> (iv) give written notice to the appropriate government agency to enable it to ascertain compliance with the provisions of this Rule; and
> (2) there are no other circumstances in the particular representation that create an appearance of impropriety."

[8]** (Rules of Professional Conduct [*22 NYCRR 1200.0*] rule 1.11).

Rule 1.12 provides, in relevant part:

> Rule 1.12 Specific conflict of interest for former judges, arbitrators, mediators or other third-party neutrals.
> (a) A lawyer shall not accept private employment in a matter upon the merits of which the lawyer has acted in a judicial capacity.
>
> (b) Except as stated in paragraph (d), and unless all parties to the proceeding give informed consent, confirmed **[*7]** in writing, a lawyer shall not represent anyone in connection with a matter in which the lawyer participated personally and substantially as:
> (1) an arbitrator, mediator or other third-party neutral; or
> (2) a law clerk to a judge or other adjudicative officer or an arbitrator, mediator or other third-party neutral. . . .
> (d) When a lawyer is disqualified from representation under this Rule, no lawyer in a firm which with that lawyer is associated may knowingly undertake or continue representation in such a matter unless:
> (1) the firm acts promptly and reasonably to:
> (i) notify, as appropriate, lawyers and nonlawyer personnel within the firm that the personally disqualified lawyer is prohibited from participating in the representation of the current client;
> (ii) implement effective screening procedures to prevent the flow of information about the matter between the personally disqualified lawyer and the others in the firm;
>
> (iii) ensure that the disqualified lawyer is apportioned no part of the fee therefrom; **[**9]** and
> (iv) give written notice to the parties and any appropriate tribunal to enable it to ascertain compliance with the provisions of this Rule; and
>
> (2) there are no other circumstances **[*8]** in the particular representation that create an appearance of impropriety."

(Rules of Professional Conduct [*22 NYCRR 1200.0*] rule 1.12).

Not surprisingly, the parties disagree as to whether Ms. Donahue's level of involvement with the case as a court attorney was such that she could be found to have "participated personally and substantially" with the case as a court attorney. Because the court finds that the movant has waived the right to move to disqualify Ms. Donahue or Jaspan, it need not reach that issue.

There is a dearth of case law on the issue of waiver in the context of attorney disqualification in the New York

courts where the disqualification is sought on the basis that the attorney had previously been involved in the case as a public officer or employee. There are, however, quite a number of federal court cases on the analogous basis that the attorney had previously represented another party to the litigation or otherwise had a conflict. A state court, in deciding a case before it, may, of course, consider how the federal courts have resolved the same or a similar issue (*see Brady v Williams Capital Group, L.P., 14 NY3d 459, 928 N.E.2d 383, 902 N.Y.S.2d 1 [2010])*.

The courts have recognized that "disqualification has an immediate adverse effect on the client by separating him from counsel **[*9]** of his choice, and ... disqualification motions are often interposed for tactical reasons" (*Board of Ed of City of New York v Nyquist, 590 F2d 1241, 1246 [2d Cir 1979])*. Furthermore, "[c]ourts have disallowed disqualification on the basis of waiver or estoppel where the moving party has failed to move for disqualification in a timely manner. 'It is **[**10]** well settled that a former client who is entitled to object to an attorney representing an opposing party on the ground of conflict of interest but who knowingly refrains from asserting it promptly is deemed to have waived that right'" (*Official Unsecured Creditors Comm. of Valley-Vulcan Mold Company v Ampco-Pittsburgh Corp, 5 Fed Appx 396 *401 [6th Cir 2001]*, quoting *Trust Corp of Montana v Piper Aircraft Corp, 701 F2d 85, 87 (9th Cir 1983)*.

"[T]he Court must also bear in mind that the court's authority to disqualify an attorney or craft appropriate relief to punish or deter attorney misconduct derives from the court's equitable powers, and as such equitable considerations like waiver and estoppel apply. The California Supreme Court has similarly noted that a disqualification motion may involve such considerations as a client's right to chosen counsel, an attorney's interest in representing a client, the financial burden on a client to replace disqualified counsel, and the possibility that tactical abuse underlies the disqualification motion. Thus, where delay in making the disqualification motion is unreasonable and **[*10]** the resulting prejudice is great, the court will assume an implied waiver of the right to disqualify. [A] former client who is entitled to object to an attorney representing an opposing party on the ground of conflict of interest but who knowingly refrains from asserting it promptly is deemed to have waived that right" (*Sirisup v It's Thai, L.L.C., 2015 US Dist LEXIS 11360 *5 [CD CA 2015]*[internal citations and quotations omitted]).

In another case, the court, in denying the motion to disqualify counsel and rejecting the movant's contention that it acted to remove counsel "at the first reasonable opportunity" held that "[w]aiting five months before raising the issue with opposing counsel cannot be characterized as "the first reasonable opportunity" under any circumstances. If [movant] had genuine concerns regarding whether confidences would be shared with [opposing] counsel, it would have acted immediately" (*Matter of National Century Financial Enterprises, Inc. 2010 US Dist LEXIS 39524 *41 [SD OH 2010])*.

[11]** Courts have identified several criteria to be considered in determining whether a party moving to disqualify an attorney has waived the right to do so based on waiver. They are:

(1) the length of the delay in bringing the motion to disqualify

(2) when the movant learned of the conflict

(3) whether the movant was represented by counsel during the delay

(4) why **[*11]** the delay occurred, and

(5) whether disqualification would result in prejudice to the non-moving party (*Lyon v Goldstein, 2006 US Dist LEXIS 71274 *17 [D NJ 2006]*[internal citation omitted]).

Here, movant delayed not merely five months but nearly two years from the date she knew or should have known of Ms. Donahue's prior involvement in the case as a court attorney. Movant's affidavit in support of her motion is noticeably silent on when she learned of Ms. Donahue's representation of her sister but her attorney clearly knew immediately and to suggest, as has not even been done, that Mr. Hoffman failed to advise his client of Ms. Donahue's representation of her sister would be completely incredible. Movant was represented by counsel throughout the period of delay by the same attorney who had conferenced the case with Ms. Donahue when she was a court attorney; he continues to represent movant at the current time. Depriving Ms. Donahue's client of her attorneys of nearly eight years in this litigation would clearly be prejudicial to their interests. Any argument that the movant delayed moving timely for disqualification in the hopes of a settlement would be unavailing as the fact that settlement negotiations may have been ongoing does not relieve **[*12]** the movant of the obligation to move promptly to disqualify counsel where a basis for disqualification exists (*Safe-T-Products, Inc. v Learning*

Resources, Inc. 2002 US Dist LEXIS 20540 *24 [ND Il 2002]). Finally, arguing against the possibility of a finding of waiver, Mr. Hoffman alleges that he delayed making the instant motion at Ms. Donahue's request. However, a movant cannot "rely on evidence **[**12]** submitted for the first time in its reply papers in support of its motion" (L'Aquila Realty , LLC v Jalyng Food Corp., 103 AD3d 692, 692, 959 N.Y.S.2d 724 [2d Dept 2013]; *see also* GJF Construction Corp. v Cosmopolitan Decorating Co., Inc., 35 AD3d 535, 828 N.Y.S.2d 409 [2d Dept 2006]).

Accordingly, those branches of the motion which seek to disqualify Ms. Donahue or Jaspan Schlesinger LLP as counsel for Joan and Kenneth Husserl are denied.

2. Disqualification of, or Recusal by, Surrogate Edward W. McCarty III

The order of judicial disqualification is sought pursuant to *Judiciary Law § 14*, which provides in part: "A judge shall not sit as such in, or take any part in the decision of, an action, claim, matter, motion or proceeding to which he is a party, or in which he has been attorney or counsel." Mr. Hoffman bases this request for relief on the fact that my Principal Law Clerk served as counsel to Joan and Kenneth Husserl while employed at Jaspan and worked on the matters presently pending before me. While conceding that I never served as counsel to Joan and Kenneth Husserl, counsel argues that **[*13]** since my current Principal Law Clerk served in that capacity, mandatory judicial disqualification is required.

