NYSBA SPRING 2014 | VOL. 47 | NO. 1

Trusts and Estates Law Section Newsletter

A publication of the Trusts and Estates Law Section of the New York State Bar Association

Chair's Message—Finale "The Chair's Award"

Carl T. Baker

As "the old order changeth, yielding place to new," a final opportunity is given to the retiring Section's Chair to bestow the "Chair's Award," an award for service and leadership in our Section. While many members contribute in ways that meet this definition, a few are remarkable for their long-term dedication and contributions.

When I first had the opportunity to serve on our Executive Committee (a number of years ago that will remain uncounted) I was quite lost and quite overwhelmed. Issues and matters that were not then common to my practice were discussed and debated, all dependent upon and derived from the reams of supporting materials that needed the detailed time and attention that the active practice of law sel-

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A Message from the Incoming Chair

Ronald J. Weiss

Traditionally, an incoming U.S. President uses his inaugural address to lay out his broad agenda for the next four years. As my tenure as Chair of our Section is only one year, my agenda, perforce, must be more limited. It therefore consists of four parts: (1) to facilitate amendment of New York's General Obligations Law to clarify some of its Powers of Attorney provisions; (2) to encourage implementation of the Section's other legislative goals, including amending New York's estate tax to bring it in conformity with the exemption under federal law (which I also note was proposed in Governor Cuomo's January 2014 State of the State Address); (3) to continue to support the work of the New York

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Chair's Message—Finale "The Chair's Award"

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dom provided. While trying to understand the content and import of the matters at hand took all of my concentration, one quiet, calm, impressively knowledgeable voice, often challenging the proposal or seeking its clarification, demanded my attention (and quite clearly received everyone's else's attention as well).

"Micky" seemed to be known to and respected by all. In the years that have passed since that first meeting, and at practically every meeting I have attended since, including the most recent conference call on the new proposed Uniform Trust Code that our Section is working on, this gentle, thoughtful contrarian has been involved and contributing to our work.

Often perhaps a bit of a burr in a Committee's proposal—challenging the need for a change; concerned about the long-term, real world impacts; trying to make certain that what we produced created more certainty and simplicity in the Trusts and Estates practice area—her comments were always presented with an intellectual honesty and humility that required thoughtful response. The debates and discussions that followed sometimes convinced Micky that she was wrong, sometimes simply allowed her to accept the need for the proposed change, but oftentimes resulted in an improved proposal.

I only know Micky in the limited milieu of our Executive Committee meetings. In that context she has been a continuous contributor to and influence on the work of our Section. As my final act as your Chair, I am most proud to be able to recognize, to thank and to honor Marilyn "Micky" Ordover with the Chair's Award for 2013.

Carl Baker

A Message from the Incoming Chair

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Uniform Trust Code Committee; and last but definitely not least (4) to continue the tradition of bringing high quality and interesting CLE programs to the Section's membership.

The cleanup of the Power of Attorney provisions is particularly significant to me, as former Chair G. Warren Whitaker and I worked closely with members of the New York Law Revision Commission and other members of the Section to come up with a proposal to revamp the POA law. In January 2012, the Law Revision Commission issued an excellent report (which can be accessed through the Law Revision Commission's website) making some needed classifications and improvements to the existing law. For example, where a testator has the requisite mental capacity but is physically unable to sign his or her name, EPTL 3-2.1(a)(1)(C) allows a third party to sign the testator's name to a Will. The GOL, on the other hand, is silent as to whether a third party can sign a POA for a similarly situated principal. The Commission's report includes a proposed amendment to remedy this inconsistency. The Section has formed an ad hoc committee, chaired by Robert Freedman, to look at the Law Revision Commission's report, with the goal of facilitating the enactment of many of its findings and other recommendations into law.

As to the other parts of our Section's legislative agenda, adjusting the payment due to a legatee on the deferred payment of a pecuniary legacy is also one of our top priorities. In addition, as noted above, for the first time since 2000, there appears to be positive movement on conforming New York's estate tax exemption to the federal exemption. I look forward to working with the Taxation, Legislation and Governmental Relations Committees of the Section and the staff of State Bar's Governmental Relations Department to encourage our State Legislature to implement this long-needed change.

The New York Uniform Trust Code Committee, chaired by Professor Ira Bloom, continues its hard work. We have been working with the staff of the Association to arrange a high level retreat where Professor Bloom and Professor William LaPiana can consolidate the Committee's work and the parallel work of the City Bar's committees into a report to be circulated to the interested constituencies by late September.

Finally, my goal is to follow in the footsteps of Carl Baker and have our Section present interesting and informative CLE programs. One point of reference will be the excellent CLE program that was presented at the Section's Annual Meeting in January. For those who missed it, the program (chaired by Lori Sullivan, Sally Donahue an Jennifer Hillman) was on updates on marriage, domestic relationships and estate law in light of the Supreme Court's *Windsor* decision. The lunch that followed featured a fascinating talk by Alexia Koritz,

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Editor's Message

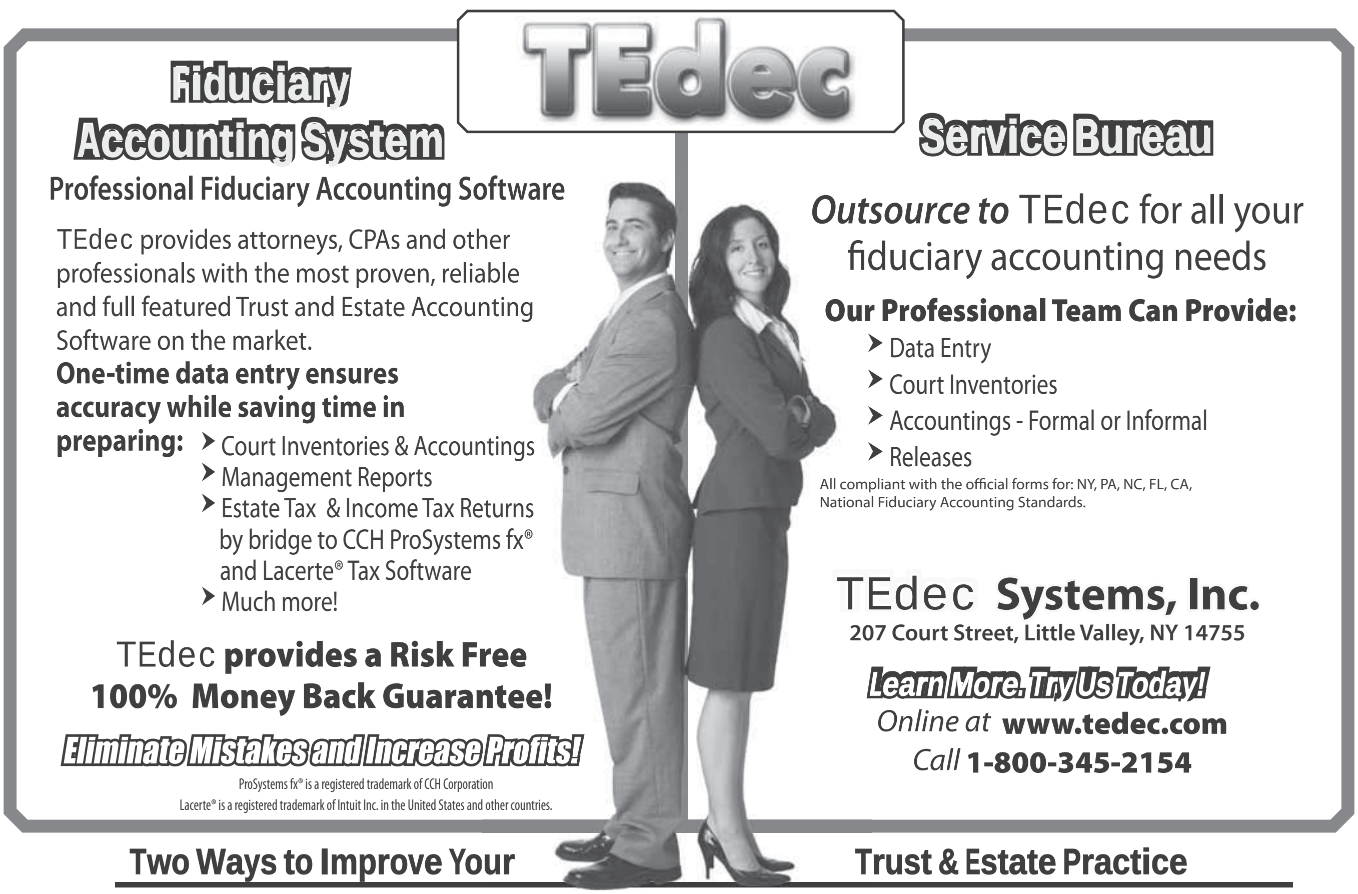
This edition of our *Newsletter* contains several excellent articles for your information and enjoyment.

Particularly timely is Joseph T. La Ferlita's summary of updates to the decanting statute that became effective in November 2013. Another current topic is addressed by Nanette Lee Miller, Janis Cowhey McDonagh and Lorraine Paceleo, with their estate planning and tax tips for non-traditional families. Lenore S. Davis discusses the essential yet often neglected subject of incorporating pets into an estate plan, and Anthony J. Enea reminds fellow practitioners of pertinent steps to follow in preparing oneself for his or her "elder years." In addition, recent law school graduate Dennis Lyons analyzes the history and evolution of the Prudent Investor Rule, and the influence of the Modern Portfolio Theory thereon.

Our next submission deadline is June 9, 2014 for the Fall 2014 issue.

The editorial board of the *Trusts and Estates Law Section Newsletter* is:

Jaclene D'Agostino



(paid advertisement)

New Technical Corrections and Clarifying Amendments to Decanting Statute

By Joseph T. La Ferlita

Having been substantially revised in August 2011, New York's decanting statute was again amended on November 13, 2013. The legislative history (in the form of an Assembly Memorandum in Support) characterizes the changes, which originated as Assembly Bill A7061 and became effective immediately, as "technical corrections and clarifying amendments" to the decanting statute, codified at EPTL 10-6.6.

The 2013 amendments alter the decanting statute in six ways, which are summarized below.

1. Exclusion of Successor and Remainder Beneficiaries When Trustee Has Absolute Discretion

The 2013 amendments clarify that the appointed trust may properly exclude all of the successor and remainder beneficiaries of the invaded trust when the invaded trust confers on the trustee absolute discretion to invade principal. Prior to the 2013 amendments, EPTL 10-6.6(b) stated, in relevant part, "The successor and remainder beneficiaries of such appointed trust shall be one, more than one or all of the successor and remainder beneficiaries of such invaded trust (to the exclusion of any one or more of such successor and remainder beneficiaries)." A literal interpretation of this would require the appointed trust to include at least one of the successor and remainder beneficiaries of the invaded trust.

The purpose of this requirement appears to have been to protect the interests of at least one of the successor and remainder beneficiaries when a trustee decants, but many practitioners concluded that such protections were unwarranted and probably inconsistent with the grantor's intent. As the legislative history of the 2013 amendments explains, since the grantor gave the trustee absolute discretion to distribute principal to the current beneficiary (which is a requirement for decanting under EPTL 10-6.6(b)), the grantor necessarily rendered the successor and remainder beneficiaries' interests "susceptible to exclusion." In other words, the rights of a successor and remainder beneficiary should not be greater when the trustee decants than when he makes an outright distribution to the current beneficiary.

The newly amended EPTL 10-6.6(b) addresses this problem, and now states, in pertinent part, "The successor and remainder beneficiaries of such appointed trust may be one, more than one, or all of the successor and remainder beneficiaries of such invaded trust (to the exclusion of any one, more than one or all of such successor and remainder beneficiaries)."

2. Statute of Limitations

The newly revised statute addresses the effect a decanting has on the six year statute of limitations for compelling a trustee to account. Actually, it punts on the issue. The question is whether a decanting starts the running of the statute, either because it constitutes a "repudiation" under *Matter of Barabash*, 31 N.Y.2d 76, 334 N.Y.S.2d 890 (1972) (statute begins to run on repudiation of the trust relationship), or a "termination" under *Matter of Tydings*, 11 N.Y.3d 195, 868 N.Y.S.2d 563 (2008) (statute begins to run on known termination of trust relationship by appointment of successor trustee).

The legislative history reveals that the legislature considered making every decanting trigger the running of the statute of limitations—a bright line test that was rejected. Although this solution would create certainty, the legislature was concerned that it would make it too easy for a trustee to start the running of the statute to the detriment of unsuspecting beneficiaries, who could unknowingly find themselves without recourse for breaches of fiduciary duty. The legislature was mindful that not every decanting is created equally. One decanting could involve an appointed trust that has the same trustees, beneficiaries, and dispositive provisions as the invaded trust, but one that differs from the invaded trust only in connection with an obscure (at least to a layman) administrative provision. Another decanting could involve an appointed trust that has a different trustee and a completely different dispositive scheme in relation to the invaded trust. The legislative history strongly suggests that the former example should not trigger the running of the statute, whereas the latter should. The test in the legislative history appears to be whether a beneficiary reasonably could be expected to identify the circumstances that give rise to the running of the statute of limitations.

Notwithstanding this, it is important to note that the newly revised decanting statute does not resolve the issue one way or the other; it does not state when a decanting does or does not trigger the statute of limitations. Instead, it does two things: (1) adds to the end of EPTL 10-6.6(j)(5) the statement, "Whether the exercise of a power under paragraph (b) or (c) begins the running of the statute of limitations on an action to compel a trustee to account shall be based on all the facts and circumstances of the situation[;]" and (2) requires the decanting instrument, which the decanting trustee is required to serve on the interested parties, to state that "in certain circumstances the appointment will begin the running of the statute of limitations that will preclude persons interested in the invaded trust from compelling an accounting by the trustees after the expiration of a given time."

Another bright-line solution—which also was not adopted—would be to have the statute of limitations begin to run when the decanting covers all of the invaded trust's assets, but not begin to run when it covers only part of same. In conjunction with this, the decanting instrument, which the 2011 decanting statute already required to be served on the interested parties and to state whether the decanting covered all or only some of the invaded trust's assets, would have to state explicitly whether the decanting at issue has triggered the running of the statute of limitations (*i.e.*, when the decanting covers all of the assets) or not (*i.e.*, when the decanting covers only part of the assets). It is not clear if the legislature ever considered this option.

3. Execution of the Appointed Trust

The 2011 version of the statute included in the definition of an appointed trust "a new trust created by the creator of the invaded trust or by the trustees, in that capacity, of the invaded trust" (EPTL 10-6.6(s)(1)). The 2011 version of the statute went on to state, "[f]or purposes of creating the new trust, the requirement of section 7-1.17 of this chapter that the instrument be signed by the creator shall be deemed satisfied by the signature of the trustee of the appointed trust." The problem is that EPTL 7-1.17 now refers to "the person establishing such trust," and not "the creator." To make the decanting statute conform, EPTL 10-6.6(s)(1) now states, in pertinent part, "[f]or purposes of creating the new trust, the requirement of section 7-1.17 of this chapter that the instrument be executed and acknowledged by the person establishing such trust shall be deemed satisfied by the execution and acknowledgment of the trustee of the appointed trust."

