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Trusts and Estates Law Section Newsletter

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A Message from the Section Chair

Colleen F. Carew

I am pleased to report on the Trusts and Estates Law Section's fall activities, legislative initiatives and the fall program "Anatomy of an Estate," which was held in Philadelphia, PA.

Congratulations to Gary B. Freidman, Esq. and Peter S. Schram, Esq. for creating a program that one member described as offering something for every estate practitioner. A special thank you is owed to the Association's professional staff, Kathy Heider, Christy Douglas and Lisa Bataille, whose efforts ensured that everyone had a fabulous time in Philadelphia.

The executive committee met on the eve of the program. As is usually the case, the agenda included several proposals for our consideration. Robert Kruger, Esq. and Anthony Enea, Esq., chair and vice-chair respectively of the Committee on Law of the Elderly and Disabled, presented a proposed bill which provides a procedure for the turnover of assets by a guardian to the personal representative of an estate. Neither the Mental Hygiene Law, nor the SCPA, currently provides such procedure. As a result the administration of estates often languishes while the guardian of a person's property seeks to settle his or her account in Supreme Court. Surrogate Roth addressed the issue in *In re Baron*, 180 Misc. 2d 766, holding that a personal representative may seek turnover of assets from the guardian, less a reasonable reserve from which the guardian may pay final expenses. The proposal met with the unanimous approval of the Executive Committee and will be submitted to the New York State Bar Association's Executive Committee for its consideration. Thank you Bob and Anthony for this excellent proposal.

Another bill approved by our Section's Executive Committee is a proposal by Ilene Cooper, Esq., which provides that under SCPA 2211 a respondent may obtain documents from an accounting fiduciary prior to filing objections. The right to such pre-objection disclosure presently exists in a probate proceeding under SCPA 1404. To properly prepare for and conduct a meaningful examination of an accounting fiduciary, a respondent should have access to the underlying documents. This proposal will also be presented to the State

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Bar Association's Executive Committee. Ilene has been a wellspring of legislative initiatives for which our Section is most appreciative.

The fall program opened with a message from Kathryn Grant Madigan, Esq., the President-Elect of the New York State Bar Association. We were fortunate that Kate agreed to share her time and thoughts with us in Philadelphia. Kate inspires members to commit to being active in the Bar Association.

The program was devoted to examining the multiple ways an estate plan may fail. Each panelist considered her or his subject in relation to a fact pattern which was devised to stump even the most experienced attorney. The panelists explored new topics such as honing communication skills and consideration of issues from the court's perspective. We were very fortunate to have Surrogate Anthony A. Scarpino, Jr. (Westchester County) and Surrogate Kristin Booth Glen (New York County) on the panel. Surrogate Scarpino and Surrogate Glen served as the "Greek chorus" by providing the court's commentary on the various subjects.

While all of the topics were stimulating, the question of whether pre-mortem probate should be authorized by statute triggered a lively and thought-provoking discussion among the panelists and the audience. Case law is unclear as to the authority of the Supreme Court to set aside a will during an incapacitated person's lifetime. In a recent Second Department decision, *In re Rita R.*, 26 A.D.3d 502, 811 N.Y.S.2d 89 (2d Dep't 2006), the Appellate Division invalidated a will on the ground that the incapacitated person lacked capacity at the time it was executed.

The recent reporting on the Brooke Astor estate causes me to wonder if pre-mortem probate contests may be the trend for estate litigation. Our section is already on top of it with a sub-committee, co-chaired by Eve Rachel Markewich, Esq. and Michael Kutzin, Esq., to study the issue.

There was barely time to breathe after wrapping up the fall program before turning my focus to the January 2007 Annual Meeting. I encourage each of you to save the date for the New York State Bar Association Trusts and Estates Section's Annual Meeting scheduled for Wednesday, January 24, 2007. Ronni Davidowitz, Esq., has developed an excellent program devoted to issues related to charitable giving. I am delighted to report that Justice A. Gail Prudenti, Presiding Justice of the Appellate Division, Second Department, will be the keynote luncheon speaker. We will end the day with a cocktail reception, which is always a wonderful opportunity to mingle and network with friends and colleagues. Please join us.