Mr. Hoffman's argument for my disqualification fails to account for the fact that I never represented the parties in these proceedings and have no interest in these matters.

> "The disqualification statute . . . is an adaptation of the common-law rule forbidding a Judge to sit in or take part in a cause or matter in which he is interested. The rule is based on the maxim that no man can be a Judge in his own cause and on the rule that a Judge not be, or appear to be, aligned with a party appearing before him. . . . [T]he nature of the interest required to disqualify a Judge is an interest as a party or in a pecuniary or property right from which he might profit or lose. It must be an interest in the subject matter of the suit. The interest need not be large, but it must be real; it must be certain, and not merely **[**13]** possible or contingent; it must be one which is visible, demonstrable, and capable of precise proof. It must be a present interest and not merely one that formerly existed."

Matter of Sherburne, 124 Misc 2d 708, 709-710, 476 N.Y.S.2d 419 [Sur Ct Queens County 1984] [citations omitted]).

At the same time, I am being asked to recuse myself from this matter pursuant **[*14]** to Code of Judicial Conduct Canons 2 and 3 (1992). Mr. Hoffman notes that pursuant to Canon 2 of the Code of Judicial Conduct, a Judge must "act at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary (Code of Judicial Conduct [2.1] [2A]).

"[W]here an appearance of improper judicial interest emerges, the integrity of the judiciary requires that a Judge disqualify herself . . . No matter what the outcome of the case and the ultimate fairness of her judgment, the integrity of the court will be called into question because of defendant's doubt as to the Judge's impartiality. We deem it appropriate that the Judge disqualify herself in such case [citation omitted]" (Murray v Murray, 73 AD2d 1015, 1015-1016, 424 N.Y.S.2d 50 [3d Dept 1980]).

I have no interest in these proceedings, past, present, or future, and my Principal Law Clerk has not been involved in any of these matters in her prior or current position at the Court. Nevertheless, I have concluded that the best interests of these proceedings will be furthered by my recusal from the matter, lest there be even the slightest question, even without a substantive basis, concerning the integrity of this Court.

Mr. Hoffman has requested, in the event of recusal, that these proceedings be transferred to Judge Thomas A. Adams, the Administrative **[*15]** Judge for the Tenth Judicial District Supreme **[**14]** Court, Nassau County. Ms. Donahue argues for transfer of these proceedings to another Surrogate's Court. Generally, when I recuse myself, the matter is transferred to one of two Acting Surrogates for Nassau County, who is then assisted by a member of my law department. A conference to address the practical implications of the transfer of these proceedings to another court has been scheduled with a member of my law department on April 29, 2015 at 2:15 p.m.

3. Application for Extension of Preliminary Letters

Preliminary letters testamentary issued to Ms. Silverman on April 6, 2010 and were extended since. Ms. Silverman again seeks a further extension of her letters, and Ms. Husserl objects. Having recused myself from

the matter, the decision on the request for an extension of preliminary letters shall be made by the judge to whom these matters are assigned.

This constitutes the decision and order of this court.

Dated: April 6, 2015

EDWARD W. McCARTY III

Judge of the Surrogate's Court

End of Document

Reprinted with Permission

FILED
SURROGATES COURT
SUFFOLK COUNTY

DEC 15 2016

MICHAEL CIPOLLINO
CHIEF CLERK

SURROGATE'S COURT : SUFFOLK COUNTY

Probate Proceeding, Estate of
Estate of

RUTH E HOWELL,

Deceased.

DECISION/ORDER

By: HON. JOHN M. CZYGIER, JR.,
Surrogate

Dated: DEC 15 2016

File #: 2014-3328

In this contested probate proceeding, objectant Edwin P. Howell, II has moved for disqualification of the law firm of Christopher J. Cassar, Esq. from serving as counsel for petitioners. For the following reasons, objectant's motion is denied.

Background

The record reflects that decedent died on June 19, 2014 survived by five children, including petitioners Patricia Prianti and Paul Howell, as well as objectant Edwin P. Howell, II. Petitioners have proffered an instrument dated June 6, 2014 as the last will and testament of decedent. On March 9, 2015, objectant filed his objections to the propounded instrument on the grounds that, *inter alia*: (1) the June 6, 2014 instrument was not duly executed; (2) the decedent lacked testamentary capacity; (3) the instrument was the result of undue influence; and (4) Patricia Prianti and Paul Howell committed "misconduct, fraud, and undue influence over the decedent," failed "to preserve and account for the property of the Estate," and failed "to fulfill their fiduciary duties to protect and preserve the interest[s] of the distributees and heirs of the Estate" (Objs. ¶ 4).

The parties entered into a discovery schedule, at the completion of which both sides sought summary judgment. Pursuant to this court's June 20, 2016 decision and order, the undersigned granted petitioners' motion for summary judgment with respect to the objection alleging lack of due execution and the objection to petitioners as fiduciaries. The court otherwise denied both petitioners' and objectant's motions for summary judgment, thus concluding that there are issues of fact regarding testamentary capacity and undue influence remaining for trial. Said decision

and order recounts the full background of this contested probate, which the court will not restate herein.

As is relevant here, the record indicates that on May 16, 2014, Richard C. Toscani, Esq., then an employee of the Cassar Office, met with petitioners and decedent to discuss decedent's estate planning. After their meeting, Mr. Toscani drafted the propounded instrument. On June 6, 2014, the Cassar Office received a phone call stating that decedent had been hospitalized and requesting that Mr. Toscani visit decedent at Huntington Hospital in order to complete the will execution ceremony. Mr. Toscani obliged that request on the same day, bringing with him Courtney Ahlsen and Alexandra Brunswick, two paralegals from the Cassar Office. Ms. Ahlsen and Ms. Brunswick each testified during their depositions in this case that they witnessed the will execution ceremony and signed the propounded instrument accordingly. Neither Mr. Toscani nor Ms. Brunswick currently work for the Cassar Office.

Presently, objectant moves to disqualify the law firm of Christopher J. Cassar, Esq. (the "Cassar Office") from serving as counsel for petitioners. Objectant argues that the Cassar Office is conflicted from serving as counsel for petitioners "on the ground[s] of conflict of interest, attorney-witness conflict[,] and a violation of Rule 3.7 of the New York State Rules of Professional Conduct" (Notice of Motion ¶ 2) due to the involvement of Cassar Office employees in the drafting and execution of the propounded instrument. Petitioners assert that Rule 3.7 does not apply because Mr. Toscani is no longer an employee of the Cassar Office, that disqualification at this stage would be prejudicial, and that objectant has failed to meet his burden of proving that disqualification is necessary.

In addition to the pleadings, pre-trial orders, and submissions in connection with the motions for summary judgment, the record on this motion consists of Walter D. Long, Jr., Esq.'s affirmation and accompanying exhibits; Joseph J. Karlya, III, Esq.'s affirmation in opposition and accompanying exhibits; and Walter D. Long, Jr., Esq.'s reply affirmation. The court notes that, although the reply affirmation appears to suggest that Ms. Ahlsen and Ms. Brunswick are both current employees of the Cassar Office, only Ms. Ahlsen's affirmation submitted in opposition to objectant's motion for summary judgment and in support of petitioners' cross-motion for summary judgment indicates her current employment with the Cassar Office.

Applicable Law and Discussion

Pursuant to Rule 3.7 of New York's Rules of Professional Conduct, an attorney is prohibited from acting as advocate before a tribunal in a matter in which the lawyer is likely to be a witness on a significant issue of fact unless:

> (1) the testimony relates solely to an uncontested issue; (2) the testimony relates solely to the nature and value of legal services rendered in the matter; (3) disqualification of the lawyer would work substantial hardship on the client; (4) the testimony will relate solely to a matter of formality, and there is no reason to believe that substantial evidence will be offered in opposition to the testimony; or (5) the testimony is authorized by the tribunal.