One question inadvertently created by this technical amendment is whether EPTL 7-1.17 is deemed satisfied when the newly created appointed trust is executed by the trustee of the invaded trust in the presence of two witnesses instead of being acknowledged. Although logic would suggest it would, the explicit language of the newly revised decanting statute refers only to situations where the signature of the trustee of the invaded trust is acknowledged.

4. Whether the Appointed Trust Could Include a Discretionary Income Beneficiary

As revised in 2011, the decanting statute appeared to prohibit a trustee with absolute discretion from decanting to an appointed trust that carried over the interest of a discretionary income beneficiary of the invaded trust. The problem was that, under EPTL 10-6.6(b), a trustee "with unlimited discretion to invade trust principal may appoint part or all of such principal to a trustee of an appointed trust *for, and only for,* the benefit of, one, more than one or all of the current beneficiaries of the invaded trust (to the exclusion of any one or more of such current beneficiaries)" (emphasis added). Suppose, for example, that the invaded trust confers on the trustee absolute discretion to distribute (1) some, all, or none of the invaded trust's income to A, and (2) some, all, or none of the principal to B. Could the trustee decant to an appointed trust that has the same dispositive terms as the invaded trust, or must A's interest be eliminated in the appointed trust? The legislative history acknowledges that a literal interpretation of EPTL 10-6.6(b) would prohibit the appointed trust from including A's interest, but goes on to state that there is no reason why a grantor would not desire the continuation of A's interest in the appointed trust. The legislature handled this issue by amending the definition of "current beneficiary or beneficiaries," which is now "the person or persons…to whom the trustees may distribute principal at the time of the exercise of the power, *provided however that the interest of a beneficiary to whom income, but not principal, may be distributed in the discretion of the trustee of the invaded trust may be continued in the appointed trust*" (EPTL 10-6.6(s)(4) (emphasis added)). Thus, in this example, A's interest may properly continue in the appointed trust.

5. Whether Decanting from a Non-Grantor Trust to a Grantor Trust Is Prohibited

The revised statute addresses a concern that decanting from an non-grantor trust to a grantor trust violates the general prohibition of having a new appointed trust contain beneficiaries who had no interest in the invaded trust (in other words, one generally cannot add beneficiaries when decanting). The question was whether, in this circumstance, the grantor is deemed a new beneficiary, thus rendering the decanting ineffective. The concern was rooted in existing EPTL 7-1.11, which allows a trustee to distribute trust principal to a grantor in order to reimburse him for income taxes that he incurred on behalf of the trust (*i.e.*, in the case of a grantor trust). The legislative history discusses this issue at length, and, in the end, characterizes the grantor's right to receive principal as reimbursement for income taxes incurred on behalf of the trust as a non-beneficial interest in the appointed trust. For that reason, the grantor is not deemed to be a "new beneficiary" in this case, thus rendering the decanting effective.

6. Does Decanting Require Co-Trustees to Exercise Their Authority to Invade Principal Unanimously?

There was some concern that, where an invaded trust had multiple trustees, unanimity among them was required to decant. After all, EPTL 10-6.6 explicitly characterizes decanting as the exercise of a power of appointment and, under the general rule of EPTL 10-6.7, a power of appointment conferred on multiple donees must be exercised unanimously. Moreover, the statute that contains the "majority rules" test, EPTL 10-10.7, explicitly excludes powers of appointment. The legislature clarified that a mere majority of trustees is needed to effectuate a decanting. It did so by amending EPTL 10-6.7 by excluding decantings from its application, EPTL 10-10.7 by including decantings in its application, and 10-6.6 by adding an explicit reference to the former two sections (*see* EPTL 10-6.6(t)).

Conclusion

Recent technical corrections and clarifying amendments should, as a whole, help practitioners and trustees more successfully utilize New York's decanting statute.

Joseph T. La Ferlita, Esq. is a Partner at Farrell Fritz, P.C. in Uniondale, New York. He is a member of the NYSBA Trusts and Estates Law Section Executive Committee, serving as a District Representative for the 10th District, a former Chair of the Surrogate's Court Committee, and a member of the Estate and Trust Administration Committee.

Estate Planning and Tax Tips for Non-Traditional Families

By Nanette Lee Miller, Janis Cowhey McDonagh and Lorraine Paceleo

ESTATE PLANNING CHECKLIST

1. **PREPARE YOUR LAST WILL & TESTAMENT**: A will or trust is the best vehicle to ensure that your assets pass as you intend. In the absence of a will, the intestacy laws of your state will govern distribution, and assets will not pass to an unrelated (unmarried) partner.

2. **CREATE A TRUST**: A trust can be a useful alternative to a will for LGBT couples whose families may not support their relationships, thereby making a will contest more likely. In addition to providing privacy by virtue of not becoming public record (as is the case with a will once it is probated), trusts are also more difficult to contest than wills which have stringent execution rules, etc.

3. **BENEFICIARY DESIGNATIONS**: Certain types of assets, such as life insurance, 401(k)'s and IRA accounts, may be transferred directly upon death and are not subject to the probate process. However, when the designation forms are not filled out completely and/or correctly, the assets default to the decedent's estate and become part of the probate estate. Therefore, LGBT couples may wish to list each other as beneficiaries on such accounts or policies. On non-retirement accounts, consider establishing transfer-on-death (TOD) or payable-on-death (POD) provisions where state law permits such transfers.

4. **ESTABLISH A DURABLE POWER OF ATTORNEY**: A durable power of attorney permits you to designate an agent to handle all aspects of your financial affairs. You may select a power of attorney that becomes effective immediately upon signing, or one that becomes effective at a future time or upon the occurrence of some contingency (commonly known as a "springing power of attorney") such as your incapacitation. Power of attorney documents become especially important for same-sex couples who are not afforded the same range of privileges and access to each other's financial information as opposite sex married couples enjoy.

5. **ESTABLISH A HEALTH CARE PROXY AND LIVING WILL**: A health care proxy allows you to designate an agent to make medical decisions on your behalf if you are unable to do so for yourself. A living will sets forth your wishes concerning life-sustaining measures. These documents are crucial for same sex couples, who are often denied "next of kin" status by hospitals and other medical care providers. This is especially true when a same sex couple that is married in one state has a medical emergency while on vacation in another state that does not recognize their marriage. In such an instance, although the couple is married in their home state, the spouse may be treated as a legal stranger.

6. **ESTABLISH A DESIGNATION FOR THE DISPOSITION OF REMAINS**: Such a document can be used to designate which individual(s) have the right to make funeral and burial decisions. If the decedent has any particular wishes concerning their final disposition, such wishes should be explicitly set forth in the designation. Further, language concerning who should have the ability to select a grave marker, and the language contained thereon, should be included in order to avoid battles with family members who may not agree with the language on the tombstone (*i.e.*, "beloved partner") of the decedent.

7. **ESTABLISH A COHABITATION AGREEMENT**: For couples that are going to mix assets, financially support one another and incur debt together, a cohabitation agreement should be considered in order to delegate how the assets will be handled during the relationship and in the event the relationship ends. For same-sex married couples, a prenuptial agreement should be prepared for the same purposes. Prenuptial agreements are especially crucial for members of the LGBT community, many of whom have amassed substantial wealth when same-sex marriage was prohibited, and now face entering into a marriage with significant assets to protect.

8. **ESTABLISH A JOINT CUSTODY AGREEMENT**: Most states permit second-parent adoptions, and it is strongly recommended that couples consider such adoptions. However, a joint custody agreement is one alternative which helps protect the rights of both parents in their home state and while traveling to non-LGBT friendly jurisdictions.

9. **PROPERTY CONSIDERATIONS**: Owning property as joint tenants with the right of sur-

vivorship offers a simple solution to many of the difficulties unmarried or same sex couples face regarding their assets, but this approach also has many pitfalls. By taking title to an asset (bank account, real estate, etc.) in this manner, the surviving partner will become the owner of the property automatically by operation of law. Such transfers pass outside of the Will and are not subject to probate, thereby eliminating many of the challenges that adverse parties can potentially bring. However, very careful consideration must be given to issues such as gift tax, state prohibitions against non-married persons executing joint deeds, coop board restrictions, proof of contribution, and many similar issues, before any transfers are made or ownership on purchase is determined.

10. **RETIREMENT PLANNING**: One of the most popular retirement tools, the Roth IRA, is federally governed. Therefore, one partner of a same-sex couple is unable to create a Roth IRA for the benefit of a stay-at-home partner, married or not. Further, while a federally recognized married person can inherit a 401(k) without incurring taxes, unmarried 401(k) beneficiaries may be subject to extra taxes without proper estate planning. LGBT couples also have a difficult time accessing the Social Security benefits of their partners, even when their home state recognizes their marriage. In order for same-sex or unmarried couples to ensure sufficient savings for retirement, the working partner should maximize contributions to his or her own 401(k) especially when his or her employer has adopted a contribution-matching policy. Further life insurance, especially if one partner depends on another's income to survive, should be purchased and used as part of the larger estate plan.

TAX TIPS FOR LEGALLY MARRIED SAME-SEX COUPLES

1. **MARRIED TAX STATUS**: Determine if there is any benefit to filing amended income tax returns using "married" status. Married tax status as compared to single or head of household status could result in a lower joint tax liability because of the netting of income and deductions, eligibility for certain tax credits, and income exclusions. It could also result in an increased tax liability due to the marriage penalty tax or because of limitations on deductions based on combined adjusted gross income. File amended returns as soon as possible; don't wait until April 15th. Amended returns must be filed before the Statute of Limitations runs—generally 3 years from the filing of the original return or 2 years from when the tax was paid, whichever is later.

2. **NON-TAXABLE FRINGE BENEFITS**: Consider amending income tax returns to exclude previous taxable income which was used to purchase job-related benefits for your spouse, such as health insurance, life insurance, and other fringe benefits. Employers may be entitled to a refund of matching FICA payments on fringe benefits that are now non-taxable. The Statute of Limitations for refund claims also applies.

3. **EMPLOYER SPOUSAL BENEFITS**: Save current tax dollars by contacting your company's Human Resources Department for a list of marital benefits available. Take advantage of all non-taxable fringe benefits available to your spouse. Also look for a benefit that may pay you a buy-back amount if you no longer need employer-paid benefits (because you are now covered under your spouse's plan).

4. **RETIREMENT ACCOUNTS**: To save taxes your beneficiaries will pay after your death and allow the payout to be stretched out as long as possible, check your IRA / 401K plan designations. A same-sex spouse may not inherit or roll over such a plan to his / her own name in states that do not recognize same-sex marriages. Also, consider making a year-end retirement account contribution for your spouse (if applicable) and receive an additional deduction.

5. **SOCIAL SECURITY**: Apply for social security marital benefits and the lump sum death benefit, if applicable. Currently, the Social Security Administration is only processing claims for same-sex married couples who reside in a state that recognizes their marriage. If you reside in a state that recognizes same-sex marriage, apply for benefits before you move to a state that does not recognize same-sex marriages.

6. **ESTATE TAXES**: If your spouse recently died and the estate paid estate taxes on the portion of the estate that you inherited, file a claim for refund. If you and your spouse did not do any estate planning prior to death, be sure to consult with an attorney or an accountant in a timely manner as there are estate planning techniques and elections available for married couples after death. Even if you are not required to file a federal estate tax return, consider filing one to take advantage of portability. Portability allows your deceased spouse's unused federal exemption amount to be rolled over to you as the surviving spouse. The estate must timely file an estate tax return to elect portability.

7. **MAKING GIFTS**: Consider the effect of transferring assets, gift tax free, to your spouse. When making gifts to loved ones and children, consider the benefits of year-end gift-splitting. One spouse may now utilize the other spouse's annual gift tax exclusion amount by electing to split gifts (annual gift tax exclusion: $14,000 for 2013 and 2014).

8. **ESTATE PLANNING**: If you reside in a state that has a death tax and recognizes same-sex marriages, establish a marital trust, Qualified Terminable Interest Property Trust (QTIP) or disclaimer trust for your spouse in your Will. If you reside in a jurisdiction that does not recognize same-sex marriages, you must plan as if you are single and execute a Will as state laws control inheritance rights. Your spouse will not automatically inherit or be entitled to any of your estate if you die without a Will.

9. **PAYROLL TAX WITHHOLDING:** Update your Form W-4 with your employer to change your status to married and increase or decrease your exemptions. Make a note and place it with your other 2013 tax preparation documents so your tax preparer can advise you again in April if another revision is recommended.

10. **OTHER POINTS**: Same-sex couples in a Domestic Partnership or Civil Union should consider getting married, as different laws apply. Same-sex married couples who divorce may now be able to take a deduction for alimony payments. Same-sex spouses may now take advantage of innocent spouse protection rules.

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Pitfalls in Pet Planning

By Lenore S. Davis

I read in the *New York Times* obituary section that Barbara Blum had passed away during the same time I was studying Pet Planning. How are they connected?

Barbara Blum was a woman who believed in civil rights. The City of New York used her to break open the doors of the horrific Willowbrook State School, where the disabled and handicapped were hidden away until death freed them. The story of Willowbrook was revealed by Geraldo Rivera, a reporter who went undercover at Willowbrook and exposed the subhuman conditions endured by its inhabitants. It was the spark that ignited great strides in integration of the disabled and handicapped and others with mental and physical illnesses.

Barbara Blum's death reminded me that *Brown v. The Board of Education*[1] is less than 60 years old. The Willowbrook expose in 1972 is merely 40 years old. With human civil rights only recently addressed, it is no wonder that it should take further time for the rights of animals to be addressed. But the commonality of disabled humans and pets are that both will always be dependent on others to plan for their care.

At a casual glance, the area of planning for pets appeared to be a very small niche area because the majority of pet owners have someone in their home that could care for a pet, or at the very least, assume ownership and care of the pet if necessary. After initial research, it became clear that the need is much greater than realized: 63% of American households—or over 100 million households—own pets. They include 83 million dogs and over 96 million cats.[2] The assumption that most pet owners have a relative or friend who could assume the care of a family pet is clearly in error because a significant number of the 4 to 6 million animals euthanized in the United States annually are animals left without care when their owners died. In a 2005 study, 73% of dog owners and 65% of cat owners consider their pets to be akin to a child or other close family member. In 2013, $55.5 billion was spent by Americans on pet supplies. The pet supply field is expected to continue its great growth.[3]

Presently, although pets are considered personal property, recent federal statutes afford pets greater rights.[4] In addition, state laws contain anti-cruelty statutes and enforcement agencies which enforce these animal rights. The State of New York Department of Agriculture and Markets issued Circular 916, effective November 2013, entitled Article 26 of the Agriculture and Markets Law relating to CRUELTY TO ANIMALS, Article 25b, Abandoned Animals, and Sections 601 and 602 of the Vehicle and Traffic Law.[5]

Though an evolution of the statutes and case law of animal rights could be a fascinating separate article, this article focuses on the practical side of estate planning for pets.

I. Partial Planning—Creating the Gaps

A. The Need for Pet Care Terms in a Will

Beginning with the first pet-planning gap, *i.e.*, having no specific plan in place at all, most Americans do not have a will in place.[6] As stated above, many Americans might assume that a family member or friend will care for the pet when they die. Millions of animals are euthanized as a result.