Finally, I note that this is my last message as Chair of the Trusts and Estates Law Section. I am proud to be a member of our Section and consider my involvement with the New York State Bar Association to be instrumental in my development as an attorney. Not a day goes by that I do not learn something from our colleagues, many of whom have become close friends. Thank you for granting me this incredible opportunity to serve as Chair of the Section.

Colleen F. Carew

Fiduciary Investing After *Dumont*: Have You Lost Your Concentration?

By Charles J. Groppe

On June 25, 2004, the Surrogate of Monroe County (Rochester, N.Y.) handed down his decision in *In re Dumont*.[1] After lengthy consideration of the facts and law, he surcharged the corporate trustee—which was successor to the original corporate trustee by merger and not The Bank of New York—the sum of $20,958,303.31, covering damages, forfeiture of commissions and interest compounded at the statutory rate.

The basis of the decision was the Court's view of the Bank's overall administration of the trust, which was held to be negligent, and particularly its failure to have divested itself of the substantial position it held in Kodak stock, an original holding received from the testator. The Kodak comprised nearly 100% of the portfolio.

What distinguishes *Dumont* from the other cases that preceded it and that also involved failure to divest a substantial equity position resulting in surcharge, is that Charles Dumont, the testator, wrote directions into his Will relating to retention and disposal of the Kodak stock. We'll discuss those other cases, but first note the critical provisions of Dumont's Will:

> It is my desire and I hope that said stock will be held by my said Executors and by my said trustee to be distributed to the ultimate beneficiaries under this Will, and neither my Executors nor my said trustee shall dispose of such stock for the purpose of diversification of investment and neither they or [sic] it shall be held liable for any diminution in the value of such stock.
>
> The foregoing provisions shall not prevent my said Executors or my said Trustee from disposing of all or part of the stock of Eastman Kodak Company in case there shall be *some compelling reason other than diversification of investment for doing so*. [Emphasis added]

Here, a brief reference to key dates and events is also critical:

(a) Dumont died on February 21, 1956.

(b) Blanche, his daughter and first measuring life, died on December 29, 1972.

(c) The Bank's first intermediate accounting through December 29, 1972 is settled without objection.

(d) The Bank's second intermediate account and supplements are filed for the period December 30, 1972 through September 15, 2003 showing ultimate sales of Kodak in 2001.

(e) The Objectants (secondary life beneficiaries and the Attorney General) filed objections alleging that due to the low income yield of Kodak and the "high risk and volatility" of the concentration in Kodak, a compelling reason existed to sell Kodak as soon as January 31, 1973, one month after the close of the first intermediate account. Their objections focused on that date.

The Surrogate concluded that the Bank did not act imprudently in January 1973, in continuing to retain the Kodak stock, given the existence of the retention clause. That was a mere month into the new accounting period and "Kodak was enjoying a great high." But, the Surrogate added, the tide quickly turned.

The Surrogate considered rather briefly some sales price quotes and published analyses of Kodak and the Bank's own in-house reports and concluded:

> It is therefore the court's holding that compelling reason existed to sell off the concentration of Eastman Kodak stock by January of 1974, and that such sale ought to have occurred on or before January 31, 1974.

The Bank appealed. On February 3, 2006, the Appellate Division 4th Department unanimously reversed the Surrogate.[2] The Appellate Division concluded that ". . . the Surrogate properly rejected the contention of the objectants that a compelling reason to sell the stock existed as of January 31, 1973. . . ." But, the Appellate Division also concluded that Surrogate Calvaruso should have stopped there and that it was error to look beyond the objections (based on January 1973) and to determine that a compelling reason to sell existed on January 31, 1974, a year later.