(Rules of Professional Conduct [22 NYCRR 1200.0] Rule 3.7[a]).

The burden of proof is on the party seeking disqualification (*Tekni-Plex, Inc. v. Meyner & Landis*, 89 NY2d 123 [1996]), requiring a clear showing that counsel's removal is warranted (*Goldstein v. Held*, 52 AD3d 471 [2d Dept 2008]). Disqualification motions present competing concerns. The court must balance the vital importance of avoiding even the appearance of impropriety against the party's entitlement to be represented in an ongoing litigation by counsel of its own choosing and the danger that such motions can become tactical "derailment" weapons for strategic advantage in litigation (*see Jamaica Public Service Co. v. AIU Ins. Co.*, 92 NY2d 631 [1998] [citing *S&S Hotel Ventures Ltd. Partnership v. 777 S.H. Corp.*, 69 NY2d 437]). The conflict rules therefore should not be "mechanically applied when disqualification is raised in litigation" (*Kassis v. Teacher's Inc. & Annuity Assn.*, 93 NY2d 611 [1999]). The party seeking disqualification must demonstrate that the expected testimony of the attorney is necessary and prejudicial to said attorney's client (*Estate of Khaze*, NYLJ 3/10/04 at 34, col. 3 [Sur Ct, Suffolk County]).

There is ample case law concerning an attorney draftsman representing a petitioner in a contested probate proceeding. This court has consistently followed the majority rule that, although the attorney draftsman may not represent petitioner at trial, he may serve as counsel for petitioner up until the time of trial (*Matter of Giantasio*, 173 Misc2d 100 [Sur Ct, Bronx County]; *Estate of Reilly*, NYLJ 1/27/09 at 34, col. 4 [Sur Ct, Kings County];

Estate of Kelner, NYLJ 1/25/96 at 29, col. 1 [Sur Ct, Westchester County]).

Here, though, the facts are not as straightforward as the attorney draftsman seeking to act as counsel for the petitioners at trial. To begin, the conflict pertains to Mr. Toscani as the attorney-draftsman, and objectant essentially seeks to have said conflict imputed to the Cassar Office in order to prevent Christopher Cassar, Esq. from acting as trial counsel. Rule 3.7(b), which addresses imputation in this context, provides that:

> [a] lawyer may not act as advocate before a tribunal in a matter if: (1) another lawyer in the lawyer's firm is likely to be called as a witness on a significant issue other than on behalf of the client, and it is apparent that the testimony may be prejudicial to the client; or (2) the lawyer is precluded from doing so by Rule 1.7 or Rule 1.9.

(Rules of Professional Conduct [22 NYCRR 1200.0] Rule 3.7[b]). "Disqualification by imputation under Rule 3.7(b) is an 'extreme remedy' and should be ordered 'sparingly'" *(BT Holdings, LLC v. Village of Chester*, NYLJ 12/18/15 at 46 [SDNY] [quoting *Murray v. Metro. Life Ins. Co.*, 583 F3d 173 [2d Cir 2009]).

Objectant argues that this court should disqualify the Cassar Office because the "case will turn on credibility of [the] witnesses" and "put Mr. Cassar in the position of vouching for his own employees and himself" (Long Disqualification Aff. ¶ 3). However, the concerns against which the witness-advocate rule is designed to protect, such as trial counsel appearing to vouch for his own credibility, are "'absent or, at least, greatly reduced'" in imputation cases (*In re MetLife Demutualization Litig.*, NYLJ 9/30/09 at 25, col. 3 [2d Cir] [quoting *Ramey v. Dist. 141, Int'l Ass'n of Machinists & Aerospace Workers*, 378 F3d 269 [2d Cir 2004]). In this case, should Mr. Cassar act as trial counsel for petitioners, his credibility would not be at issue. Rather, any credibility issues would pertain to his former employee, Mr. Toscani, as well as to Ms. Ahlsen and Ms. Brunswick.

Other than raising the aforementioned concern, objectant has not identified how the expected testimony may be prejudicial as required under Rule 3.7(b)(1). Courts defined prejudice in this context as testimony that is "sufficiently adverse to the factual assertions or account of events offered on behalf of the client, such that the bar or the client might have an interest in the

lawyer's independence or in discrediting that testimony" *(Murray, supra* [citations omitted]; *see also Medford Petroleum LLC v. Quality Quick Mart, Inc. et al.*, 2012 NY Misc LEXIS 4463 [Sup Ct, Suffolk County 2012]; *Latimi v. New York City Transit Authority*, 2007 NY Misc LEXIS 5424 [Civ Ct, Kings County 2007]). In this case, Mr. Toscani's testimony is likely to be consistent with petitioners' position seeking probate of the propounded instrument. In particular, Mr. Toscani's affirmation in connection with the summary judgment submissions affirms that decedent was "undoubtedly of sound mind" (Toscani Aff. ¶ 3, attached as Ex. B to Long Disqualification Aff.) and that, while petitioners were present during the May 16, 2014 meeting, "they never spoke once" and Mr. Toscani discussed decedent's assets and estate planning only with decedent (Toscani Aff. ¶ 4).

In addition, Rule 1.9, addressed under Rule 3.7(b)(1) and entitled "Duties to Former Clients," states that

> [a] lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of a former client unless the former client gives informed consent, confirmed in writing.

(Rules of Professional Conduct [22 NYCRR 1200.0] Rule 1.9[a]). Typically, the party requesting disqualification must show "(1) the existence of a prior-attorney client relationship between the moving party and opposing counsel, (2) that the matters involved in both representations are substantially related, and (3) that the interests of the present client and former client are materially adverse" (*Tekni-Plex, Inc., supra; see also McCutchen v. 3 Pirncesses & AP Trust Dated Feb. 3, 2004*, 138 AD3d 1223 [3d Dept 2016]).

Putting aside that fact that objectant does not allege a prior attorney-client relationship with opposing counsel, there has not, in any event, been any showing that the interests of the present and former clients are materially adverse. As with the lack of proof regarding prejudice, objectant has not demonstrated that the proffered testimony would harm petitioners or reflect poorly upon the integrity of the legal system.

Finally, given that Ms. Ahlsen and Ms. Brunswick are paralegals and not attorneys, the Rules of Professional Conduct do not necessarily apply in the same manner to them as they do to

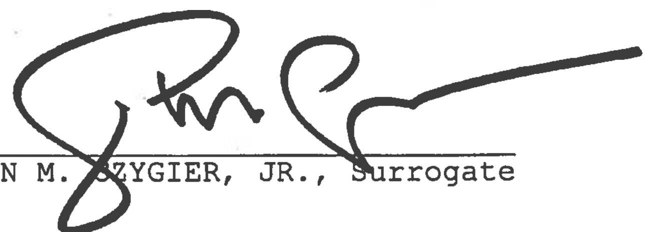
attorneys (*see NYC Medical & Neurodiagnostic, P.C. v. Republic Western Ins. Co.*, 6 Misc3d 275 [Civ Ct, Kings County] [noting that former rule DR 5-102 refers only to lawyers, and that therefore disqualification rules do not apply to nonlawyer employees]; *see also Mulhern v. Calder*, 196 Misc2d 818 [Sup Ct, Albany County]). In any event, each testified similarly to Mr. Toscani, indicating that decedent appeared to have capacity on the date of the execution ceremony (*see generally* Ahlsen Aff.; Brunswick Aff.). As such, objectant's motion as to them suffers from the same defects mentioned above.

Conclusion

For the reasons set forth herein, it is

ORDERED that objectant's motion for disqualification of the law firm of Christopher J. Cassar, Esq. from serving as counsel for petitioners at trial is denied; and it is further

ORDERED that a pre-trial conference on this matter is hereby scheduled with a member of this court's law department on Wednesday, January 18, 2017, at which time a Note of Issue and Statement of Readiness and an order framing issues shall be due.