An additional planning gap arises when a will is created and there is no specific reference to the pet. Pets are indeed considered personal property.[7] Failure to provide specifically for pets would have them pass under a will's residuary clause. But what would happen if there are several residuary beneficiaries? Certainly one cannot split a pet in the event more than one beneficiary desires the pet. Additionally, and more importantly, what if the residuary beneficiary or beneficiaries do not want the pet and there is no alternative disposition of the pet?

The second problem in not addressing a pet in a will is that there is no guidance provided to the new owner of the specifics of caring for the pet, *e.g.*, which veterinarian the pet generally uses, what food brands the pet desires, how often and where it is groomed, as well as medical and other information personal to the pet.

Accordingly, the first step for drafting a will for a client with a pet is to include specifics on to whom the pet should be given. The client should be advised at the time of drafting the will to ask whether his intended beneficiary agrees to take the pet and care for it, the same as one might do for a nominated guardian of minor children. The attorney must make clear to the client that even though the beneficiary may acquiesce presently, that person is under no fiduciary obligation to take the pet upon the client's demise. Accordingly, the attorney and client should set forth terms for a successor caregiver in the will.

B. When There Are No Pet Provisions in a Power of Attorney

There is a clear distinction between a disabled human dependent and a pet, specifically in what happens when the client is not capable of caring for the dependent human or pet, either in the short term, long term, or, in the case of death, permanently. Think of a scenario where Emergency Medical Services is called to a scene and there is a child or a disabled adult at the scene. EMS will likely call the Department of Social Services to take custody of the child or dependent, and find a proper shelter for the child either temporarily or permanently, as required.

Now think of the above scenario when a pet is involved, assuming the client even has a will. When EMS arrives, they may not know or even care whether there the pet owner has a will. Even if the client's will were taped to the door for all to see, it would only become effective upon the client's death. At that point in time, the patient might be very much alive; in fact, there may not even be an imminent threat of death, so any provisions for pet care in a will would not address any immediate need.

EMS or the police might take custody of a friendly pet, but only for a short period of time. First, the animal shelter will determine if there are friends or relatives prepared to step forward and care for the pet on behalf of the pet owner. If no one steps forward after the first few days, the animal shelter might have the ability to find someone else who would care for the pet either short term, long term or permanently. But, depending on the shelter's capacity, it is likely that after a few weeks, if no one claims the pet, the pet will be euthanized. So, if the client made no provisions for the pet in the event of disability, and he recovers weeks later, he could discover that his pet was euthanized during the term of his illness.

II. Filling in the Gaps: Power of Attorney and *Inter Vivos* Pet Trusts

Attorneys who only address the pet issue on a limited basis through wills have permitted a huge gap in coverage for their client's pets. How to fill these gaps? The one-two punch: a provision in 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 pets are cared for when a client is alive but unable to care for his pet, or communicate to whom the pet should be given.

The power of attorney in and of itself is insufficient. It is an inappropriate place to set forth the details for the care and maintenance of the pet. The job of the attorney-in-fact would purely be to transfer the pet to the caretaker or custodian set forth in an *inter vivos* trust.

The *inter vivos* pet trust is a fairly new estate-planning tool. The concept began as a so-called "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 he 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.

As the concept evolved through the legal system and state statutes, 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 compel him to carry out the terms of a trust for the benefit of a pet.

One such state is New York. 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.[8] 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, *i.e.*, the animal's life. Under the EPTL, the trust shall terminate only when all animal beneficiaries of the trust are no longer alive.[9] The trust names a trustee to manage the funds of the trust, a caretaker who has physical custody of the pet, and an enforcer.

It would be wise for the attorney to include successor fiduciaries to those set forth in the trust, as well as include those provisions for pets previously mentioned to be included in a will: daily routine, eating and grooming preferences, veterinarian's name, pertinent medical information, and other details the client would want a new caregiver to know. Having the triumvirate of power of attorney, *inter vivos* trust and will with provisions for pets, the client will ensure a continuum of care for a pet for the term of its life.

What happens, though, if the client does not have an individual whom he can trust with his pet? Veterinarian schools and other pet-oriented institutions have in recent years established pre-planning programs for pets. A pet owner can contact the organization and pay to have his pet picked up in the event the owner becomes disabled or dies. There is a better chance that such anorganization in good standing will be available for a pet than one person, who can change his mind, or die or become disabled himself.

Some of the better organizations have a planned-giving department that customizes solutions for clients and charge accordingly. Most frequently, the organization is contacted when the client becomes disabled or dies, and arranges for the pet's transportation to a pet facility where either the pet lives for the remainder of its life, or is adopted out.

III. The Funding Gap

Aside from the issue of pet provisions in estate planning and drafting, errors often occur in the funding of estate plans for pets. Funding a testamentary pet trust with an insurance policy on the life of the pet owner might seem to make sense. The life insurance policy will become liquid upon the owner's death and the testamentary provisions go into effect. However, there will be some lapse in coverage.

From the time the owner dies, until the time the will is probated, the death certificate received and forwarded to the insurance company and the insurance proceeds paid to the testamentary trustee typically takes months. There may be a double gap here. Gap One is the time it takes to get a certified death certificate, and have the insurance company issue the life insurance check. Gap Two is waiting for the Surrogate's Court to issue letters testamentary and letters of trusteeship. Even if the insurance company wants to pay out the life insurance proceeds, it would have to wait for the Surrogate's Court to issue letters of trusteeship in order to issue a check to the legal representative of the testamentary pet trust. If there is other money left for this process, then as soon as letters of trusteeship are issued, the trust may be funded.

This gap in probate and funding should be avoided by having an *inter vivos* pet trust, which acts as a stop-gap measure in the event the client becomes disabled but is still alive. An *inter vivos* trust goes into effect immediately upon the client's signing the document. It should be funded as an emergency fund, ready to be used at any moment, simply because one never knows when a pet owner will fail or cease to serve as the pet's care giver.

Several suggestions might be to have a part of pension proceeds, annuities or minimum required distributions go to the *inter vivos* trust, or fund the trust with an investment, stocks, bonds, mutual fund, etc.

Beware that, unlike any other trust, a pet trust may not be overfunded, *i.e.*, a grantor may not fund a pet trust in excess of what it would reasonably take to care for the pet(s) covered.[10]

Lastly, estate planning is more complicated for pets because under tax laws, pet beneficiaries are treated differently than human beneficiaries. This starts with the definition of person, which does not include pets.[11] To cite just two examples: a trust specifically for the benefit of pets, and a charitable remainder trust (CRAT).

Pets are not considered "persons" under Rev. Rul. 76-486,[12] which states:

IRS HEADING

> Trust for care of pet animal.
>
> In the absence of a state law to the contrary, a bequest in trust to provide for the care of a decedent's pet animal is void from its inception, and unless otherwise indicated in the will or specified by statute, the trust property passes to the residuary legatee and income earned on such property is includible in the income of such legatee.
>
> In jurisdictions where such a trust is not invalid, it is subject to the imposition of the tax of section 1(d) of the Code pursuant to section 641 and no deductions are allowable for distributions under sections 651 and 661.

This makes sense considering that trust income has to be taxed to a person or entity. A simple trust is one where all the income is currently distributed to beneficiaries. The beneficiaries are issued a K-1 and the beneficiaries include the income on their own income tax returns. The trust gets a deduction for distributions paid [and for which the beneficiary will pay income tax], otherwise the same income would be taxed twice.

A complex trust is one where there is no mandatory distribution of all the current income. As a result, if there is trust gross income greater than $600 in one year, the trustee must file a 1041 and pay taxes on said income. The tax rates for trusts are compressed, *i.e.*, the brackets of income require greater tax rates at lower income amounts.

Now we can understand why a pet trust cannot get a tax deduction for distributions made for the benefit of a pet, and why pet trusts are considered complex trusts. A pet is not an entity that pays taxes. A trust cannot issue a pet a K-1. Therefore, all income received by the trust must be paid by the trust, as a complex trust, at compressed tax rates.

Other examples of disadvantaged tax rules for pets are the rules and regulations governing charitable remainder trusts (CRATS). Often, a client would like to fund a trust for the benefit of his pet, and would like the remainder to go to charity. If the trust income were for the benefit of a human beneficiary, the grantor could count on some kind of charitable deduction; not so with trusts for the benefit of pets. Under Revenue Ruling 78-105: "no portion of the amount passing to a valid trust for the lifetime benefit of a pet qualifies for the charitable estate tax deduction, even if the remainder beneficiary is a qualifying charity" because a pet is not a "person."

It is important for attorneys to advise clients to plan for their pets. It is equally important for the estate-planning attorney to know where the hidden gaps and traps lie, and to help the client navigate the estate-planning course to ensure that all dependents, including pets, are cared for in the event of a client's disability or death.

Endnotes

1. 347 U.S. 483 (1954).
2. The Humane Society of the United States, www.Humanesociety.org.
3. American Pet Products Association, www.Americanpetproducts.org.
4. Endangered Species Act of 1973, 16 U.S.C. 1531-1544, 87 Stat. 884 (1973), as amended—Public Law 93-205, approved December 28, 1973 (repealing the Endangered Species

Conservation Act of December 5, 1969 (P.L. 91-135, 83 Stat. 275 (1969)). The 1969 Act had amended the Endangered Species Preservation Act of October 15, 1966 (P.L. 89-669, 80 Stat. 926 (1966)); the Animal Welfare Act, 7 U.S.C. 54 (1966); and the Marine Mammal Protection Act (16 U.S.C. Chapter 31 [1972]). *See also* Animal Welfare Act, 7 U.S.C. 2143 and Pets Evacuation and Transportation Standards Act of 2006, 42 U.S.C.A. §§ 5196b, 5170b(a)(3)) (West 2008); 152 CONG. REC. H6807 (daily ed. Sept. 20, 2006) (statement by Rep. Shuster) (discussing how the aftermath of Hurricane Katrina uncovered the need to account for household pets and service animals in state and local emergency preparedness plans).

5. N.Y. AGRIC. & MKTS. LAW § 350, et seq.. N.Y. VAT. LAW § 601 et seq.
6. www.Rocketlawyer.com.
7. *See, e.g.*, *Gluckman v. Am. Airlines, Inc.*, 844 F. Supp. 151, 158 (S.D.N.Y. 1994) (holding that pets are personal property, their loss is limited to evidence of the value of said pet, and there is no independent cause of action for loss of the companionship of a pet).
8. N.Y. Estates Powers and Trusts Law 7-8.1(a).
9. *Id.*
10. EPTL 7-8.1(d).
11. IRC § 7701(a)(1).
12. Rev. Rul. 76-486, 1976-2 C.B. 192.

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Are You Ready for the Elder Years?

By Anthony J. Enea

As attorneys we are all too often preoccupied by the lives and problems of others. On a daily basis we go from one client to another, utilizing all of our strength, energy and intellectual resources with the hope of providing our clients with the best legal services possible. Their problems and concerns are inevitably always on our minds. Unfortunately, our profession leaves us little time to focus on our own personal affairs, especially those related to our aging. The demographic studies done of the membership of the New York State Bar Association (NYSBA) reflect that our membership is rapidly aging. The largest demographic group of attorneys is those over the age of 55 years. Believe it or not, if you are 55 or older you qualify to be a member of NYSBA's Senior Lawyers Section.

It is my hope that this article will encourage you to take a step back and assess whether you have taken some of the most basic steps in organizing yourself for the elder years. The following are my suggestions for your consideration.

A. Physically organize your affairs. Locate and organize into separate folders / binders all of the most important legal documents you have executed, such as your original Last Will and Testament, Trust(s), Advanced Directives (Powers of Attorney, Health Care Proxies, etc.), deeds to your properties, mortgages and notes, insurance policies (life, health, disability, home, long term care, malpractice), bank and investment records, income tax returns, passports, birth certificates and military discharge records, etc.

Organizing these documents will surely be a time-consuming process; however, it will be a process that allows you to revisit many matters you may not have paid attention to for a number of years.

Once you have physically organized these documents, I would suggest that you let your spouse and / or loved ones know where they are located. I would also suggest that you not place your Last Will and Advanced Directives in a Safe Deposit Box unless someone other than yourself has a key and is authorized signatory on the box.

B. Review and update your existing Last Wills, Trusts and Advance Directives to ensure they are up to date and reflect your present financial circumstances and wishes. The Last Will you prepared when you were newly married with minor children may not be reflective of your current state of affairs and / or wishes. For example, your existing Last Will and the titling of your assets may not allow for appropriate estate tax planning on your death or the death of your spouse. Additionally, the individuals you selected as the Executors and / or Trustees 25 to 30 years ago may not be the same individuals you wish to act in that capacity now.

An extremely important document to have as one ages, which is often not properly drafted, is the Durable Power of Attorney (POA). It is most important that the Power of Attorney be Durable (survive your subsequent incapacity) and be sufficiently broad enough to allow the agent to take all steps necessary to protect and preserve your assets in the event of your incapacity. The Power of Attorney you signed appointing your spouse to act as your agent at a house closing may not be the one you need and want if you suffer a debilitating illness. In my opinion, you should have a Durable Power of Attorney with as many powers (including broad gifting powers) as humanly possible. Many Guardianship proceedings would be avoided in their entirety if a sufficiently broad POA was in existence.

C. Organize and review all existing insurance policies. We often know that we have purchased life, disability and long term care insurance, but, it may be years since we assessed the adequacy of the coverage and the policies. For example, do you have life insurance that is term, universal and / or whole life? Is the death benefit sufficient to meet the current needs of your family and / or loved ones in the event of your demise? From an estate tax and planning perspective, it may be wise to have the policy owned by a irrevocable life insurance trust, so that it is not part of your taxable estate. You also may not want your 21-year-old child receiving a million dollars outright upon your death. Generally, most insurance professionals are willing to provide a no-cost review of one's existing policies. Additionally, because of the existing low interest rate environment, the policy may not be meeting its projected rate of return, which may significantly impact the cash value projections made when you purchased the policy.

D. Organize and list the names, addresses and telephone numbers of all the professionals you are currently utilizing for your family and/or loved ones. Upon your incapacity or demise the last thing you want your family to deal with is trying to track down your attorney, CPA and / or insurance professionals. Additionally, you should advise your family and / or loved ones as to the professionals you would recommend they contact upon your incapacity or demise. You obviously do not want someone you despise handling your estate.

E. Organize the names, addresses and telephone numbers of your physicians, therapists, pharmacies and other health care providers. At a time of crisis having this information in one spot will be invaluable.

F. Inventory, organize and keep at least 8 years of your financial and bank records. Many families are unsure and unable to locate all of the bank and financial accounts their loved ones have at a time of illness or death. Additionally, if you need to apply for Medicaid to cover your possible stay in a nursing home (which would cost you approximately $15,000 per month if you are not eligible for Medicaid and don't have long term care insurance) you will need the last 5 years of all bank and investment account statements and records.

G. Review what steps if any you have taken to protect your life savings in the event you and/or your spouse/significant other need long term care in the future. Clearly, no one plans to have a stroke or heart attack and / or develop Parkinsons, Alzheimer's or dementia. It is not part of the commercial with you and your loved one walking down the beach hand in hand enjoying the glorious days of your retirement. Unfortunately, things do not always go as planned. I am often reminded by one of my associates of the Jewish saying that "Man plans, God laughs."