While the Surrogate may select a date when or by which divestiture should occur—we'll refer to this again in the *Janes*, *Saxton* and *Rowe* cases below—nevertheless an accounting and objections are pleadings; they define the issues and limit the relief. "A surcharge may not be predicated on a ground neither alleged nor proved" said the Appellate Division, citing earlier cases. The Surrogate *sua sponte* determined that the Bank acted imprudently on an unpleaded date based on a composite, unpleaded theory of imprudence.

Had the Appellate Decision itself stopped at that point, the case might be nothing more than a highlight in a practice and procedure text. But it, too, went on to discuss the Bank's actions after January 1974. The Judges concluded that, even assuming that the Surrogate could have properly considered whether a compelling reason to sell existed based on a different date and different theory than alleged by the objectants, there was no evidence of imprudence from 1973 to 1974. The Bank had not acted imprudently in failing to sell the stock by January 31, 1974. The Surrogate's determination was "impermissibly based on nothing more than hindsight." They even added that the evidence suggested just the opposite—that the Bank would have acted imprudently if it had sold the stock by January 31, 1974.

The decision was unanimous; therefore there could be no appeal as of right. The Appellate Division[3] and the Court of Appeals[4] both denied leave to appeal.

What does all this suggest to practitioners and trustees and advisers to fiduciaries? Are concentrations *less* dangerous after *Dumont*? What is the *Dumont* effect in the scheme of prudent fiduciary investment management? Do retention clauses provide protection? What is this fuss over diversification and concentration all about anyway?

Current Trust Investment Law in New York

Dumont presents an opportunity to review the current state of Trust Investment Law in New York.

It has been 11 years since the *Prudent Investor Act* (EPTL 11-2.3) took effect on January 1, 1995 and 4 years since the *New York Uniform Principal and Income Act* (EPTL Article 11-A), the *Power to Adjust* (EPTL 11-2.3 (b)(5)) and the *Optional Unitrust* (EPTL 11-2.4) took effect on January 1, 2002. These were part of the new dawn of trust investment law in New York that replaced the *Prudent Person Law* (EPTL 11-2.2).

The New York law of fiduciary investment dates back to *King v. Talbot*[5] which was based on *Harvard College v. Amory*,[6] the first expression of the familiar "prudent man rule," also known as "prudent person rule." Much of the case law will still apply despite the enactment of the *Prudent Investor Act*.

It is more than we can cover now, but I want to refer to some of that prior law to set up a background for a discussion of a few relevant points relating to current investment law. They are: (a) The *Prudent Investor Act* and its requirement of diversification; (b) Diversification in particular cases; (c) Governing instrument provisions intended to modify the rules; and (d) Trustee liability in general.

Effective Dates of the Statutes

It must first be noted that the statutes relate to two different time periods.

The *Prudent Investor Act*—the "new" law I'll call it—enacted the *Prudent Investor Rule* and applies to any investment made or held on or after January 1, 1995 by any trustee whenever appointed. The *Prudent Person Rule*—the "old" law – applies to any investment made on or after May 1, 1970 and prior to January 1, 1995.

I say "applies" not "applied" since the old law will continue to apply to any pre-1995 investment that has not yet been accounted for. If a trustee was acting prior to 1995 and continued to act after 1994, that trustee will be judged by *both* the "old" and the "new" statutes. The trustee will account for pre-1995 investments by reference to the *Prudent Person Rule* and will account for post-1994 investments by reference to the *Prudent Investor Law*. And—remember while an investment *made* prior to 1995 will be judged by the "old" standards, the decision to *hold* that investment into 1995 and beyond is *itself* a new decision—the prudence of which will be judged under the new law. The "new" law speaks to investments "made" or "held" on or after the effective date. Theoretically, an investment that was prudent on New Year's Eve 1994 could be imprudent on New Year's Day 1995.