JOHN M. CZYGIER, JR., Surrogate

Christopher J. Cassar, P.C.
Attorneys for Petitioners
13 Carver Street
Huntington, NY 11743

Walter D. Long, Esq.
Attorney for Objectant
490 Wheeler Road, Suite 165K
Hauppauge, NY 11788

FILED
SURROGATES COURT
SUFFOLK COUNTY
DEC 15 2016
MICHAEL CIPOLLINO
CHIEF CLERK

FILED
SURROGATE'S COURT
SUFFOLK COUNTY
JUN 30 2015
MICHAEL CIPOLLINO
CHIEF CLERK

SURROGATE'S COURT : SUFFOLK COUNTY

Probate Proceeding, Will of

HELENE RECCO, a/k/a

HELENE J. RECCO,

Deceased.

DECISION/ORDER

By: HON. JOHN M. CZYGIER, JR.,

Surrogate

Dated: 6/30 2015

File #: 2011-2918

In this contested probate proceeding, an instrument dated May 8, 2011, has been offered for probate as the last will and testament of the above named decedent by Mary Iadanza ("Iadanza"), decedent's niece and a co-executrix nominated therein. Objections have been filed to the probate of the propounded instrument by Helene Anzai-Tarter, decedent's niece and the other co-executrix nominated in the propounded instrument, Anne Anzai, Rose Recco-Esposito, Janice Recco-Louis, and Mary Recco-Santi, decedent's sisters.

Objectants now move pursuant to Rule 3.7(a) of the Rules of Professional Conduct to disqualify Anthony J. Colleluori, Esq., ("Colleluori") from representing respondents Lois Colleluori, Frank Colleluori, and Salvatore Colleluori.

For the reasons set forth below, obtectants' motion is granted in part and denied in part.

Background

Decedent died May 10, 2011, survived by her five sisters, four of whom are objectants named above; decedent's fifth sister is Lois Colleluori, petitioner's mother. Decedent was also survived by a brother, Angelo Recco, Jr., who has not appeared herein. An instrument purporting to be decedent's last will and testament was offered for probate on August 8, 2011 by Iadanza and Helene Anzai-Tarter ("Helene"). Shortly thereafter, Helene obtained new counsel, who advised the court she was no longer in favor of probating this will, and an amended petition was filed on February 28, 2012, in which Iadanza is the sole petitioner. As noted above,

Helene has filed objections to the probate of the propounded instrument.

A prior original will, dated July 14, 2005, was filed with the court. The will offered for probate is a departure from the earlier will, in that the new will increases the share passing to the Colleluori branch of the family.

On August 24, 2012 objections to probate were filed by the guardian ad litem appointed to represent infants who were adversely affected by the propounded instrument, and on August 28, 2012 "Amended Objections to Probate" were filed by movants asserting that at the time of execution, decedent lacked testamentary capacity; that the instrument was not duly executed; and that the execution of the propounded instrument was the result of fraud, mistake, and undue influence.

The objections filed herein relate to decedent's lack of capacity, undue influence exerted on decedent by Colleluori, his mother, and Iadanza (and possibly others), and lack of due execution. The propounded instrument, and other estate planning documents, were executed two days prior to decedent's death while she was hospitalized.

Pleadings

The motion is supported by the affirmation of counsel for movants, a second affirmation of counsel, and a memorandum of law. Anthony Colleluori, who represents his wife and two sons, is the brother of the petitioner, Iadanza. He has filed and affirmation in opposition.

In the memorandum of law, counsel for objectants states that Colleluori is "likely to be a witness on a significant issues of fact in this proceeding" [Memorandum of Law, ¶ A, page 2]. Counsel further states that:

> Mr. Colleluori is believed to have been the mastermind and implementer of the eve of death changes to the 2005 Will and the eve of death transfers of assets. He and his family were believed to have been around Helene during her two day stay at Huntington Hospital where the 2011 Will discussed on May 7, 2011 and then executed on May 8, 2011. Mr. Colleluori was the one who called the attorney-draftsman of the 2011 Will, Christopher Petillo,

> twice on Saturday May 7, 2011 to have Mr. Petillo meet with Helene at the emergency room of Huntington Hospital in the late afternoon of Saturday May 7, 2011 to discuss updating her will after Helene had been taken to the hospital earlier that day. Mr. Colleluori was the person who called Mr. Petillo on Sunday May 8, 2011 to have Mr. Petillo come to the hospital that day to supervise the execution of the 2011 Will. Mr. Colleluori was the person who had a prior relationship with Mr. Petillo, not Helene. Mr. Colleluori and Mr. Petillo met each other in 2006 through Mr. Petillo's wife, who worked for Mr. Colleluori. . . . In summary, Mr. Colleluori's testimony touches upon all the factual issues in this proceeding and will be crucial to the trier of fact in determining same.

[References to the Transcript of Mr. Petillo's 1404 examination omitted].

Colleluori argues that he "is not a necessary witness as to the issue of Helene Recco's mental capacity," in that his testimony would be cumulative. He downplays movants' assertions regarding the role he played in arranging the production and execution of the propounded instrument and the other estate planning documents which benefitted his family. The court does not accept, however, that movants should be barred from calling him as a witness simply because he has attempted to minimize his role.

It is movants' contention that Colleluori will most certainly be called as a witness in the will contest, as he has unique knowledge as to decedent's mental capacity and the possible exertion of undue influence at the time that he executed the will. In addition, in light of the role he played in calling the attorney-draftsman, his testimony will be relevant on the issue of undue influence.

Applicable Law and Discussion

Pursuant to Rule 3.7 of New York's Rules of Professional Conduct, which replaced all prior rules of professional responsibility effective April 1, 2009, an attorney is prohibited from acting as advocate before a tribunal in a matter in which the lawyer is likely to be a witness on a significant issue of fact unless:

> (1) the testimony relates solely to an uncontested issue; (2) the testimony relates solely to the nature and value of legal services rendered in the matter; (3) disqualification of the lawyer would work substantial hardship on the client; (4) the testimony will relate solely to a matter of formality, and there is no reason to believe that substantial evidence will be offered in opposition to the testimony; or (5) the testimony is authorized by the tribunal (Rules of Professional Conduct [22 NYCRR 1200.0] Rule 3.7 [a]).

Additionally, Rule 3.7 prohibits an attorney from advocating before a tribunal if precluded by Rule 1.9, entitled Duties to Former Clients.

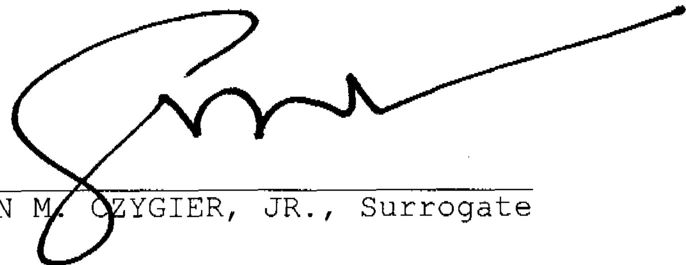
The burden of proof is on the party seeking disqualification (*Tekni-Plex, Inc. V. Meyner & Landis*, 89 NY2d 123), requiring a clear showing that counsel's removal is warranted (*Goldstein v. Held*, 52 AD3d 471). Disqualification motions present competing concerns. The court must balance the vital importance of avoiding even the appearance of impropriety against the party's entitlement to be represented in ongoing litigation by counsel of its own choosing and the danger that such motions can become tactical "derailment" weapons for strategic advantage in litigation (see *Jamaica Public Service, supra at* 638, *citing S&S Hotel Ventures Ltd. Partnership v. 777 S.H. Corp.*, 69 NY2d 437). The conflict rules therefore, should not be "mechanically applied when disqualification is raised in litigation" (*Kassis*, supra at 617). The party seeking disqualification must demonstrate that the expected testimony of the attorney is necessary and prejudicial to said attorney's client (*Estate of Khaze*, NYLJ 3/10/2004, p. 28, col. 5).