Planning for the potential need of long term care is an endeavor that requires foresight and recognition of the fact that it is possible that you may suffer a debilitating and chronic illness. The purchase of long term care insurance should be strongly considered. There are many new products that are available that are a hybrid of life insurance and long term care insurance. Additionally, utilization of a Medicaid Asset Protection Trust should be high on the list of available planning options, especially as you get closer to the age of 65.

H. Review and assess your retirement goals and plans. Retiring from the practice of law as a single practitioner or as a member of a small firm requires an organized plan and strategy. While many of us want to go out with our boots on, doing so without having a plan in place for the transition of your practice and files to other attorneys will create significant havoc for your clients, your estate and family.

I. Review and assess any pension, social security and annuity benefits you are entitled to. Review potential IRA and / or qualified annuities and their minimum required distributions.

J. Review and organize your burial arrangements. The purchase in advance of a burial plot(s), mausoleum, crypt, etc., while it may sound morbid, will generally alleviate a great deal of stress from your family and loved ones upon your demise.

I regularly find myself extolling the virtues of organization and planning to my associates and staff. As we approach the "elder years" it's important that we apply those organizational virtues to our own personal and professional lives. As Winston Churchill once said, "Let our advance worrying become advance thinking and planning."

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This article originally appeared in the Winter 2014 issue of the NYSBA One on One *newsletter.*

Message from the Incoming Chair

(Continued from page 2)

an attorney with Paul, Weiss, the firm that successfully argued the case of Edie Windsor.

Fortunately for me, my tasks over this coming year will be helped along by the dedicated members of the Section's Executive Committee, including its former Chairs. Unlike the soldiers in General MacArthur's famous speech, former chairs do not just fade away; they invariably stay active and provide needed guidance to those who succeed them. I plan on consulting with them often, and Carl Baker and Ilene Cooper have already given me valuable advice in organizing our Spring Meeting. That Meeting will be held at the Four Seasons Hotel in Toronto from May 1-3, 2014 (including Saturday night at the Hockey Hall of Fame), and our Fall Meeting will be at the Hyatt Regency in Rochester on October 16 and 17, 2014. I hope that many of you will attend these meetings, so please save the dates on your calendars.

I look forward to working with the members of the Section and staff of the State Bar Association to make 2014 a productive year for our Section; I know it will be an interesting one.

Ron Weiss

Endnote

1. When I lived in Menands, I lived near the Albany Rural Cemetery. Trivia Question: What U.S. President (who was a lawyer) is buried in the Albany Rural Cemetery? (answer on page 32).

The Prudent Investor Rule: The Evolution of Prudence in Trustee Investing and the Influence of Modern Portfolio Theory

By Dennis Lyons

Introduction

The past 50 years have seen rapid changes in fields such as technology and communications, transportation, government policy and finance. Finance in particular has seen enormous rises in stock markets, increased inflation, and recently, bouts of extreme volatility in financial markets. Throughout this time, it is undeniable that finance has come to play a critical role in the global economy. Alongside the rise in its importance, finance has been the subject of academic study which has deepened our understanding of risk, return and market behavior. In particular, Modern Portfolio Theory has come to dominate the industry's approach to investing.

These developments necessitated a change in the standard governing a trustee's investments. Previously, trusts had been one of the most conservative types of investors in the marketplace. As a result, trusts were largely missing out in the historic appreciation of stock markets around the world, and trusts were having an increasingly difficult time providing for all income and remainder beneficiaries in the face of increasing inflation. Reforms began to be implemented in the 1990s which effectively unshackled trustees, allowing them to consider a wide array of investments and rely on the most modern theories of investing in order to more effectively manage trust assets and provide for the beneficiaries. This article will examine the historical development of the standards governing trustees' investments, then discusses the enormous influence of Modern Portfolio Theory in the most recent reforms. Finally, the article will investigate the application of the new standard in New York.

History

The modern era of trust law has seen generally three categories of standards applied to a trustee's investments of trust assets. We have seen a long standing "legislative lists" standard, followed by the prudent man rule, and most recently, the prudent investor rule under the Uniform Prudent Investor Act. The first of those standards, the legislative lists seen earlier in the twentieth century, evolved from several early bad experiences to which American and English courts had to react.

In 1719, English parliament authorized trustees to invest in shares of the South Sea company.[1] This was less than 120 years after the emergence of the British East India Company, one of the earliest and most famous joint-stock companies. In a pattern that would become familiar throughout subsequent history, the 1719 authorization came at the height of what was arguably the first stock bubble. From the early 1700s up until 1720, a great number of stock companies were formed.[2] During this short time, the amount of capital invested in stock went from just above nil to 13% of England's national wealth. The bubble culminated in the collapse of the shares of the South Sea Company.

After the 1719 authorization, many English trustees took advantage of the opportunity to invest in stock.[3] Only one year after trusts bought into the South Sea Company issue, the shares declined 90% as the bubble burst. In reaction to the bursting of the bubble, the law quickly changed again and became much more conservative. "Legal lists" were developed which contained the exclusive options available for trustees to invest the assets under their control. At first, these lists included only government debt and well-secured first mortgages; later certain select stock securities were added to the list, such as the East India Company.[4]

American trust law developed along similar lines. Legal lists were similarly restricted to specific investments approved by statute or court holdings, and were generally limited to government debt, first mortgages, and select corporate issues.[5] The first step in the evolution away from legal lists occurred in Massachusetts in 1830. In *Harvard College v. Amory*, the court laid out what would become known as the prudent man rule. The *Amory* court held that:

> All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.[6]

In applying this new standard, the court held that stocks were not prohibited *per se* as risky, since any time money was invested in any type of security, even government debt, there is some risk to the capital.[7]

Despite this progress toward expanding investment options, trustees remained extremely conservative, and for good reason. Almost 40 years after *Amory*, many courts still viewed stocks as highly speculative, and therefore deserving no place in a trust portfolio. The New York case *King v. Talbot* is one of the more frequently cited cases applying the legal list principle to trust investment. In *King*, the court enunciated a standard that "necessarily excludes all speculation, all investments for an uncertain and doubtful rise in the market."[8]

The *King* opinion contains an interesting twist in arriving at its holding. At first, when describing the duties of a trustee, the court recites the prudent man rule as enunciated in *Amory*, when it describes a trustee's duty as being "bound to employ such diligence and such prudence in the care and management, as in general, prudent men of discretion and intelligence in such matters, employ in their own like affairs."[9] Despite reciting this rule as the one governing trustees, the court went on to hold "it be said, that men of the highest prudence do, in fact, invest their funds in such stocks…and they lawfully may, put their principal funds at hazard; in the affairs of a trust they may not."[10] Thus, while giving lip service to the prudent man rule, the effect of the holding was to greatly limit what a trustee could invest trust assets in. Securities which, by their terms, did not promise to return the principal of the investment (stock as opposed to bonds) put such principal at risk, and were thus too speculative. By the 1880s, many state legislatures responded to *King* by adopting "legal list" regimes.[11]

The rule of prudence parallels the negligence principle of reasonableness, and the two concepts developed alongside one another. By the 1940s, state legislatures began adopting the prudent man rule as governing trust investments, and by 1980 forty-five states employed some form of a prudent man rule over legal lists.[12]

During this time, stock investments were still considered risky and speculative to a degree. For example, in the Restatement (Second) of Trusts published in 1959, the comments relating to trust investments specifically describe government bonds, municipal bonds, and corporate bonds as presumptively safe.[13] Stock was conspicuously missing, although later in the comments the Restatement provided that some investment in stock of very established companies that regularly paid dividends could be prudent (so long as stock was never purchased on margin, which was presumptively imprudent).[14] Thus, despite the apparent latitude allowed under the prudent man rule, trustees rarely strayed from government securities, first mortgages, and a small amount of the bluest of the blue chip stocks in order to attempt to insulate themselves from charges of speculation in risky investments.

Up until the Restatement (Third) of Trusts was published in 1992, the prudent man rule remained largely intact from the *Amory* decision. A trustee was only to make "such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived."[15] Under this standard, a trustee had to exercise the "skill of a man of ordinary intelligence," and was not allowed to delegate his authority to select investments.[16] Importantly, in determining whether a trustee was liable under this standard, a court would analyze "[the fiduciary's] consideration and action in light of the history of *each individual investment*, viewed at the time of its action," without the benefit of hindsight.[17]

Though courts would strive to view an investment decision from the perspective of the trustee at the time the decision was made, this approach opened up the possibility of hindsight bias creeping into an analysis of a trustee's investment decisions. One of the most egregious examples of such hindsight bias was a case in New Jersey in 1931 dealing with trust losses sustained in the stock market crash of 1929. In holding that the trustee was liable for the losses, the court held that "[i]t was common knowledge, not only amongst bankers and trust companies, but the general public as well, that the stock market condition at the time of testator's death was an unhealthy one, that values were very much inflated, and that a crash was almost sure to occur. In view of this fact, I think it was the duty of the executors to dispose of these stocks immediately."[18] If everyone knew that a crash was "almost sure to occur," then everyone would have sold earlier, and the crash would have begun earlier.

Aside from the risk of hindsight bias coloring an analysis of a trustee's investments, under the prudent man rule courts also analyzed each investment separate from the rest of the portfolio. So if a trustee constructed a well-diversified portfolio of investments and one of those investments lost money, the trustee may still be liable for that loss even if the portfolio as a whole was performing exceptionally well.[19]

The restrictions imposed by the prudent man rule drew several other criticisms from the legal and investment worlds. Chief among them was the criticism that while the prudent man rule protected trust assets from a great deal of investment risk and outright loss of capital, the rule left trustees unable to protect trust assets from the rising risk of inflation.[20] In the post-WWII economy, inflation arguably became as large a risk to trust assets as investment loss.

Another category of criticism focused on how rigid the rule had become, and how it worked to deprive trust beneficiaries of the newest and (arguably) best understanding, knowledge and practice of investing. One commentator points out the paradox of how "a rule founded on the adaptable wit of the prudent man has become a hindrance to sound fiduciary investment management," since "modern portfolio theory presents a better account of risk and safety, and thus a better guide to prudent investment" and yet trustees have been constrained in its application under the prudent man rule.[21] Thus, the seeming contradiction identified in the *King* case persisted: the prudent man rule actually hindered a trustee from making investments that had become favored by prudent investors of the modern times.

As a result of these criticisms, the American Law Institute promulgated the Restatement (Third) of Trusts in 1992. The Restatement (Third) implemented many of the changes advocated by the prudent man rule's critics, updating the standard for trustee investing to incorporate the now prevalent Modern Portfolio Theory.[22] Two years later in 1994, the National Conference of Commissioners on Uniform State Laws adopted the Uniform Prudent Investor Act (UPIA), incorporating many of the concepts from the Restatement (Third) of Trusts.[23]

The UPIA, by adopting principles of the Restatement, made five important changes to the standard guiding trustee actions.[24] First, the prudence of any investment is to be judged with regard to the entire portfolio. Second, the tradeoff in all investing between risk and return is identified as the fiduciary's central consideration. Third, the categorical restrictions on types of investments are repealed such that no investment is *per se* imprudent; instead any type of investment could be prudent if it meets the rest of the standards in the new prudent investor rule. Fourth, the principle of diversification, long established by case law, was codified into statute as a mandatory requirement, subject to certain exceptions when maintaining a concentration of trust assets in a particular investment is prudent. And finally, the UPIA eliminated the rule forbidding a trustee from delegating investment decisions. As the next section will discuss, these changes embody a modern understanding of investment risks and return known as Modern Portfolio Theory.

Modern Portfolio Theory and Reform of the Prudent Man Rule

The rigidity and constraint of the prudent man rule that existed prior to the reforms of the 1990s largely stemmed from the difficulty courts had in differentiating between "speculative" investments, which trustees were prohibited from investing in, and other "prudent" investments.[25] Falling back on categorical classifications of "speculative" investments was the next best option, rather than struggle to identify a particular investment as speculative or prudent. A large contributor to this problem courts faced in separating speculative from prudent investments is that the finance community itself had little to offer courts and legislature in the way of determining if an investment was speculative.[26] That changed with the advent of Modern Portfolio Theory.

During the second half of the twentieth century, finance saw a significant development of new theories, models and practices that transformed the way investment risk and return was measured and forecasted. Specifically, Modern Portfolio Theory became the dominant theory underlying asset allocation and risk management. Modern Portfolio Theory is a mathematical theory that describes the relationship between risk and return of a financial security.[27] It was first presented by Harry Markowitz in a 1952 article published in the *Journal of Finance*. Markowitz would go on to win a Nobel Prize for his work presented in that article.[28] Modern Portfolio Theory rests on three central tenets. The first is that riskier investments offer a "risk premium," that is, the investment will offer a greater return on capital to compensate for the increased risk of the loss of capital. The second tenet is that diversification can reduce risk to a portfolio without lowering the return on the portfolio's investments. And third, Modern Portfolio Theory holds that the allocation between riskier assets and safer assets will determine exposure to broad market risk.[29] Modern Portfolio Theory has been enormously influential in the trust investment reform movement and has been expressly endorsed by the Restatement (Third) of Trusts.[30]

The first of these tenets, that a higher return of a security is a reward for taking more risk, relies on a second theory that has developed over the past few decades, called Efficient Capital Market Hypothesis ("ECMH"). Briefly, the ECMH holds that the price of a security accurately reflects all available information about that security's future risk and prospect for providing a return.[31] As applied to trustees, ECMH would lead to the conclusion that by the time the trustee had information available to him from which to conclude that a trust asset should be sold, the price of that security would have already fallen to reflect that information. An efficient market would therefore preclude the possibility of any money manager, trustee or otherwise, from beating the market.

This first tenet of modern portfolio theory, and the underlying assumption that markets are efficient as described in the ECMH, directly bears on the first of the problems discussed above regarding the prudent man rule. For example, if Stock A was trading at $40, and information (like poor business prospects) came out that would lead a trustee to conclude the proper value was $20, a prudent trustee would sell Stock A in order to protect the trust from the expected losses. However, an efficient market would rapidly adjust to the information that the trustee obtained and Stock A would rapidly trade down to $20 before the trustee could sell.

Put in the context of the New Jersey case discussed above, the court claimed that it was "common knowledge that a crash was almost sure to occur." Yet, under ECMH (and common sense), if everyone knew the market was going to crash ahead of time, then all investors would have begun selling as soon as that information became known and this would have created an earlier crash. Thus, expecting a trustee to correctly predict a decline in the value of a security or market *before* the decline actually occurred would be to expect trustees to consistently beat the market. More modern research tells us that money managers cannot consistently beat the market returns.[32]

Courts often acknowledge that the law does not require a trustee to beat the market in order to be determined prudent.[33] Yet by evaluating a trustee's actions regarding each trust investment in isolation and, if determined liable, holding him accountable for declines in stock prices, courts were expecting the trustee to recognize that a security faced losses and to dispose of that security before the rest of the market came to the same conclusion (at which point the price of the security would already trade lower to reflect the anticipated loss). Despite the language about not expecting a trustee to beat the market, the development of the ECMH shows that by expecting trustees to take "prudent" actions to prevent trust losses the courts were in fact expecting the trustee to beat the market.