Both the "old" and "new" statutes are default statutes, that is, the trustee's duties, responsibilities, powers, limitations or authority can be modified by the express provisions of the governing instrument. In this regard I commend to your attention the article by Charlie Gibbs and Colleen Carew entitled "Diversification—What If the Instrument Provides Otherwise?" in *The New York Law Journal* on August 19, 2004 at page 3, column 1. In my view, the judgment as to whether a trustee has or has not acted prudently, whether under the statute alone or by any express "otherwise" provisions, will be made through the filter of existing statutory and case law interpretations and general principles of prudent trust administration. The new law comes with a lot of history.

Comparison of "Old" and "New" Law: Highlights

This chart compares some of the major elements of the "old" and "new" law.

"Old Law" Prudent Person EPTL 11-2.2	"New Law" Prudent Investor EPTL 11-2.3, EPTL 11-2.4
(1) Emphasis on preservation of capital, production of reasonable income. Each investment is judged separately. No netting of gains and losses.	(1) Requires attention to "total return" of overall portfolio and consideration of risk and return. Each investment is evaluated based on contribution to the entire portfolio.
(2) May invest in "securities." Abhorred notion of "risk."	(2) No particular investment is inherently imprudent. Risk tolerated by expectation of reward.
(3) Not geared to protect against inflation.	(3) Inflation must be taken into account among many factors.
(4) Opposition between rights of current versus future beneficiaries, i.e., income versus principal. Difficult but necessary to serve both fairly.	(4) Trustee must have strategy to permit appropriate present and future distributions. Power to adjust[1] and Unitrust allow access to principal.[2]
(5) Diversification of investments was only one factor in evaluating prudence.	(5) Diversification required unless in the interests of beneficiaries not to diversify.
(6) Trustee *may* dispose of or retain initial assets if due care used.	(6) Trustee *must* determine within reasonable time whether to retain or dispose of initial assets.
(7) Delegation not allowed. Limitation on extent Trustee could avail self of special outside skills without paying for them personally.	(7) Delegation allowed together with duty to exercise skill and special skills.

1. EPTL 11-2.3(b)(5), L. 2001, Ch. 243, eff. 1/1/02.
2. EPTL 11-2.4, L. 2001, Ch. 243, eff. 1/1/02.

Fortunately, the "old" and "new" law still use the test of the trustee's conduct rather than performance or outcome as the device to measure prudence. The conduct must be evaluated at the time of the investment without the benefit of hindsight. The question remains: Was the trustee negligent? A mere error of investment judgment will not warrant surcharge.

Diversification: The Four Horsemen

Dumont came on the heels of 3 other notorious investment surcharge cases: *In re Janes*,[7] *In re Saxton*[8] and *In re Rowe*,[9] that also involved undiversified concentrations of "blue chip" stocks. The *Janes* trustee retained Kodak; the *Saxton* and *Rowe* trustees retained IBM.

There was great similarity in trustee misconduct between *Janes* and *Saxton*: lack of oversight, inattention to industry trends, failure to heed the respective bank's own investment policies without good reason, ignoring beneficiaries, failure to obtain legal advice when requested by beneficiaries, as well as retaining the undiversified portfolio without reason. In *Saxton*, however, the bank attempted to rely on a so-called Investment Direction Agreement (IDA) which, it contended, evidenced the three beneficiaries' consent to retaining the stock. That defense collapsed when the Courts—Surrogate and Appellate Division—ruled that, even assuming the IDA could otherwise be relied upon, there came a point when two of the beneficiaries repudiated the directions. Thereafter, attention had to be paid!

Rowe involved failure to diversify out of a holding of about $3,378,750 worth of IBM, that paid only 1.7%, in spite of the obligation assumed by the trustee to pay an 8% per year lead trust interest to charity for 15 years. The stock yield was about $57,000 a year; the required payment was $270,000 a year. The trustee hoped for a turnaround to sell. It didn't happen. Result: surcharge, removal, denial of commissions, embarrassment and shareholder displeasure!