While not specifically raised in the papers, this court must consider the impact of the new Rules of Professional Responsibility on established case law. A careful comparison of the two rules show the preservation of much of the language and substance of the prior advocate witness rule, and in fact, the advocate witness rule, now embodied in Rule 3.7, is substantially the same to the prior rule (*see Gabayzadeh v. Taylor,* NYLJ 8/7/2009, p. 33, col. 3). Therefore, it is the court's conclusion that the new rule does not alter counsel's ability to represent the client up until the time of trial.

Accordingly, objectant's motion to disqualify Colleluori is denied in that Anthony J. Colleluori may serve as counsel to respondents up until the time of trial and granted in that Anthony J. Colleluori may not serve as counsel during the trial of this matter.

Counsel for the parties shall appear on Tuesday, July 28, 2015, at 9:30 a.m. at the Suffolk County Surrogate's Court, County Center, 320 Center Drive, Riverhead, New York, for a conference with a member of the Law Department.

This decision constitutes the order of the court.



JOHN M. CZYGIER, JR., Surrogate

Walsh Marcus et al., LLP
Attention: Paul R. McDougal, Esq.
Attorneys for Objectants / Movants
229 Seventh Street, Suite 200
Garden City, New York 11530

Reisman Perez et al., LLP
Attention: Joseph Capobianco, Esq.
Attorneys for Petitioner / Respondent
1305 Franklin Avenue
P.O. Box 119
Garden City, New York 11530

Law Offices of Anthony J. Colleluori & Assoc., PLLC
Attorney for Respondents
6800 Jericho Turnpike, Suite 208 E
Syosset, New York 11791

Speaker Biographies

AMY B. BELLER, ESQ.
Biography

Ms. Beller is a founding member of Beller Smith, P.L., a full-service trusts and estates firm located in Boca Raton, Florida. A 1992 graduate of Hofstra Law School, Ms. Beller began her legal career in New York with firms such as White & Case and Chadbourne & Parke. Ms. Beller relocated to Florida in 2004, and was associated with Kaye Scholer's West Palm Beach office. Ms. Beller founded Beller Smith with fellow New York attorney, Yoshimi O. Smith, Esq., in late 2009.

Ms. Beller is a Fellow of the American College of Trust and Estate Counsel (ACTEC). She is a Member of the Executive Committee of the Real Property, Probate and Trust Law Section of the Florida Bar. a member of the Palm Beach County Bar Association, the South Palm Beach County Bar Association, and the New York Bar Association's Trusts and Estate's Section. She is Board Certified in Wills, Trusts and Estates, and is a certified Circuit Civil Mediator. Ms. Beller's primary focus within the trusts and estates practice is in litigation and dispute resolution.

A prolific speaker and author, Ms. Beller has published in the *New York State Bar Association Trusts & Estates Section Newsletter*, the *Florida Bar Real Property, Probate and Trust Law Section's Actionline*, the *Florida Bar's Litigation Under the Probate Code (Eleventh Ed.),* and the American Bar Association's book, *The Road to Independence: 101 Women's Journeys to Starting Their Own Law Firms.* Ms. Beller has lectured for ACTEC, the New York State Bar, the Florida Bar, the City Bar (New York), and the Heckerling Institute, among others, on topics including Florida homestead, beneficiary rights, privity and malpractice, estate planning to avoid disputes, multistate estate planning, and mediation.

HONORABLE JOHN M. CZYGIER, JR.
Biography

John M. Czygier, Jr. was admitted to practice law in New York State in 1975. After serving as a prosecutor in the Suffolk County District Attorney's office, he entered private practice and, for twenty-five years, concentrated in estate administration and estate litigation in the New York metropolitan area. He was awarded an "AV" rating by Martindale-Hubbell, the highest rating for practicing attorneys. He is a member of the Suffolk County Bar Association, where he served as Director, Chair of the Surrogate's Court Committee and Co-Chair of the Bench Bar Committee. He is also a member and former Director of the Suffolk County Women's Bar Association. While in private practice, Surrogate Czygier served as a Mental Hygiene Law Article 81 Court Examiner for New York and Suffolk Counties, and was counsel to the Public Administrator of Suffolk County.

On April 26, 2001, Judge Czygier was appointed Judge of the Surrogate's Court of Suffolk County by Governor George Pataki and subsequently confirmed by the New York State Senate on May 8, 2001. In November, 2001 he was elected to a ten-year term, and was re-elected in November 2011; he was a Judicial Fellow of the prestigious American College of Trust and Estate Counsel. He retired from the bench on December 31, 2018.

In October of 2000, Judge Czygier was elected to the Fellows of the New York Bar Foundation. He is a member of the Surrogate's Association of the State of New York, where he previously served as Secretary/Treasurer, Vice President and President. He is a member of the Trusts and Estates Law Section of the New York State Bar Association where he served on the Estate and Trust Administration Committee, and was formerly a vice-chairman of the Estate Litigation Sub-Committee. He has also served on the Committee on Trusts, Estates & Surrogate's Courts of the Association of the Bar of the City of New York.

In addition to his involvement in numerous professional associations, Surrogate Czygier has played an active role on various Committees to improve the law, administration and practice in the Surrogate field. Judge Czygier has served as a member of the Surrogate's Court Advisory Committee to the Chief Administrative Judge of the Courts of the State of New York since his appointment in 1999 by the Hon. Jonathan Lippman. He has also been a member of the EPTL-SCPA Legislative Advisory Committee; the mission of both committees is to review existing statutes and to draft legislation. In 2009, he was appointed to The Administrative Board for the Offices of the Public Administrator where he served as Chair, and he has served as Chairman of the Distinguished Alumni on the Bench at Hofstra Law School. He has lectured on various aspects of Trust and Estate Law at numerous law schools, state and local bar associations, and has trained newly elected Surrogate Judges at the New York Judicial Institute. Judge Czygier has also been a contributing author to *Warren's Heaton on Surrogates' Courts* (Matthew Bender) and to *Weinstein, Korn & Miller New York Civil Practice* (Matthew Bender), and has written for the New York State Bar Association Trusts and Estates Newsletter, the New York Law Journal, and the New York State Bar Association Journal.

GARY B. FREIDMAN, ESQ.
Biography

GARY B. FREIDMAN was graduated from St. John's University School of Law in 1978 and was admitted to the New York bar in 1979. He received a Master's degree in Taxation from New York University Graduate School of Law in 1982. Mr. Freidman received his B.A. in Economics from Queens College of the City University of New York in 1975.

From 1979 to 1981, Mr. Freidman served as an appellate law assistant to the Justices of the Appellate Division of the Supreme Court, Second Judicial Department. There, he was responsible for the preparation of confidential bench memoranda analyzing pending appeals for the Justices. In 1981, he joined Greenfield Stein & Senior, LLP (then known as Greenfield Eisenberg Stein & Senior) as an associate, becoming a member of the firm in 1986. His practice is in trust and estate related litigation.

Mr. Freidman has been involved in numerous contested Surrogate's Courts proceedings, both as an advocate and a mediator and has participated in trials and hearings in the Surrogate's Courts. These matters involved diverse issues such as the extent to which an *in terrorem* clause may be enforced, the validity of a charitable remainder unitrust, investment loss disputes, objections to wills and accountings, the jurisdiction of the Surrogate's Court and the validity of pre-death gifts.

Mr. Freidman has lectured on Mediation and Surrogate's Court matters before the American Law Institute; the New York State Bar Association; the Association of the Bar of the City of New York; the Surrogate's Association of the State of New York, the Elder Law Section of the New York State Bar Association, the New York State Society of Certified Public Accountants, the American Bankers Association and the Richmond and Suffolk County Bar Associations. In addition, he has lectured on Surrogate's Court and litigation matters at Cardozo Law School and the New School for Social Research.

Mr. Freidman has authored numerous articles in the field for the New York State Bar Association and the New York Law Journal.