The Restatement (Third) of Trusts recognized this inherent problem in the old prudent man standard. In the comments of §227, the Restatement largely adopts the view of an efficient market:

> Economic evidence shows that, from a typical investment perspective, the major capital markets of this country are highly efficient, in the sense that available information is rapidly digested and reflected in the market prices of securities. As a result, fiduciaries and other investors are confronted with potent evidence that the application of expertise, investigation, and diligence in efforts to "beat the market" in these publicly traded securities ordinarily promises little or no payoff, or even a negative payoff after taking account of research and transaction costs.[34]

Following this rationale, the Restatement included a significant reform in the new prudent investor rule. Under §227(a), a trustee's investments are not to be analyzed in isolation, but "in the context of the trust portfolio and as a part of an overall investment strategy."[35] When combined with the second tenet of Modern Portfolio Theory regarding the benefits of diversification, the reformed prudent investor rule alleviates trustees from the implicit expectation that he or she exercise sufficient foresight to beat the market, an outcome that even Wall Street's most informed and experienced money managers cannot achieve.[36]

The second tenet of Modern Portfolio Theory states that diversification can reduce risk to a portfolio without lowering the return on the portfolio's investments.[37] On the surface, this tenet seems to claim there is a costless, risk free return in the markets, an idea that would seem to conflict with the first tenet that return is compensation for risks taken in investments. To understand how diversification can reduce risk without reducing return, risk must be broken down into three categories. The three types of risk an investor faces in the market are market risk, industry risk, and firm risk. Firm risk is specific to the specific company whose shares are owned by an investor. These risks include the skill of management, competition from other firms, quality of the products sold, etc. Industry risk is broader, and includes risks to all companies within an industry. For example, the advent of the automobile led to the decline of every company that made horse-drawn carriages. Regardless of how well each individual company was run (firm risk) the entire industry declined due to the automobile. Finally, there is market risk which includes risks like government policy, interest rates, etc. With these factors, it would not matter if you own stock in a tech company or a pharmaceutical company since *all* stocks will decline in unison.

Under Modern Portfolio Theory, a well-diversified portfolio can reduce firm and industry specific risk without compromising returns.[38] For example, if a trustee determines that an appropriate investment strategy for a particular trust allows for more risk, it will seek to maximize returns for the amount of acceptable risk. Under tenet one of Modern Portfolio Theory, securities with similar risk profiles will offer similar returns in compensation for taking that risk. Therefore, after the trustee identifies several possible investments that fit the trust's risk parameters, the securities should all be offering the same return since they were selected for having a specific amount of risk. For this example, let's say these securities all have an expected return of 8% annually. If the trustee invests all its money in one of these possible securities, the portfolio will be earning 8% per year but it is fully exposed to firm, industry, and market risk. If the trust assets are split between two companies that are part of two different industries, then the portfolio will still be earning the expected 8% per year, yet the portfolio now faces reduced industry and firm specific risk. Since return stays the same yet risk is reduced, diversification has increased the portfolio's risk-adjusted return without additional costs.

The benefits of diversification espoused in Modern Portfolio Theory were incorporated into the reforms under the UPIA and Restatement Third. A duty to diversify trust assets is imposed on trustees unless under the circumstances it would be more prudent not to.[39] Additionally, the UPIA and Restatement included an important principle: that "specific investments or techniques are not per se prudent or imprudent."[40] In a complete rejection of the original legal lists approach to trust investments, the reformed prudent investor rule takes the approach that "trust beneficiaries are better protected by…emphasis on close attention to risk / return objectives…than in attempts to identify categories of investment that are per se prudent or imprudent."[41] In other words, so long as an investment has a level of risk appropriate for the trust, no type of investment is automatically imprudent.

As discussed earlier, Modern Portfolio Theory leads to an understanding that a trustee cannot be expected to foresee declines in the price of a security and therefore "prudently" sell that security before the decline takes place. Therefore, so long as the investments chosen were appropriately risky for the trust, and so long as the investments, when analyzed as part of the whole portfolio, were properly diversified, then the trustee has done everything in his power to ensure the trust earns the most income for the amount of risk that is appropriate for the trust. The reformed prudent investor rule therefore recognizes the limitations of investing as espoused by Modern Portfolio Theory and Efficient Capital Market Hypothesis, and only holds trustees to a level of prudence that one can reasonably expect from any investor. This principle can be summed up as "process over performance," or "conduct over outcome." Essentially, if the securities were appropriate for the trust and well diversified, a trustee cannot be held liable for the losses of any individual investment, since it is now recognized that the trustee cannot reasonably be expected to foresee such losses. As far as trustees are concerned, this is arguably the most important change from the prudent man rule to the modern prudent investor rule, as it greatly limits their liability for trust investment losses.

While diversification can limit both firm and industry risk, as discussed above, it cannot limit broad market risks. This is where the third tenet of Modern Portfolio Theory comes in—that the allocation between riskier assets and safer assets will determine exposure to broad market risk. Thus, making a trust less risky as required by its risk tolerance requires an appropriate asset allocation among high- and low- risk investments. In practice, this means that a trust that requires a less risky portfolio will hold more bonds and cash rather than stocks, and vice versa if the trust would appropriately benefit from taking more risk.[42]

Beyond incorporating the modern understanding of investing as described in the Modern Portfolio Theory, the reforms embodied in the UPIA and the Restatement Third made two other changes to the old prudent man rule. First, the reforms lifted the ban on trustee delegation of duties.[43] Now, under the Restatement, "in administering the trust's investment activities, the trustee has power, and may sometimes have a duty, to delegate such functions and in such manner as a prudent investor would delegate under the circumstances."[44] Given that the reforms removed the limitations on what assets a trust may invest in (by declaring that no investment is *per se* imprudent), there is now a much wider universe of investments to choose from. Additionally, these investments had to be analyzed by new and more advanced economic models that would measure risk and correlation, the two factors that mattered most to a trustee trying to pick risk-appropriate assets and sufficiently diversify the investments. Taking these issues into account, the rule change allowing delegation of the investment function allows a trust to benefit from the expertise, tools, and experience of a professional investment advisor—practically a necessity in today's world of increasing financial complexity.

Along with the expansive investment options now available, including actively managed mutual funds, passive mutual funds, hedge funds, etc., as well as the ability to delegate duties to third parties, the reforms smartly imposed a limitation on the trustee's ability to run up costs in managing the trust. The Restatement requires that trustees "incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship."[45] Thus, a trustee must act judiciously to guard trust assets from excessive or unreasonable fees.

Studies measuring the impact of the new standard on trust investments reveal an expected result of unshackling trustees from investing only in conservative assets: allocation of trust assets has shifted and now includes a greater percentage of stock and other risk assets.[46] Using tax returns filed by trusts as well as filings regarding trust assets held by banks within the Federal Reserve system, one paper found that the percentage of trust assets invested in stock rose approximately thirteen percentage points within ten years after the state in which the trust was located adopted the less constrained prudent investor act.[47]

Unfortunately, as trusts began allocating more trust assets to stock following the reforms of the 1990s, stock markets entered a lengthy period of volatility and stagnation that has tested every investor's resolve. As could be expected, the losses sustained by trusts that were invested in stock often formed the basis of lawsuits brought by beneficiaries. The courts were quickly presented with the challenge of applying the new prudent investor standard.

New York and Application of the Prudent Investor Act

As of 2011, nearly every state had adopted its own version of the UPIA.[48] New York's version of the UPIA, the Prudent Investor Act, was codified in New York Estates Powers & Trusts Law 11-2.3, which became effective as of January 1, 1995. According to the legislative history, "[t]he bill reflects a major national trend in the law of fiduciary investment, in response to changing economic conditions, newer investment vehicles and strategies, modern investment theory and an evolving regulatory environment for fiduciaries…Specifically, the bill incorporates certain basic principles of Restatement 3d, Trusts, Prudent Investor Rule, as adopted and promulgated by the American Law Institute."[49]

Based on the Restatement, New York's Prudent Investor Act includes all the major principles of Modern Portfolio Theory discussed above. The law requires trustees to diversify in most cases, allows for delegation of investment functions, imposes a reasonableness standard on incurring costs, declares that no investment is *per se* imprudent, and requires that the prudence of an investment be judged as part of the entire portfolio, and not in isolation.[50] The language in New York's EPTL 11-2.3 also emphasizes that a trustee will be judged by whether the entire trust portfolio is in substantial compliance with the prudent investor rule, and if it is, then the trustee will be insulated from liability.[51] The prudent investor rule expressly "requires a standard of conduct, not outcome or performance."[52] Thus, "the prudent investor standard (EPTL 11–2.3) now in effect judges prudence by reference to risk management and the underlying determination of the appropriate level of risk for a particular portfolio."[53] Finally, the prudent investor rule applies to any "trustee," which includes trustees, guardians, and any personal representative.[54]

The Surrogate's Court case *In re Hunter* applied the prudent investor rule to JP Morgan's management of a testamentary trust for which it was trustee. The trust contained a large holding of Kodak stock which had been held in the trust for many years, and the prudent investor rule applied from 1995 onward. From the evidence offered at trial, the court found that the trustee "never took steps to determine whether it was in the interests of the beneficiaries not to diversify [the Kodak stock] in relation to the purposes and terms of the trust and under the provisions of the governing instrument."[55] Furthermore, the bank did not take into account the best interests of all people interested in the trust. In fact, the court found that the trustee paid virtually no attention at all toward the remainder interests. The court also found no evidence that the bank undertook any formal analysis in order to measure the risk such investments presented, and determine whether that was an appropriate amount of risk for the trust. Finally, there was no evidence indicating that the trustee came up with any plan based on the factors enunciated in EPTL 11-2.3. The court held that the trustee violated the prudent investor rule, and was liable for the losses incurred during the time the standard was applicable.[56]

Hunter illustrates a proper analysis under the prudent investor rule. The court never considered the performance of the stock as indicative of the trustee's imprudence. Instead, the court considered the evidence (and lack of evidence) regarding the *process* the trustee underwent in determining to hold on to the concentration of Kodak stock. The trustee failed to take into consideration some of the trust's beneficiaries in coming up determining a plan, and in fact the trustee never established an investment plan. There was never a formal analysis of the risks of the Kodak stock and whether that amount of risk was appropriate for the trust. And finally, the trustee never investigated whether such a concentration of Kodak stock was prudent and beneficial to the trust, and therefore the statutory requirement of diversification applied. The complete lack of formal procedure for investing the trust assets left the trustee exposed to liability for the losses sustained by the trust.

Hunter can be contrasted with another Surrogate's Court case, *In re Kopec*, where the fiduciary was an executor as opposed to a trustee, but was held to the same prudent investor standard under EPTL 11-2.3.[57] In *Kopec*, the objectant to the executor's accounting was seeking to recoup losses sustained in the 2001 stock market downturn. The objectant alleged that the executor breached the prudent investor rule by failing to sell the estate's stock, because the stock holdings were inappropriately risky given the time frame in which the estate was expected to be distributed. The executor countered by making a *prima facie* showing that he made an investment plan for the estate assets, which included distributing the stock in kind to the objectant. The executor argued that since the stock would be distributed in kind, the proper time frame from which a prudent investor would determine appropriate risk would be the beneficiary's lifetime. By such a measure, the investment would have been prudent.[58]

The court found that the executor had made an investment plan, as required by the prudent investor rule. Furthermore, since the stock was to be distributed in kind, the proper time frame to plan for was the objectant's lifetime, not the length of the estate administration. Under such circumstances, the stock was an appropriate investment. The court further found that the portfolio was appropriately structured to meet the beneficiary's income needs, and that the stock portfolio holdings were appropriately diversified when looking at the estate as a whole. As such, the court held that the executor made a *prima facie* showing that he satisfied all requirements under the prudent investor rule, and denied the objection seeking a surcharge.[59]

As discussed above, an essential element in forming an optimal portfolio, and in satisfying the requirements of EPTL 11-2.3, is diversifying the securities held by a trust portfolio. New York courts have held that "[t]he diversification mandate of the new rule was generally consistent with the diversification standards already developed by the courts under the prudent [man] rule."[60] The Surrogate's Court case *In re Ely* is illustrative of the diversification requirement, the lack of a bright line rule regarding diversification, and the importance of judging investments in the context of the entire portfolio while taking into account the unique needs of each trust.[61]

In *Ely*, the bank was a trustee of a family trust which held a large concentration of shares in a family owned company, making up 60% of the trust's assets. All parties agreed these were not marketable securities, and that the bank was prudent to retain them. Of the remaining 40% of the trust assets, 30% of the trust was split between shares of Microsoft, GE, Pfizer, and Merck. The objectants to the bank's accounting argued that of the marketable securities (so excluding the stock in the family owned company), the four stocks constituted nearly 20% each of the trust's assets, and that this concentration of trust assets violated the prudent investor rule. The Surrogate's Court rejected the objectants' argument that the bank's investment decisions must be examined in isolation from the family owned company's stock, since "neither the statutes nor the case law permit a Court to review a fiduciary's actions and, in that process, ignore a critical aspect of the overall trust strategy and investment decision-making…the investment and management decisions for the entire portfolio must be considered."[62] As part of the entire portfolio of trust assets, the four stocks complained of by the objectants each only constituted about 7% of the trust's assets (as opposed to 20% of the marketable portion of the trust), and since the bank met all other requirements under EPTL 11-2.3

in formulating its investment plan for the trusts, the 7% holdings in Microsoft, Pfizer, Merck and GE did not constitute a breach of the prudent man rule generally, nor the duty to diversify specifically.