Mr. Freidman is a Fellow of the American College of Trust and Estate Counsel, a member of the American Bar Association (Real Property, Probate and Trust Law Section), the New York State Bar Association (Former Chair, Trusts and Estates Law Section; Former Chair, Estate Litigation and Legislation Committees), the Association of the Bar of the City of New York (Committee on Trusts, Estates and Surrogate's Courts) and the Westchester County Bar Association.

Mr. Freidman has received an "AV" rating from the Martindale-Hubbell Law Directory and has been ranked by Chambers High Net Worth 2017, 2018 and 2019 in its highest tier, Band 1 in Private Wealth Disputes, across the United States of America. Mr. Freidman has been named as a "Super Lawyer" for 2006 through 2019 (http://www.superlawyers.com).

ANGELO M. GRASSO, ESQ.
Biography

Angelo M. Grasso is a partner at Greenfield Stein & Senior, LLP, whose practice is in trusts & estates litigation and contested Article 81 guardianships. Angelo represents clients in a variety of proceedings in Surrogate's Court, including will contests, discovery proceedings, contested accountings, and guardianship proceedings. Angelo has served as lead counsel on trials in Surrogate's and Supreme Court, and argued appeals in the Appellate Division.

Angelo is a frequent lecturer on Surrogate's Court matters, and co-chaired the New York State Bar Association's 2014 program on Discovery Proceedings. Angelo is an active member of the Trusts and Estates committee of the New York State Bar Association, where he serves on the Executive Committee, is the Chair of the Surrogate's Court Committee, and will co-chair the section's Spring 2019 meeting in Naples, Florida. He is also a member of the Trusts, Estates and Surrogate's Court Committee of the New York City Bar Association, and the Westchester County Bar Association.

Angelo graduated from the Georgetown University Law Center in 2002, where he was an associate editor of the American Criminal Law Review, and was admitted to practice in New York in 2003. He received his B.A. from Columbia University in 1999, where he wrote his senior thesis on the history of American anarchism.

Prior to joining Greenfield Stein & Senior, Angelo was an associate at Cahill Gordon & Reindel, LLP, Mongelli, P.C., and Littman Krooks LLP. He joined Greenfield Stein & Senior in 2008, and became a member of the firm in 2016.

Angelo resides in Westchester with his wife Hilary, daughter Zoë, and goldendoodle Phoebe. He is an active member of the Board of Directors of the Music Conservatory of Westchester.

Articles and Publications

Electronic Discovery in Surrogate's Court Litigation, Part II: Surrogate's Court Decisions, New York State Bar Association Trusts and Estates Law Section Newsletter, Fall, Vol. 51, No. 3, 2018

Electronic Discovery in Surrogate's Court Litigation, Part I: An Introduction to Electronic Discovery Concepts, New York State Bar Association Trusts and Estates Law Section Newsletter, Winter, Vol. 50, No. 4, 2018

Current Ethics Issues for Trusts & Estates Attorneys, New York State Bar Association Program "Conducting SCPA §1404 Discovery," Fall 2017

Honors and Awards

AV Rating, Martindale Hubbell
Super Lawyer, New York *Super Lawyers* magazine, 2018
Rising Star, New York *Super Lawyers* magazine, 2014-2017

RAYMOND JOSEPH
Biography

Raymond Joseph, Jr. is a Managing Director and the Global Head of Portfolio Solutions at Citi Investment Management. In this capacity, Ray oversees the global portfolio solutions team responsible for managing assets for high net worth individuals, pensions, endowments, and charitable organizations. He also has responsibility for the traditional investment strategies research and due diligence team. Additionally, Ray is a voting member of the Private Bank's Global Investment Committee, which sets tactical asset allocation recommendations for investment solutions on both a discretionary and advisory basis.

Prior to joining Citi, Ray was a Managing Director and Head of Portfolio Management & Model Solutions at UBS Wealth Management Americas where he oversaw the day-to-day management of the portfolio managers constructing and managing equity, fixed income, liquid alternatives, and multi-asset class discretionary portfolios and models. He was also responsible for the traditional investment strategies manager research team.

Before his role at UBS, Ray was a Vice President and Research Analyst for AllianceBernstein, a global investment management firm. At AllianceBernstein, he was responsible for the firm's global investments in financial services and healthcare service companies including stock recommendations for value, core, growth, thematic, long/short, and market neutral portfolios.

Prior to joining AllianceBernstein, Ray worked ten years as an Equity Analyst and Portfolio Manager at Capital Research Company, investment adviser to the American Funds. His previous professional experience also includes roles at Merrill Lynch and Morgan Stanley.

Ray received his MBA from Harvard Business School and his BA in Government from Harvard College.

SURROGATE PETER J. KELLY
Biography

Surrogate Kelly is a graduate of Iona College and St. John's University School of Law where he received his Juris Doctor degree in 1983.

Prior to his election to the bench, Surrogate Kelly was employed in the New York City Criminal and Civil Courts as a Law Assistant Trial Part, in the Queens Supreme Court as Principal Law Clerk, and, ultimately, as the Principal Law Clerk for Queens Surrogate Hon. Robert L. Nahman.

He was elected as a Judge of the New York City Civil Court in 1998 and as a Justice of the New York State Supreme Court in 2002. Thereafter he was elected as Surrogate of Queens County and has served in that capacity since January of 2011.

In addition to his regular duties, Surrogate Kelly has served as an instructor for court clerks and has frequently lectured at various bar associations and organizations including the Queens County Bar Association, the Nassau County Bar Association, the New York State Bar Association, the New York State Trial Lawyers Association, the New York State Surrogate's Association, and the New York State Judicial Institute.

Surrogate Kelly is a member of the Surrogate's Court Advisory Committee to the Chief Administrative Judge, and serves as Chair of the Executive Committee of the New York State Surrogate's Association. He is also a member of the Trust and Estates section of the New York State Bar association, the Queens County Bar Association, the Queens County Women's Bar Association, and the Queens Catholic Lawyer's Guild, serving as Judicial Moderator since 2009. He is also a former member of the Board of Directors of the New York City Supreme Court Justices' Association and the New York City Civil Court Judges Association.

Surrogate Kelly is admitted to the New York State Bar as well as the United States District Court for the Southern District and the United States Supreme Court.

TONI ANN KRUSE, ESQ.
Biography

Toni Ann Kruse, a partner at McDermott Will & Emery, focuses her practice on estate and wealth transfer planning. She advises clients on estate, gift and generation-skipping transfer tax issues, trust and estate administration, and charitable planning, as well as contested trust and estate matters. She has significant experience working with family companies, drafting and administering complex estate plans for domestic and multinational high-net-worth individuals and families, implementing leveraged wealth transfer techniques and counseling fiduciaries in estate administration.

Toni Ann received the 2012 McDermott Award for Commitment to Pro Bono and Community Service, in part for her work leading a team of 70 tax lawyers from the Firm to create a global index and report on charity law and philanthropy incentives. The index scores the tax readiness for philanthropy of all 193 United Nations countries. Toni Ann formally introduced the project to hundreds of participants at The Nexus Global Youth Summit. It serves as a reference and benchmark for civil society organizations to promote a United Nations resolution calling for a global campaign for a culture of philanthropy.

Toni Ann has been appointed a 2016-2017 ACTEC Foundation Young Leader. Toni Ann serves as the chair of the New York office's Pro Bono and Community Service Committee.

While in law school, Toni Ann was the note editor for the *Boston College Journal of Law and Social Justice*.

RECOGNITION

American Bar Association, one of five attorneys selected to serve as a Trust and Estates Fellow for the Real Property, Trust and Estate Section for 2014–2016

ACTEC Foundation Young Leader, 2016–2018

Super Lawyers, Estate Planning & Probate: New York, 2017 & 2018

COMMUNITY

American Bar Association, Real Property, Trusts & Estates Section; charitable organizations co-chair, fellows vice-chair and membership member

New York State Bar Association, Estate and Trust Administration Committee member

CREDENTIALS

Education
Boston College Law School, JD, 2008
Boston College, BA, 2003

Admissions
New York

HONORABLE ACEA M. MOSEY
Biography

Judge Mosey is a lifelong resident of Western New York. She graduated from Amherst High School in 1985. She earned a Bachelors in Business Administration degree from Canisius College in 1992 and then went on to the Thomas M. Cooley School of Law in Lansing, Michigan. She graduated with her Juris Doctorate in 1994 and was admitted to the New York State Bar in March 1995.

Having practiced as a private attorney in Surrogate's Court for over twenty years, including 14 years as Erie County Public Administrator under former Surrogate Judge Barbara Howe, Judge Mosey was elected as New York State Surrogate Judge for the County of Erie in November of 2017.

Judge Mosey was a founding partner with the firm Mosey Associates LLP, formerly known as Mosey Persico LLP, located at 625 Delaware Avenue in Buffalo, New York. She previously served as a Commissioner at the Erie County Water Authority from May 2000 to May 2006, being the first woman to serve as a Commissioner as well as a Chair at this Authority. She gained a vast amount of business experience from her employment with a family-owned, Great Lakes Bureau, Inc. for over twelve years, along with being the trustee of her family's trust which runs and operates, or is involved in, over 20 local companies and businesses.

Judge Mosey resides in Buffalo, New York. She is a lifelong member of St. John Maron Church. She is a member of the New York State Bar Association, the Bar Association of Erie County, and the Western New York Women's Bar Association.

Judge Mosey has been a proud member of her community, previously serving on several boards including the Greater Buffalo Savings Bank, Canisius College Board of Trustees, The Buffalo Zoo Board as well as the Children's Hospital Foundation.

NATALIA MURPHY, ESQ.
Biography

Natalia Murphy is Head of Trust and Wealth Planning for North America, Citi Private Bank. Based in New York, Natalia leads a high performing wealth planning team dedicated to delivering sophisticated and comprehensive wealth planning services for ultra-high net worth families globally.

Prior to joining the Private Bank, Natalia practiced law in New York for fourteen years focusing her practice on sophisticated estate and trust planning for affluent US and international families.

Natalia graduated from St. Francis College with a B.A., summa cum laude, in Economics and Political Science and received her J.D., Dean's List, from St. John's University School of Law. She is a member of the Bars of the State of New York and the State of Connecticut.

Natalia is a Fellow of the American College of Trust and Estate Counsel (ACTEC), a prestigious organization of trust and estate attorneys who have achieved top professional recognition in their field. She is Chair of the Trusts and Estates Law Section of the New York State Bar Association, a member of the Society of Trusts and Estates Practitioners (STEP), a member of the Committee on Investment of Funds of the Association of the Bar of the City of New York and the Association of the Bar of the City of New York Fund, Inc., and a member of the Trusts and Estates Advisory Group to the Board of the Optometric Center of New York, State University of New York College of Optometry.

Natalia is fluent in Russian and Ukrainian.

ERIC PENZER, ESQ.
Biography

Eric W. Penzer is a Partner at Farrell Fritz's Uniondale office where he concentrates in trust and estate litigation. His practice includes contested probate proceedings, fiduciary accounting proceedings, discovery proceedings, and other litigation related to estates and trusts. He is a frequent contributor to Farrell Fritz's New York Trusts & Estates Litigation blog, a frequent author, and lecturer on trust and estate litigation topics.

EDUCATION

- Fordham University School of Law
- State University of New York at Stony Brook

AFFILIATIONS & APPOINTMENTS

- American College of Trust and Estate Counsel (ACTEC), Fellow
- New York State Bar Association, Member, Executive Committee, Trusts and Estates Section
- New York State Bar Association, Former Chairperson, Practice & Ethics Committee, Trusts and Estates Section
- New York State Bar Association, Former Chairperson, Litigation Committee, Trusts and Estates Section
- New York City Bar Association, Member, Estates & Gift Taxation Committee
- Nassau County Bar Association, Member, Surrogate's Court Estates & Trusts Committee

HONORABLE STACY L. PETTIT
Biography

Judge Pettit is the Surrogate in Albany County, serving since January 2015. A graduate of Vassar College in 1981 and Albany Law School in 1984, she practiced law for the first half of her career, concentrating in Surrogate's Court practice, estate and trust planning and administration. Judge Pettit then worked as a law clerk and as chief clerk of Albany Surrogate's Court for many years. She also worked for a few years as an appellate court attorney at the Appellate Division, Third Department, before she became a judge.

Prior to her election in 2014, Judge Pettit was vetted by the New York State Independent Judicial Election Qualification Commission and received its highest rating – "highly qualified" – for the Surrogate's Court judge position. She currently serves on the Editorial Board of Warren's Heaton on Surrogate's Court Practice, on the Office of Court Administration's Judicial Institute Curriculum Advisory Committee, and as a member of the New York State Surrogates' Association. An active member of the New York State Bar Association, she has previously served as chair of the committee on Surrogate's Court and as Third District Representative of the Trusts & Estates section, and as a delegate to the New York State Bar House of Delegates. She has also served on several Office of Court Administration Surrogate's Court committees. She writes and presents on trusts and estates topics for numerous organizations.

HONORABLE MARGARET C. REILLY
Biography

Margaret (Meg) Reilly was appointed to the Nassau County District Court in May, 1998. In November 1998, she was elected to the District Court, representing the 4th District, which consists of the Town of Oyster Bay and the City of Glen Cove. She was re-elected as a Nassau County District Court Judge in 2004 and again in 2010. In December 2006, she was appointed as an acting Nassau County Court Judge. In November 2011, she was elected to the Nassau County Supreme Court. In November 2015, she was elected the Surrogate of Nassau County. On January 1, 2016, she began her term as Surrogate.

Meg graduated from Hamilton College with honors in Classical Studies and received her law degree from St. John's University School of Law.

After law school, she was appointed as Deputy County Attorney in the Litigation Bureau where she tried many cases, including civil rights and other tort matters. She then entered private practice and served as a trial attorney in all types of tort litigation, including medical, dental and legal malpractice. During this time, she served as the Prosecutor for the Village of Stewart Manor. In addition, she served as adjunct professor in Trial Advocacy at St. John's University School of Law.

Meg has served as the chairperson for the Nassau County Bar Association Defendant's Roundtable. She also served as an appointed member of the Nassau County Bar Association Judiciary Committee. She has lectured for the Nassau and Suffolk Academies of Law, Touro Law School and Hofstra University School of Law. She served as Co-Chair of the Nassau County Court's Women in the Courts Committee from 2004 to 2012. She served on the Irish Advisory Board of the Irish Institute at Molloy College. In addition, she is currently a member of the Board of Trustees of the Boys and Girls Club of Oyster Bay-East Norwich, a member of the Pastoral Council of St. Dominic's of Oyster Bay, the Immaculate Heart of Mary Guild and Ladies Ancient Order of Hibernians. She is the former Vice-President of the Parents Council of the Boys and Girls Club of Oyster Bay-East Norwich.

During her tenure as Judge, she has been the recipient of several awards, including the Fraternal Order of Police Fidelis Juri Award and the Court Officers Benevolent Association of Nassau County Fidelis Juri Award.

ELISA SHEVLIN RIZZO, ESQ.
Biography

Before joining Northern Trust in 2017 as Senior Fiduciary Officer and Senior Legal Counsel, Elisa was Managing Director, Trust Counsel and, most recently, Director of Estate Administration with Fiduciary Trust Company International. There, she led the restructuring of FTCI's estate administration department, provided guidance on a variety of wealth planning, administration and fiduciary issues and oversaw the administration of complex estate arrangements.

EDUCATION
She received her J.D. from Fordham University School of Law and her B.A. from the College of the Holy Cross.

CREDENTIALS
She has been profiled in Barron's and has presented before audiences for various organizations including the New York State Bar Association (NYSBA), the Family Office Exchange and the American Heart Association.

EXPERTISE
As head of fiduciary and legal counsel in Greater New York, she's responsible for delivering fiduciary service, legal counsel and holistic advice to trust advisors, wealth advisors, advisory account managers and wealth strategists.