It is also important to mention that EPTL 11-2.3(b)(6) includes a second, higher standard for trustee investments where the trustee is a bank, trust company, paid professional investment advisor, or "any other trustee representing that such trustee has special investment skills."[63] In such cases, the prudent investor standard requires the trustee to exercise "such diligence in investing and managing assets as would customarily be exercised by prudent investors of discretion and intelligence having special investment skills."[64]

In a 2007 Third Department case, the court had a chance to apply this higher standard. In *In re Witherill*, the co-executor of the decedent's estate (the "fiduciary") was appealing a Surrogate's Court ruling that denied him his executor fees and surcharged him $35,000.[65] Prior to the decedent's death, the fiduciary was the decedent's investment advisor, and was paid on average $17,000 per month for his services. The relationship continued from 1984 to 1998. After the decedent died, the fiduciary and his longtime assistant were named co-executors pursuant to the decedent's will, and they filed their final accounting in 2003. During the five-year period during which the fiduciary was entrusted with the estate assets, he made a large investment in a Merrill Lynch junk bond mutual fund. Given the nature of the fiduciary's responsibilities, especially the short time frame of winding up estate assets, the court found that this investment was initially inappropriately risky investment, and that the fiduciary essentially ignored the investment over the next 17 months while it lost a considerable amount of money.[66]

"Because he claimed to be a skilled financial advisor and was paid handsomely for such services during decedent's lifetime," the court held the fiduciary to the higher standard in EPTL 11-2.3(b)(6), and upheld the Surrogate's Court's holding of the trustee's liability for the losses to the estate.[67]

A final issue that arises in the prudent investor rule case law is calculation of damages. Where a fiduciary is found liable for imprudence under the prudent investor rule, the proper measure of damage is lost capital.[68] The lost capital is calculated by determining when an imprudent investment should have been sold, then from the price of the security on that date a court will subtract the price of the security on the date the security was actually sold (or the date of the accounting if the stock is still owned). On top of this loss, a court may impose an appropriate rate of interest on the lost capital up to the statutory rate, which is currently 9%. The appropriate interest rate is up to the discretion of the court. Whether the interest is to be simple or compounded is also up to the discretion of the court. Finally, from this total amount in damages, a court must offset any income attributable to the imprudently held investments, such as dividends or interest.[69] Additionally, any real or hypothetical capital gains tax that had to be or would have to be paid on the sale of the stock should be deducted from damages.[70]

Interest is added to the surcharge in order to compensate the aggrieved party for the cost of not having the lost capital to dispose of; that is, the interest is added to make the party whole.[71] In applying interest to surcharges, courts have used the statutory rate of 9% virtually across the board, despite having the discretion to apply any interest rate up to the statutory rate.[72] As has been expertly detailed before, the history of the statutory rate has tended to track interest rates in the economy.[73] New York first set a statutory rate in 1972 at 6%, when the yield on a U.S. 10-year Treasury Bond was 6.55%. The rate was adjusted once in 1981, when the statutory rate was changed to 9% at a time when a 10-year U.S. Treasury Bond yielded 14.28%.[74] At the time of writing, a 10 year Treasury Bond is yielding 1.91% with negligible inflation in the economy. The statutory interest rate, however, remains at the 9% set in 1981. The high interest rate, combined with the fact that Surrogate's Courts rarely exercise their discretion to lower the rate applied to the surcharge, is exacerbating a problem identified by the Hon. Raymond Radigan—that an interest award that is intended to be compensatory is effectively punitive.[75]

A recent Surrogate's Court opinion, *In re Lasdon*,[76] discussed the factors that weigh in deciding what interest rates to apply. In the Court of Appeals case *Estate of Janes*, the Court applied the full statutory interest rate "in view of the trustee's inexplicable neglect of its investment duties, amounting to imprudence, the abuse of its fiduciary position and its violation of a basic standard of conduct."[77] Other court opinions reviewed by the *Lasdon* court similarly dealt with egregious conduct by the fiduciaries.[78] In *Lasdon*, the trustees were held to be liable and surcharged; however, their actions were taken in good faith, and the mistakes were largely a result of failure to communicate. Therefore, the court awarded the objectants 6% interest instead of the 9%.[79] The *Lasdon* opinion seems to agree with the idea discussed above—that the statutory 9% interest rate may be punitive in today's economic environment.

A final issue that arises in calculating damages for breaches of the prudent investor rule is in regards to the anti-netting rule. The anti-netting rule prohibits a trustee whose negligence caused a loss to the trust from offsetting, or netting, the losses he caused with other gains in the portfolio of trust assets. The principle traces its roots back to the *King* case discussed above. In *King*, the court held that "[trust] money invested is the beneficiary's money; and in respect of each and every dollar…he has an unqualified right to follow it, and claim the fruits of his investment, and…the trustee cannot deny it."[80] Therefore, any profits generated from trust assets belong to the beneficiary from the moment they come into the trust, and are therefore unavailable to offset other trust losses caused by the trustee.

With the adoption of the prudent investor rule and the requirement to view the entire portfolio as a whole when analyzing trustee investments, some commentators have pointed out that there was a risk the anti-netting rule would be effectively overruled by the reforms.[81] The anti-netting rule, however, is entirely consistent with the new prudent investor rule. The prudent investor rule only requires examining each investment in the context of the whole portfolio *for determining if a breach occurred*. If it is determined that an investment, in the context of the entire portfolio, was imprudent, then the losses would be the trustee's to bear; the losses would not be offset by any gains in the rest of the portfolio. Though this issue has not come up frequently in the case law, the only court opinion to address this issue has employed the anti-netting rule after determining that an investment was imprudent under the prudent investor rule.[82]

Conclusion

The reforms to trust investments ushered in by the Restatement and UPIA certainly seem to have had the intended effect: to modernize the trustee's approach to investing. Although the Modern Portfolio Theory is a mathematically complicated guideline to investing, the reforms also allow for delegation of investment selection, a sensible reform allowing trustees and the trust's beneficiaries to benefit from professional expertise. Overall, the new standard for measuring trustee prudence is much friendlier to the trustee. By focusing on the process and conduct of the trustee, instead of a *post hoc* judgment of the prudence of each investment, the prudent investor rule eliminates the ever-present risk of hindsight bias and reduces the risk of being surcharged for any losses to trust assets. Unshackled from the stricter standard for investing, trustees are now able to use the best strategies available for protecting trust assets from losses and inflation while providing income and capital growth for the beneficiaries. While it is unfortunate that the reforms preceded a decade of stagnant returns and high volatility in the financial markets, the flexibility afforded by the reforms will likely help trustees navigate the uncertain future in a way that will protect trust beneficiaries.

Endnotes

1. John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 Iowa L. Rev. 641, 643 (1996).
2. C.E. Walker, *The History of the Joint Stock Company, The Accounting Review*, Vol. 6, No. 2 (June 1931), pp. 95-107.
3. Langbein at 644-45.
4. *Id.*
5. *Id. See also Bogert's* The Law of Trusts and Trustees (2012) § 613.
6. *Harvard College v. Amory*, 26 Mass. 446, 469 (1830).
7. *Id.* at 468-69. ("It will not do to reject those stocks as unsafe, which…may involve a total loss. Do what you will, the capital is at hazard. If the public funds are resorted to, what becomes of the capital when the credit of the government shall be so much impaired as it was at the close of the last war?").
8. *King v. Talbot*, 40 N.Y. 76, 86 (1869).
9. *Id.*
10. *Id.* at 89.
11. W. Brantley Phillips, Jr., *Chasing Down the Devil: Standards of Prudent Investment Under the Restatement (Third) of Trusts*, 54 Wash. & Lee L. Rev. 335, 341 (1997).
12. *Bogert's* The Law of Trusts and Trustees (2012) § 613.
13. Restatement (Second) of Trusts (1959) § 227 comment f.
14. *Id.* at comment m.
15. *Id.* at § 227(a).
16. *Id.* See comments, generally.
17. *Matter of Janes*, 90 N.Y.2d 41, 51, 659 N.Y.S.2d 165 (1997) (emphasis added).
18. *In re Chamberlain's Estate*, 156 A. 42, 43 (N.J. Prerog Ct. 1931).
19. Max Schanzenbach & Robert Sitkoff, *The Prudent Investor Rule and Trust Asset Allocation: An Empirical Analysis*, 35 ACTEC Journal 314, 318 (2010).
20. 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) ("Increasingly, low-risk, interest-bearing securities fail to keep pace with inflation, and thus, inflation becomes the roaring lion, walking about, seeking to devour the trust. Unfortunately, the traditional restrictions on fiduciary investment largely remain in place. Such restrictions now hamper a trustee's ability to be vigilant against this new adversary—the devil of inflation.").
21. Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 NYU L. Rev. 52, 55 (1987).
22. *Bogert's* Law of Trusts and Trustees § 612 (2012).
23. *Bogert's* Law of Trusts and Trustees § 613 (2012).
24. *Id.* ("The Prefatory Note to the UPIA describes the objectives of the UPIA as follows: UPIA makes five fundamental alterations in the former criteria for prudent investing.").
25. Harvey E. Bines, *Modern Portfolio Theory and Investment Management Law: Refinement of Legal Doctrine*, 76 Colum. L. Rev. 721, 727 (1976) ("Unable to create a workable definition of speculation, courts and legislatures fell to identifying categories of securities as either of investment grade or speculative without regard for the unique characteristics of a given commitment or the particular purpose for which a manager might desire to select it.").
26. *Id.*
27. Charles F. Gibbs and Colleen F. Carew, *Taking Stock of the Prudent Investor Act*, N.Y.L.J., Feb. 29, 2012, p. 3, col. 1.
28. Stewart Sterk, *Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine*, 95 Cornell L. Rev. 851, 858 (2010).
29. *Id.* at 867-68.
30. Restatement (Third) of Trusts § 90 (2007), *see comments* ("What has come to be called "modern portfolio theory" offers an instructive conceptual framework for understanding and attempting to cope with nonmarket risk.").
31. Stewart Sterk, *Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine*, 95 Cornell L. Rev. 851, 871-72 (2010).
32. Restatement (Third) of Trusts, § 227 (1992) Comments e through h. "Empirical research supporting the theory of efficient markets reveals that in such markets skilled professionals have rarely been able to identify under-priced securities (that is, to outguess the market with respect to future return) with any regularity. In fact, evidence shows that there is little correlation

between fund managers' earlier successes and their ability to produce above-market returns in subsequent periods."

33. *In re Duffy*, 25 Misc. 3d 901, 910, 885 N.Y.S.2d 401 (Sur. Ct., Monroe Co. 2009) ("expecting [the trustee] to have had the prescience to invest and outperform the market [is] an unreasonable requirement the law does not expect").
34. Restatement (Third) of Trusts, § 227 (1992) Comments e through h.
35. Restatement (Third) of Trusts, § 227(a) (1992).
36. *See* note 32.
37. Stewart Sterk, *Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine*, 95 Cornell L. Rev. 851, 867-68 (2010).
38. Stewart Sterk, *Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine*, 95 Cornell L. Rev. 851, 872-73 (2010).
39. Restatement (Third) of Trusts, § 227(b) (1992).
40. Stewart Sterk, *Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine*, 95 Cornell L. Rev. 851, 874 (2010), *citing* Restatement (Third) of Trusts § 90 cmt. f (2007).
41. John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 Iowa L. Rev. 641, 643 (1996) ("The heart of the [Uniform Prudent Investor] Act, section 2(b), states that the "trustee's investment and management decisions" are required to "have risk and return objectives reasonably suited to the trust." The Act recognizes that investment returns correlate strongly with risk. However, as the official Comment explains, "tolerance for risk varies greatly with the financial and other circumstances of the investor, or in the case of a trust, with the purposes of the trust and the relevant circumstances of the beneficiaries.").
42. Stewart Sterk, *Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine*, 95 Cornell L. Rev. 851, 877(2010).
43. Restatement (Third) of Trusts, § 227(c)(2) (1992) (a trustee must "act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents").
44. Restatement (Third) of Trusts, § 227 (1992) Comment j.
45. Restatement (Third) of Trusts, § 227(c)(3) (1992).
46. *See* Max M. Schanzenbach and Robert H. Sitkoff, *The Prudent Investor Rule and Trust Asset Allocation: An Empirical Analysis*, 35 ACTEC Journal 314 (2010).
47. *Id.* at 326.
48. *Bogert's* Law of Trusts and Trustees § 613 (2012).
49. Edward V. Atnally, *Prudent Investor Act: Its Effect on Executors*, N.Y. St. B.J., July / August 1995, at 12, 16-17.
50. N.Y. Estates Powers and Trusts Law 11-2.3.
51. EPTL 11-2.3(b)(1).
52. *Id.*
53. *Matter of Siegel*, 174 Misc. 2d 698, 700, 665 N.Y.S.2d 813 (Sur. Ct., N.Y. Co. 1997).
54. EPTL 11-2.3(e)(1).
55. *In re Hunter*, 27 Misc. 3d 1205(A), 910 N.Y.S.2d 405 (Table) (Sur. Ct., Westchester Co. 2010).
56. *Id.*
57. *In re Kopec*, 25 Misc. 3d 901, 885 N.Y.S.2d 401 (Sur. Ct., Monroe Co. 2009), *aff'd*, 79 A.D.3d 1732, 913 N.Y.S.2d 627 (4th Dep't 2010).
58. *Id.*
59. *Id.*
60. *In re Hyde*, 44 A.D.3d 1195, 1198, 845 N.Y.S.2d 833 (3d Dep't 2007).
61. *In re HSBC Bank USA*, 37 Misc. 3d 875, 881, 952 N.Y.S.2d 740 (Sur. Ct., Erie Co. 2012).
62. *Id.*
63. EPTL 11-2.3(b)(6).
64. *Id.*
65. *In re Witherill*, 37 A.D.3d 879, 828 N.Y.S.2d 722 (3d Dep't 2007).
66. *Id.*
67. *Id.*
68. *See Matter of Janes*, 90 N.Y.2d 41, 55, 659 N.Y.S.2d 165 (1997).
69. *Id.*
70. C. Raymond Radigan, *Rulings on Trustee's Duty to Diversify: What Have We Learned?*, N.Y.L.J., Sept. 12, 2011.
71. *See In re Lasdon*, 32 Misc. 3d 1245(A), 939 N.Y.S.2d 741 (Table) (Sur. Ct., N.Y. Co. 2011) ("factoring interest into the surcharge here serves the purpose of making objectants whole"), see also C. Raymond Radigan, *Rulings on Trustee's Duty to Diversify: What Have We Learned?*, N.Y.L.J., Sept. 12, 2011 ("damages based on the statutory interest rate are designed to make beneficiaries "whole").
72. C. Raymond Radigan, *Rulings on Trustee's Duty to Diversify: What Have We Learned?*, N.Y.L.J., Sept. 12, 2011.
73. *Id.*
74. *Id.*
75. *Id.*
76. *In re Lasdon*, 32 Misc. 3d 1245(A), 939 N.Y.S.2d 741 (Table) (Sur. Ct., N.Y. Co. 2011).
77. *Id.* at 5.
78. *Id.*
79. *Id.*
80. *King v. Talbot*, 40 N.Y. 76, at 91 (1869).
81. Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 NYU L. Rev. 52, 96-97 (1987) ("Another tenet of trust law that may be unsettled by a portfolio theory approach is the rule against balancing losses against gains. Because portfolio theory looks at the performance of the portfolio as a whole, the concern is that the standard trust law anti-netting rule would have to be discarded.").
82. *In re Lasdon*, 32 Misc. 3d 1245(A), 4, 939 N.Y.S.2d 741 (Table) (Sur. Ct., N.Y. Co. 2011) ("Accordingly, when (as here) a fiduciary's breach has been established, there is nothing to prevent a court from fidelity to the anti-netting precedents by imposing the surcharge without regard to such investment gains as the trustee may have at the same time achieved.").

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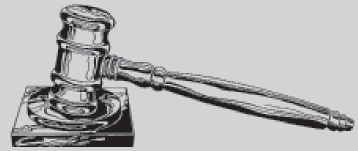
Recent New York State Decisions



By Ira M. Bloom and William P. LaPiana

Ira M. Bloom

COURTS

Surrogate Cannot Be Required to Confirm Accounting

In *Matter of LaDelfa*, 82 A.D.3d 1683, 919 N.Y.S.2d 416 (4th Dep't 2011), the court held that once the administrator of decedent's estate allowed a claim against the estate and filed the accounting reflecting allowance of the claim, in the absence of any objection by an interested party the Surrogate was required to confirm allowance of the claim and direct that it be paid. On remand, the Surrogate refused to sign the administrator's proposed decree settling the account and allowing the claim, and denied a motion seeking approval of the claim. On appeal from that refusal, the Appellate Division held that its previous decision was clearly erroneous because under *Stortecky v. Mazzone*, 85 N.Y.2d 518, 626 N.Y.S.2d 733, 650 N.E.2d 391 (1995), the Surrogate cannot be compelled to allow an accounting to which no party objects because the Surrogate has an independent statutory duty to settle the account as justice requires. The court further held that the previous decision was not the law of the case because it was indeed clearly erroneous and affirmed the decree settling the account as modified to disallow the claim. *Matter of LaDelfa*, 107 A.D.3d 1562, 968 N.Y.S.2d 759 (4th Dep't 2013).

DEAD BODIES

Public Health Law § 4201 Does Not Immunize Hospital from Claim Based on Violation of Right of Sepulcher

Decedent's next-of-kin sued hospital and funeral home alleging violation of their common law right of sepulcher. The alleged violation was that the hospital released the decedent's body to a funeral home which had not been authorized to take possession of the remains. Hospital moved for summary judgment on the common law claim on the grounds that by releasing the body to an authorized representative of a licensed funeral home, PHL § 4201(6) immunizes a "person" acting in good faith from civil liability for disposition of a decedent's remains "if done with a reasonable belief that such disposal is consistent" with the statute. The court denied summary judgment for the hospital on the common law claim, holding that "person" is defined in the statute as a natural person and that the other exculpatory provision, PHL § 4201(7), applies by its terms only to cemeteries, funeral directors, undertakers, embalmers, and funeral firms. Because there was a factual issue whether

William P. LaPiana

the hospital interfered with the plaintiffs' common law right to immediately possess the body, defendant's motion for summary judgment and plaintiffs' cross motion for summary judgment were denied. (The hospital did succeed on its summary judgment motion that it did not violate regulations (10 NYCRR §§ 77.7(b), 405(f)(9)) governing the release of remains by hospitals.) *Turner v. Owens Funeral Home, Inc.*, 41 Misc.3d 444, 970 N.Y.S.2d 694 (Sup. Ct., Bronx Co. 2013).

DISTRIBUTEES

Acknowledgment of Non-Marital Children Need Not Be Made to Other Relatives

Decedent's brother objected to the appointment of two of decedent's non-martial children as co-administrators. The Surrogate determined that the decedent had three non-marital children and dismissed the brother's objections. The Appellate Division affirmed. Under EPTL 4-1.2 paternity may be established by clear and convincing evidence which may include evidence of open and notorious acknowledgment of the child or children. The appellate court found that the affidavits submitted established that the decedent had a least one non-martial child, which meant that the brother could not be a distributee and therefore lacked standing. The brother's statement that the decedent never acknowledged the children to him is insufficient to affect their status as distributees. In accord with precedent, the required acknowledgment need not be made to the father's other relatives so long as it is made to the community in which the child lives. *Matter of Reape*, 110 A.D.3d 1082, 974 N.Y.S.2d 496 (2d Dep't 2013).

RIGHT OF ELECTION

Law Office Failure Excuses Late Filing

Decedent's surviving spouse executed a notice of her exercise of her right of election which was timely served on the attorney for the executor but, unbeknownst to her, was not filed with the Surrogate's Court as required by EPTL 5-1.1-A(d)(1). After obtaining new counsel and more delays, the surviving spouse petitioned for permission to file a late election under EPTL 5-1.1-A(d)(2). The Surrogate denied the petition and the Appellate Division reversed, holding that the surviving spouse had demonstrated the reasonable cause demanded by the statute by showing among other things that the delay was caused by law office failure and, also in conformity with the statute, that no other party would be prejudiced by the late filing. *Matter of Sylvester*, 107 A.D.3d 903, 968 N.Y.S.2d 528 (2d Dep't 2013).

TRUSTS

Decanting into Supplemental Needs Trust Approved

Grandson was the sole beneficiary of an irrevocable trust created by his grandfather when he was an infant. The trustees had discretion to make distributions of income and principal until grandson attained 21 years of age at which time he is to receive quarterly distributions of income with one-third the principal distributed to him at age 25, one-half at age 30, the remainder at age 35. On reaching 21, grandson may also withdraw all or part of the trust principal. Sometime after the creation of the trust it became evident that grandson was severely disabled and before his twenty-first birthday he began to receive both Medicaid and SSI benefits.

Prior to the beneficiary's twenty-first birthday the trustees "decanted" the trust under EPTL 10-6.6(b) into a new trust (the "appointed trust") that qualifies as a third-party supplemental needs trust. The trustees filed a petition seeking the court's approval of the decanting. The guardian ad litem for the beneficiary recommended granting the petition but the Department of Health objected first because under EPTL 10-10.6(s)(2) the trustee is not an authorized trustee. The court disagreed, holding that the language refers to *trustees* who are beneficiaries, and not to the other beneficiaries of the trust. The second objection was based on the assertion that the trust was created after the beneficiary's twenty-first birthday at which time the beneficiary had a general power of appointment over the trust. Because the beneficiary could acquire all of the trust principal for himself, the trust could only be a first-party supplement needs trust which must include a payback provision effective on the death of the beneficiary (Social Services Law § 366(2)(b)(2)(ii),(iii)), and the appointed trust did not include such a provision. The objection rested on EPTL 10-10.6(j), which makes a decanting effective 30 days after service of the instrument appointing property to the appointive trust, unless the persons entitled to notice of the decanting consent to a sooner effective date. Under the 30-day rule the instrument of decanting became effective after the beneficiary's twenty-first birthday. The Surrogate denied this objection as well, holding that the trust provision authorizing the parent or guardian of a beneficiary under a disability to receive notice and act for the beneficiary allowed the beneficiary's father to consent to the decanting, which he did the day after the trustees acted.

The appointed trust is a valid third-party supplemental needs trust. *Matter of Kross*, 41 Misc.3d 954, 971 N.Y.S.2d 863 (Sur. Ct., Nassau Co. 2013).

Conversion to Unitrust Approved

Life income beneficiary of testamentary trust petitioned to convert the trust into a 4% unitrust under EPTL 11-2.4(e)(2)(B), having previously asked the sole trustee, a bank, for more income. The corporate trustee stated its policy to use of the power to adjust under EPTL 11-2.3(b)(5)(A) to make annual payouts of 2.75% of the value of the trust (here approximately $6,000,000) and offered to increase the payout to 3% with the consent of the beneficiary's daughters who, along with all of the beneficiary's issue, succeed to the income interest on the beneficiary's death. The trustee took no position on the grant of the petition and no remainder income beneficiary objected. The court granted the petition, finding the statutory criteria to be satisfied. The trust was created to provide the beneficiary with income which is now insufficient to meet her needs. In addition, given the beneficiary's advanced age, payment of the 4% unitrust amount will not exhaust the trust during the beneficiary's lifetime. While one of the presumptive remainder income beneficiaries consented with the "understanding" that the trust would continue as a unitrust after the beneficiary's death, the court noted that under EPTL 11-2.4(d)(2) the trust is deemed to be a new trust after the death of the current beneficiary, and if it is to continue as a unitrust a new election by the trustee must be made or a new petition for conversion brought. *Matter of Moore*, 41 Misc.3d 687, 971 N.Y.S.2d 419 (Sur. Ct., Nassau Co. 2013).

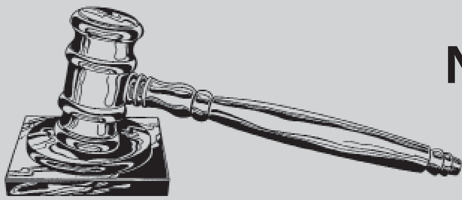
WILLS

Penal Statute Prohibiting Concealing of a Will or Other Testamentary Instrument Requires a Facially Valid Document

Penal Law § 210.10 prohibits unlawfully concealing "a will, codicil or other testamentary instrument." Decedent's father was indicted on several counts including violation of this statute. In a case of first impression, the County Court held that violation of the statute requires the concealing of a document that is at least facially valid as a will, that is, that at least appears to be executed in conformity with EPTL 3-2.1 (formally executed wills) or with EPTL 3-2.2 (nuncupative and holographic wills). The document the father was accused of concealing did not meet the test. Nor was the document "a testamentary instrument," which the court found was not statutorily defined, since however the term is construed the instrument must be at least facially valid for Penal Law § 210.10 to apply. The court therefore dismissed that portion of the indictment. *People v. Karlsen*, 41 Misc.3d 339, 969 N.Y.S.2d 888 (County Ct., Seneca Co. 2013).

Ira Mark Bloom is Justice David Josiah Brewer Distinguished Professor of Law, Albany Law School. William P. LaPiana is Rita and Joseph Solomon Professor of Wills, Trusts and Estates, New York Law School.

Professors Bloom and LaPiana are the co-authors of Bloom and LaPiana, DRAFTING NEW YORK WILLS AND RELATED DOCUMENTS (4th ed. Lexis Nexis).



Case Notes—New York State Surrogate's and Supreme Court Decisions

By Ilene Sherwyn Cooper

Cy Pres

Before the Surrogate's Court, Bronx County in *In re Mayer* was an application by the decedent's two sons, successor trustees of an inter vivos trust, to substitute one charitable beneficiary thereunder for another pursuant to the cy pres doctrine.

The record revealed that the decedent, a Holocaust survivor, was the grantor, trustee, and income beneficiary of the subject trust, consisting of funds derived from the German government as restitution for Nazi persecution. Upon the death of the grantor, 35% of the remaining principal and income of the trust was to be paid in various percentages to 12 named individuals and six charities having Jewish charitable purposes, and the remaining 65% was to be paid to the petitioners. According to the petition, one of the named charitable beneficiaries, entitled to 1% of the trust corpus, although previously a nonprofit entity supporting a German language Jewish newspaper, no longer operated as a charitable organization in New York, and had not made filings with the Attorney General's Charities Bureau since 2003. As such, the petitioners requested the court exercise its cy pres powers in order to substitute another charitable organization with purposes comparable to the charity named in the trust.

The court noted that application of the cy pres doctrine required consideration of the following factors: (1) whether the disposition was charitable in nature; (2) whether the language of the instrument evinced a general, rather than a specific charitable intent; and (3) whether the donor's purpose in making the disposition had failed or become impracticable. Applying this criteria to the record, the court found that the trust instrument evinced a general charitable intent of benefitting only charities with Jewish charitable purposes and/or charities that provided access to Holocaust survivors, and that the grantor did not intend a forfeiture of any charitable bequest to an individual or the remaindermen of the trust in the event the bequest failed.

Accordingly, based upon the foregoing, and the nature and focus of the substitute charity proffered by the petitioners, the application was granted. *In re Mayer*, N.Y.L.J., Aug. 30, 2013, p. 31 (Sur. Ct., Bronx Co.).

Disclosure of Financial Records

In *In re Selvaggio*, a contested probate proceeding, the court granted the objectant's request for, *inter alia*, financial records, including income tax returns, accounting records and books, and bank records of a corporate non-party. The record revealed that the corporation was either solely owned by the decedent, or owned jointly by the decedent and one or both of the petitioners. Thus, the court held that the relationship between the family members in the closely held corporation, and particularly the existence of any transactions between them as shareholders, appeared relevant to the issue of undue influence. Moreover, the court found that the records were relevant to the decedent's financial status, and thus to the issues of fraud, and again undue influence, where the value of the decedent's estate is a proper scope of inquiry. The court directed that the records be produced for a period that extended beyond the scope of the three year/two year period, concluding that the objectant had submitted sufficient evidence of a continuing course of conduct of undue influence or a scheme to defraud the decedent. *In re Selvaggio*, N.Y.L.J., Oct. 17, 2013, p. 25, col. 6 (Sur. Ct., Queens Co.).

In Terrorem Clause

In *In re Weintraub*, the Surrogate's Court again had occasion to examine the safe harbor provisions of EPTL 3-3.5 and the provisions of SCPA 1404, within the context of the decisions in *Baugher*, 29 Misc.3d 700, 906 N.Y.S.2d 856 (Sur. Ct., Nassau Co. 2010) and *Singer*, 13 N.Y.3d 447, 892 N.Y.S.2d 836 (2009). Before the court was an application by the decedent's son to examine the associate of the attorney-draftsman and attorney who supervised the execution of the propounded instrument pursuant to the provisions of SCPA 1404, in order to avoid triggering the instrument's in terrorem clause. The court noted that following the decision in *Singer*, the legislature amended the provisions of both EPTL 3-3.5 and SCPA 1404 to authorize the court, upon a showing of special circumstances, to permit the examination "of any person whose examination the court determines may provide information with respect to the validity of the will that is of substantial importance or relevance to a decision to file objections to the will." The record revealed that the decedent had been diagnosed with Alzheimer's Disease prior to the execution of the will, which occurred in the hospital, and that two days prior to executing the will, she was confused as to how she wanted to dispose of her estate, and did not recall speaking with the attorney-draftsman about her testamentary plan, although she had done so. Based upon these circumstances, the court granted the application, finding that special circumstances existed to permit the requested examination as part of the SCPA 1404 examination. *In re Weintraub*, 2103 NY Slip Op. 5107 (U) (Sur. Ct., Nassau Co.).

Open Commission

In *In re Levine*, the court denied a request by the petitioner for an open commission to take the deposition of non-party witnesses in Florida. Pending before the court was a contested discovery proceeding, in which the executor of the estate sought information from the decedent's surviving spouse regarding, *inter alia*, certain personal and household effects contained in a Florida home that had been owned by the decedent. The application was opposed by the decedent's spouse. The court opined that in order to justify the issuance of a commission to take the deposition of an out-of-state non-party witness, the party seeking the commission must demonstrate that the information sought is material and necessary to the prosecution and defense of claims, and that a voluntary appearance or compliance by the witness is unlikely or that discovery cannot be obtained by stipulation or cooperation of the witness either in New York or the other state. Absent such a showing, the moving party has failed to sustain his burden of demonstrating that a commission is necessary or convenient.

Based upon the foregoing, the court held that while the petitioner had demonstrated that the testimony and information sought were relevant, the application was devoid of information concerning the efforts, if any, made by petitioner's counsel to obtain the cooperation and voluntary appearance of the non-party witnesses. Accordingly, the motion for a commission was denied, without prejudice. *In re Levine*, N.Y.L.J., Apr. 22, 2013, p. 32 (Sur. Ct., Nassau Co.).

Reformation

Before the Surrogate's Court, New York County in *In re Knapp* was an application by the co-trustees of a testamentary trust to reform the provisions of the instrument so as to, *inter alia*, allow the trustees a limited power to invade trust principal, reduce the ages for distribution of the trust corpus, so as to effectively accelerate the termination date of the trust, create a mechanism for the appointment of successor trustees without the need to resort to the court, and require that the trustees invest in accordance with the prudent investor standard set forth in EPTL 11-2.3.

The subject trust was created under the decedent's will for the benefit of her grandnieces and grandnephews, of which there were 11 on the decedent's date of death. The terms of the trust contained specific directions for its administration and termination, requiring, in pertinent part, that each share set aside in trust for the decedent's grandnieces and grandnephews be paid outright to them only upon their attaining the age of twenty-five. Significantly, the provisions of the will explicitly denied the trustees the right to terminate the trust prior to the stated age for distribution, and directed payment of trust principal to the surviving grandnieces and grandnephews should any one of them die prior to the age of twenty-five. Moreover, the terms of the trust stated that in the event a trustee failed to act, that the survivor could act alone without the need to fill the vacancy.