COMMUNITY INVOLVEMENT
Elisa is a member of the Board of Directors of Fordham University School of Law Alumni Association, Vice-Chair of the Trust and Estate Administration Committee for the NYSBA Trusts and Estates Section, a member of the NYSBA Trust and Estates Section Taxation Committee and a past member of the NYC Bar Association Estate and Gift Taxation Committee. Outside of her professional commitments, Elisa also serves on the Board of Directors of The Chapel School's Blue Ribbon Foundation and is a past president of The Junior League of Bronxville.

FRANK T. SANTORO, ESQ.
Biography

Frank T. Santoro is a partner at Farrell Fritz P.C.'s Uniondale office where he practices trusts and estates law, concentrating in trusts and estates litigation. He represents clients in New York State Surrogate's Court in probate contests, contested accounting proceedings, discovery proceedings, and other miscellaneous proceedings, and in actions and proceedings in Supreme Court and federal court relating to trusts and estates. He also represents clients in Article 81 Guardianship Proceedings before the Supreme Court.

Frank lectures to numerous organizations on various trusts and estates litigation topics. In 2011 and 2012, he co-presented, Till Death or Divorce Do Us Part, for the Matrimonial INNS of COURT at the Nassau County Bar Association; to the Nassau and Suffolk Academies of Law; to the New York Financial Planners Association, to St. John's University School of Law and to the Queens Bar Association.

He has also lectured to the Nassau and Suffolk County Bar Associations on the subject of contested accounting proceedings in the Surrogate's Court and is a contributor to Farrell Fritz's New York Trusts & Estates Litigation blog.

Education

- Brooklyn Law School
- State University of New York at Binghamton

Bar Admissions

- New York

Court Admissions

- U.S.D.C., Southern District of New York
- U.S.D.C., Eastern District of New York
- U.S.D.C., Western District of New York

Affiliations & Appointments

- New York State Bar Association
- Nassau County Bar Association

MICHAEL S. SCHWARTZ, ESQ.
Biography

Mr. Schwartz, partner of the international law firm Curtis, Mallet-Prevost, Colt & Mosle LLP, was the co-author of the recently published 14th edition of Stocker on Drawing Wills and Trusts. He also has written articles on a wide range of current topics relating to trusts, estate planning and administration for significant industry publications such as *Estate Planning, Probate and Property, New York Law Journal, Law360, Trusts & Estates, The Senior Lawyer* and the *New York State Bar Association Trusts and Estates Law Section Newsletter.* Mr. Schwartz is also a prolific speaker on various estate and trust topics.

Mr. Schwartz's leadership in the field of trusts and estates is further reflected by his active roles in a number of key professional organizations. For example, Michael serves as the First District Representative of the Trusts and Estates section of the New York State Bar Association, and recently finished his term as the chair of the Estate and Trust Administration Committee. He is also a Fellow of The American College of Trust and Estate Counsel (ACTEC).

Mr. Schwartz counsels clients on domestic and multijurisdictional estate and succession planning, extending to all facets of estate, gift and generation-skipping transfer tax planning. Michael's practice at Curtis additionally encompasses all phases of estate and trust administration.

HONORABLE VINCENT W. VERSACI
Biography

Hon. Vincent W. Versaci began serving Schenectady County as Surrogate's Court Judge in May, 2010 after the NYS Senate unanimously confirmed Governor Paterson's earlier nomination. Judge Versaci ran a successful campaign and was elected to a 10-year Term commencing January 1, 2011. Also in January, 2011, Judge Versaci was appointed as a full-time Acting Supreme Court Justice in the Fourth Judicial District.

Judge Versaci began his judicial career when he was elected Schenectady City Court Judge in 2002. During his tenure on the City Court Bench, Judge Versaci also served as an Acting County Court Judge, and as the Supervising Judge for Town and Village Courts for the 4th Judicial District.

Prior to becoming a full-time jurist in 2004, Judge Versaci worked as an Associate Attorney with the Law Offices of Frank M. Putorti, Jr., P.C. and with Sciocchetti, Parisi and Saccocio, P.C. Judge Versaci was admitted to the New York State Bar in 1997 after having obtained his Juris Doctor from Albany Law School in 1996.

Judge Versaci was recently appointed by Chief Administrative Judge Lawrence K. Marks to serve as a member of the Surrogate's Court Advisory Committee, chaired by the Hon. Renee R. Roth. This standing committee of the Chief Administrative Judge reviews recent and proposed legislation regarding the Estates, Powers and Trusts Law, and the Surrogate's Court Procedure Act, and has been instrumental in securing the enactment of new legislation and recommending changes to the statutes and rules pertaining to the affairs of decedents and the operations of the Surrogate's Courts of New York State.

Judge Versaci is also a member of the Surrogate's Court Sub-committee of the ADR Committee. This sub-committee is currently reviewing alternative dispute resolution initiatives as they pertain to particular disputes that commonly occur in Surrogate's Court proceedings.

HONORABLE THERESA WHELAN
Biography

Theresa Whelan is the Suffolk County Surrogate's Court Judge and presides over proceedings involving wills, trusts and estates, as well as guardianship matters. She was elected to this position in November, 2018 and took the bench January, 2019.

Prior to her election as Surrogate, Judge Whelan was a Family Court Judge. She was first elected to the Family Court in 2007 and was re-elected to another ten-year term in 2017. As a Family Court Judge, Judge Whelan heard primarily child abuse and neglect cases and presided over Family Treatment Court.

Judge Whelan was appointed Supervising Judge of the Suffolk County Family Court in February, 2016. In that role, she supervised a court consisting of eight to ten judges, five referees and numerous support magistrates. During her tenure, she has reformed court practice to better accommodate the needs of the parties and litigants.

In 2009, the Office of Court Administration appointed Judge Whelan as Lead Judge of the Suffolk County Child Welfare Court Improvement Project. This local child welfare collaborative is part of statewide initiative to address court practices in cases where the court has removed children from their parents' care.

Judge Whelan was the Chair of the Suffolk County Attorneys for Children Advisory Committee which is responsible for considering the qualifications of new applicants to the Attorneys for Children panel, as well as reviewing the recertification applications for existing lawyers. The Advisory Committee also addresses issues that may arise with lawyers, conducts the annual training and ensures a fair and efficient rotation of lawyers available to take assignments from the Family Court.

In 2017, Chief Administrative Judge Larry Marks appointed Judge Whelan to the Family Court Advisory and Rules Committee, a statewide committee which meets monthly. That committee reviews proposed legislation and drafts its own proposals in the are of family law. More recently, Chief Judge Janet DiFiore appointed Judge Whelan to the New York State Commission on Parental Representation, which is tasked with holding public hearings throughout the state and reporting on the status and quality of lawyers representing parents in child welfare cases.

Judge Whelan began her law career in 1988 as a Suffolk County Assistant County Attorney. In 1990 she began her career in the judicial system, serving as a law clerk to three Supreme Court Justices: the Hon. Eli Wager (Nassau County), the Hon. Mary M. Werner, and the Hon. William B. Rebolini. As law clerk, she conferenced thousands of cases with attorneys and self-represented litigants, conducted legal research and drafted hundreds of decisions and orders. During her 17 years in the Supreme Court, she worked in nearly every part of that court, including civil litigation, guardianship, tax certiorari and condemnation cases, as well as matrimonial matters.

Judge Whelan is an active member of the Suffolk County Bar Association, where she was co-chair of the Family Court Committee from 2013-2016. She has lectured for the Law Academy, Judicial Institute and other law organizations. As a member of the Attorney for Child Task Force, she and the other members received the Suffolk County Bar Association's President's Award in 2016 for their work. Judge Whelan is also a member and past president of the Suffolk County Women's Bar Association.

Judge Whelan received a Bachelor of Arts degree in English and a Master of Science degree in Policy Analysis and Public Management from the State University of New York at Stony Brook. She holds a Juris Doctor from Albany Law School.