The petitioners indicated that the requested reformation was provoked by the failure of the trustees to agree as to the administration of the trust, and an agreement among the trust beneficiaries, seven of whom had already attained the age of twenty-five, and four of whom had not but were purportedly represented by their respective parents, to resolve the issue. In support of the application, the petitioners relied on *Matter of Kern*, 159 Misc. 682, 288 N.Y. Supp. 655 (Sur. Ct., N.Y. Co. 1936), for the proposition that agreements among the interested parties can serve as a basis for a court's reforming the terms of a testamentary trust.

The court disagreed, finding *Matter of Kern, supra*, distinguishable, and concluding that the opinion did not support a result that was contrary to the intent of the testator. The court opined that when the intent of the testator is clearly expressed, resort to principles of construction is not required. To this extent, the court noted that the trust provisions clearly evidenced the testator's intent to preclude the beneficiaries from having any access to the assets in the trust until they attained the age of twenty-five. Accordingly, the court denied the request to reform the trust in order to permit limited invasion of corpus and to reduce the age of termination.

Moreover, the court denied the petitioners' request for a plan providing for the appointment of successor trustees, finding that it was not in accord with the testator's testamentary scheme.

Finally, the court held that the request to hold the trustees to a prudent investor standard was a moot point inasmuch as the fiduciaries were already held to that obligation pursuant to the provisions of the statute, which had been enacted in 1995. *In re Knapp*, N.Y.L.J., Sept. 30, 2013, p. 29 (Sur. Ct., N.Y. Co.) (Surr. Mella).

Sale of Realty

In *Morreale v. Morreale*, the Surrogate's Court, Nassau County, addressed the issue of whether the decedent's real property, which had been devised under his Will, could be sold in order to satisfy the debts of the estate.

Before the court was an application by the Public Administrator, as administrator c.t.a. of the estate, to sell the subject realty in accordance with the provisions of SCPA 1902 and EPTL 11-1.1(b)(5). Pursuant to the pertinent provisions of his will, the decedent devised "the right to reside" in the property to his son "for the rest of his life," subject to the son's duty to pay the real estate taxes, and all other expenses, repairs, and maintenance thereon, in lieu of rent.

The petitioner argued that the Will granted the decedent's son a right of occupancy in the premises, which was subject to termination by the fiduciary. The son moved to dismiss the petition on the grounds, *inter alia*, that the documentary evidence, *i.e.*, the decedent's Will, granted him a life estate in the property incapable of being sold.

In analyzing the issue, the court reviewed the relevant authorities on the subject, opining that use of the words "use and occupation" in the context of a devise of real property generally signified a life estate rather than a right of occupancy, which is a personal privilege only. Further, the court noted that the intent to grant a life estate may also be gleaned where the dispositive instrument contains language setting forth the rights and responsibilities of the recipient of the property, including the right to collect rent or the duty to maintain the premises.

Based upon the foregoing, the court concluded that the decedent's son had a life estate in the real property and not merely a right of occupancy. Nevertheless, despite arguments by the son that the property thereby passed to him by operation of law on the death of the decedent, it held that the property, albeit a specific devise, could be sold if necessary to pay the debts and obligations of the estate.

Accordingly, the court denied the motion to dismiss the petition, and directed that objections, if any, be filed by a date certain. *Morreale v. Morreale*, N.Y.L.J., Sept. 27, 2013, p. 37 (Sur. Ct., Nassau Co.).

Summary Judgment

In *In re Curtis*, the court granted summary judgment to the petitioner dismissing objections to probate. The record revealed that the decedent had been the recipient of a $10 million structured settlement resulting from in utero exposure to toxic chemicals during her mother's employment. Thereafter, the decedent was found to be incapacitated and Article 81 guardians were appointed for her person and property. Several years later, she died with a will leaving the bulk of her estate to her home health care aide, and objections to its probate were filed. The evidence demonstrated that the instrument was drafted and its execution supervised by an attorney, who reviewed the document with her prior to it being signed. The attorney also served as an attesting witness to the instrument, together with a second witness, and each testified that the decedent appeared alert and aware that she was signing her will.

The objectant alleged that the decedent lacked the requisite capacity to execute a will due to her cognitive limitations, most particularly as evidenced by the fact that she was the subject of an Article 81 guardianship proceeding. However, the court held that the mere fact that the decedent was the subject of an Article 81 guardianship was insufficient to warrant a finding that she lacked the capacity to execute a will, and found, based on the record, including the testimony of the attesting witnesses and the decedent's medical records at or about the time the instrument was executed, that she possessed the degree of intelligence required to dispose of her estate by will. Further, in view of the fact that the will contained an attestation clause and its execution was supervised by an attorney, the court found that the instrument was duly executed. Finally, with regard to the issue of undue influence, the court held that despite the objectant's reliance on the fact that the decedent's home health aide was the primary beneficiary of her estate, her claim that the aide had played a role in drafting the will, and that she had been isolated from the decedent prior to her death, she had failed to sustain their claim of undue influence. The fact that the decedent's home health aide had developed a close relationship with the decedent and became a "motherly figure" to her did not suffice. Accordingly, the objections to probate were dismissed and probate was granted. *In re Curtis,* N.Y.L.J., Sept. 10, 2013, p. 36 (Sur. Ct., Dutchess Co.).

Summary Judgment

In *In re Kazan*, the court denied the motion of the petitioner, the decedent's second wife, for summary judgment dismissing the objections to probate. The record revealed that the propounded instrument was drafted by an attorney, who also supervised its execution. Accompanying the will was a self-proving affidavit.

The petitioner was present when the will was signed, and according to her testimony and the testimony of the draftsman, there was no discussion with the decedent about his assets prior to the preparation of the document. Two months after the will was executed, the decedent suffered a stroke. Subsequently, the attorney-draftsman learned that many of the businesses bequeathed under the decedent's will were worthless. When the draftsman brought this issue to the decedent's attention, a codicil to the will was prepared and executed, which eliminated the bequests of the businesses that had otherwise been made in the will to the petitioner and the decedent's children, and essentially disposed of the decedent's entire estate to the petitioner.

The codicil was witnessed by two witnesses but was not accompanied by a self-proving affidavit. The draftsman did not recall who contacted him to prepare the codicil, or from whom he took instructions for its contents, although for purposes of the petitioner's motion, he claimed that he recanted the testimony given at his deposition and claimed that he took his instructions from the decedent. Further, the petitioner submitted an affidavit from the decedent's physician, who treated him for his heart condition, who stated that in his opinion the decedent was of sound mind at the time the will was signed.

In opposition to the motion, the decedent submitted affidavits from various family members, who claimed that the decedent suffered from depression and confusion, and was very much dependent on the petitioner.

Based on the foregoing, the court found disputed issues of fact regarding the decedent's capacity at the time the will was executed, and therefore denied summary judgment on this issue. The court also denied petitioner's motion on the issue of due execution, holding that if the testator's testamentary capacity remains at issue, summary judgment as to due execution is premature. Regarding the issue of undue influence, the court noted that the draftsman never spoke to the decedent outside the presence of the petitioner, and as such, there were concerns whether the codicil represented the wishes of the decedent or his wife. Of particular import was the fact that the codicil represented a significant change from the decedent's prior testamentary plan, to the extent that it disinherited his children. The court held that these factors, coupled with the evidence indicating that the decedent was frail, dependent on the petitioner, and no longer able to communicate following his stroke, created a question of fact as to whether the decedent stood in a confidential relationship with the petitioner, thereby giving rise to an inference of undue influence on her part, especially in light of her involvement in the preparation of the instruments. Accordingly, summary judgment on this issue was denied. Finally, inasmuch as the objectants had failed to submit any facts to support a finding of fraud, summary judgment on this issue was granted. *In re Kazan*, N.Y.L.J., July 8, 2013, p. 30 (Sur. Ct., N.Y. Co.) (Surr. Anderson).

Ilene S. Cooper, Esq. Farrell Fritz, P.C., Uniondale, New York.

Florida Update

By David Pratt and Jonathan Galler

David Pratt

Jonathan Galler

LEGISLATIVE UPDATE

Statute Voiding Gifts to Drafting Lawyer or Relative of Lawyer

Florida has enacted new legislation providing that "[a]ny part of a written instrument which makes a gift to a lawyer or a person related to the lawyer is void if the lawyer prepared or supervised the execution of the written instrument, or solicited the gift, unless the lawyer or other recipient of the gift is related to the person making the gift." Florida Statutes § 732.806. A provision in a document purporting to waive this restriction is not enforceable. Further, a lawyer is "deemed to have prepared, or supervised the execution of, a written instrument if the preparation, or supervision of the execution, of the written instrument was performed by an employee or lawyer employed by the same firm as the lawyer." A provision appointing a lawyer or a person related to the lawyer as a fiduciary is not void under this statute.

CASE LAW UPDATE

Exercise of Powers of Appointment

Florida's First District Court of Appeal recently emphasized the importance of precision in the exercise of a power of appointment. The decedent, Sally Christiansen, made one specific bequest in her will and left "the rest and remainder" of her property to Joanne Cessac. The will noted that the decedent's estate includes three trusts. Those trusts were created by the decedent's father and provided that, upon the death of Ms. Christiansen, the trust assets are to be distributed to whomever she may "by her will, appoint, making specific reference to the power herein granted." In the absence of such an appointment, the assets of the trusts are to be divided, pursuant to the terms of trusts, among Ms. Christiansen's children. Following the admission of the will to probate, a dispute arose between Ms. Cessac and a daughter of Ms. Christiansen over the proper disposition of the assets of the trusts. Because the will did not make any specific reference to the power of appointment, as required by the trusts, the trial court concluded that the power had not been validly exercised and the assets of the trusts were not included in the "rest and remainder of the estate." The appellate court affirmed, holding that "whether a donee has validly exercised a power of appointment depends not on the intent of the donee, but on whether the power was exercised in the manner prescribed by the donor."

Cessac v. Stevens, 2013 WL 6097315 (Fla. 1st DCA November 20, 2013) (not yet final).

Creditors' Claims Period

Florida's Fourth District Court of Appeal has parted ways with two of its sister courts over the applicable claims period for a reasonably ascertainable creditor who was never served with a copy of the notice to creditors. Harry Jones died in February 2007 and a notice to creditors was published in June 2007. Neither the decedent's former wife, nor her guardian, was ever served with a copy of the notice to creditors. The guardian filed a claim in January 2009 based on a marital settlement agreement. Years later, following the former wife's death, the curator of her estate petitioned for an order determining the timeliness of the claim. The trial court ruled that the claim was untimely because it was filed after the expiration of the claims period and that, under controlling case law from Florida's First and Second District Courts of Appeal, the claim could not be filed without an order granting an extension of time to do so. The Fourth District disagreed, holding that "if a known or reasonably ascertainable creditor is never served with a copy of the notice to creditors, the statute of limitations set forth in section 733.201(1), Florida Statutes, never begins to run and the creditor's claim is timely if it is filed within two years of the decedent's death." The court remanded, however, for a determination as to whether the claimant was a known or reasonably ascertainable creditor. The court also certified the conflict among the appellate courts for Florida Supreme Court review.

Golden v. Jones, 2013 WL 5810360 (Fla. 4th DCA October 30, 2013) (not yet final).

Holographic Wills

A foreign will that devises Florida real property may be admitted to probate in Florida if the will is valid in the state in which it was executed, unless it is a holographic will that was not signed and witnessed in accordance with section 732.502, Florida Statutes.

Florida's Second District Court of Appeal recently affirmed a trial court order denying a petition to admit a Colorado will to probate because it was a holographic will signed without attesting witnesses. The execution of the will satisfies Colorado law, but it does not meet the requirements of Florida law. As a result, the Florida real property, the proceeds of which were the subject of a devise under the will, passed intestate. The appellate court rejected the argument that it was required to grant "full faith and credit" to the Colorado court order admitting the will to probate because the federal Constitution (the source of the "full faith and credit" doctrine) grants no right to dispose of property by will. Nevertheless, the appellate court dedicated much of its opinion to a discussion on whether Florida's law on holographic wills violates *Florida's* constitution by categorically defeating a testator's intent without a rational relation to the potential fraud that the law purportedly seeks to cure. The appellate court determined that it was bound to uphold the statute under controlling precedent, but it certified the issue to the Florida Supreme Court as a question of great public importance.

Lee v. Estate of Payne, 2013 WL 5225200 (Fla. 2d DCA September 18, 2013) (not yet final).

The Renunciation Rule

Florida common law provides that one who contests a will or trust must renounce his or her beneficial interest therein. The renunciation, however, is a qualified renunciation, such that the challenger still has the right to benefit under the instrument if the contest is unsuccessful. A recent opinion by the Second District Court of Appeal provides a discussion of the renunciation rule, and its origins, and also held that strict application of the rule would sometimes amount to elevating form over substance. The settlor in that case had created an irrevocable trust over which he and two of his sons were the co-trustees. The trust was funded with the settlor's assets, and the settlor was the sole beneficiary, during his lifetime, of the principal and income of the trust. When his sons began to refuse distribution requests, the settlor brought suit alleging that he had lacked testamentary capacity to create the trust and that he had been unduly influenced to do so by his sons, the co-trustees. Following his death, the settlor's wife continued to prosecute the claim, as the personal representative of his estate. The trial court granted the sons' motion for summary judgment on several grounds, including that the settlor had never renounced his beneficial interest in the irrevocable trust that he was challenging. The appellate court, however, reversed because the settlor was legally entitled to receive the benefits of this trust even if it had never existed. The court wrote that the reason why neither party had found legal precedent on point is because "it is axiomatic that one who funds a trust with his or her own assets does not have to renounce any benefits received a condition precedent" to an action contesting the trust.

Fintak v. Fintak, 120 So. 3d 177 (Fla. 2d DCA 2013) (not yet final).

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Answer to "Message from the Incoming Chair" Trivia Question

Chester A. Arthur

Scenes from the Trusts and Estates Law Section

FALL MEETING

October 10-11, 2013

Riverwalk • Binghamton, NY

Photos by Michael E. O'Connor, Esq. of Delaney & O'Connor, LLP, Syracuse, NY

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If you have written an article you would like considered for publication, or have an idea for one, please contact the *Trusts and Estates Law Section Newsletter* Editor:

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Articles should be submitted in electronic document format (pdfs are NOT acceptable), and include biographical information.

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The *Newsletter* welcomes the submission of articles of timely interest to members of the Section. Submissions may be e-mailed to Jaclene D'Agostino (jdagostino@farrellfritz.com) in Microsoft Word or WordPerfect. Please include biographical information.

Unless stated to the contrary, all published articles represent the viewpoint of the author and should not be regarded as representing the views of the Editor or the Trusts and Estates Law Section, or as constituting substantive approval of the articles' contents.

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This *Newsletter* is distributed to members of the New York State Bar Association's Trusts and Estates Law Section without charge.

ISSN 1530-3896 (print) ISSN 1933-852X (online)

TRUSTS AND ESTATES LAW SECTION NEWSLETTER