In each of these cases the court ruled that the trustee should have sold the concentration and fixed the outside sale date and the amount to be sold. In *Janes*, the court held that the trustee should have sold 95% of the Kodak within a month after getting letters. In *Saxton*, the court held that the trustee should have sold

90% of the IBM within 30 days after the repudiation of the agreements. In *Rowe*, the court ruled that the trustee should have sold most of the IBM in January 1990, having qualified as trustee in September 1989.

Janes is the most authoritative since it is a Court of Appeals case. The bank trustee contended that New York law did not permit a surcharge for failure to diversify "in the absence of additional elements of hazard. . . ." It claimed that these elements of hazard all related to deficiencies in investment quality of the stock or company in question. Since Kodak was a "blue chip" which did not have these deficiencies on the selected date—a month after probate—it could not be liable.

The Court did not accept that reasoning but stated:

> The inquiry is simply whether, under all the facts and circumstances of the particular case, the fiduciary violated the prudent person standard in maintaining a concentration of a particular stock in the estate's portfolio of investments.

In other words, *Janes*, *Saxton*, *Rowe* and the Surrogate in *Dumont*, all of which were cases decided in an era when diversification supposedly was not required, provide benchmarks to be used for and against diversification now in an era when diversification is required unless the trustee determines that it is in the interests of the beneficiaries not to diversify.

Prudent Investor Act and Modern Portfolio Theory

The financial and investing community's bias towards diversification and now the legal mandate to diversify contained in EPTL 11-2.3(b)(3)(c) are an outgrowth of *Restatement 3d, Trusts, Prudent Investor Rule*, adopted by the American Law Institute on May 18, 1990. The *Prudent Investor Rule* of the *Restatement* in turn, was derived from arcane, intellectual, economic, financial and statistical studies known as *Modern Portfolio Theory*.

It has been said that Modern Portfolio Theory is "a quiet conspiracy of pension-fund consultants and the Nobel Prize committee to dominate otherwise reasonably intelligent discourse in regard to the management of large pools of assets." See *Loring, infra*, p. 352.

However that may be, it need concern us no further than to note that anyone seeking further knowledge of the intellectual and philosophic bases of the *Rule* and *Modern Portfolio Theory* may consult: Rounds, C.E., Jr; *Loring: A Trustee's Handbook*, 2006 Ed., § 6.2.2.1 *et. seq.*; Moses, Singelton and Marshall, *Modern Portfolio Theory and the Prudent Investor Act*, 30 ACTEC Journal No. 3, 161 (Winter 2004), among other sources. *Loring's* citations are extensive.

For the legal side of the ledger, the *Restatement* is a necessary reference, as is the *Third Report of the EPTL-SCPA Legislative Advisory Committee*, restated as of April 8, 1993, and as amended May 21, 1993. For other useful legislative history, see also Program Materials, April 27-28, 1995, NYSBA Trusts and Estates Law Section Spring Meeting.

It was noted in the aforementioned Trusts and Estates Law Section materials, at page 73, that one question among others raised by the new law is: "Is the prudent investor standard too difficult for individual fiduciaries?" This might be applied to corporate fiduciaries as well, since the new law makes those with special expertise—corporate trustees—even more accountable. The level of difficulty is increased.

But, whether the law is "too difficult" is now a moot point. It is with us and we have to deal with it. As noted in the ACTEC Journal referred to above:

> Modern Portfolio Theory has become a customary tool used by investment professionals and, as such, constitutes an industry standard that prudent fiduciaries cannot ignore. Further, the Prudent Investor Rule and Modern Portfolio Theory are inextricably intertwined. (p. 166)

Overall Rate of Return and Diversification

EPTL 11-2.3(a) requires a trustee to invest and manage property in accordance with the prudent investor standard. EPTL 11-2.3(b) describes that as a standard of conduct, not outcome or performance. Compliance is determined in light of facts and circumstances prevailing at the time of decision or action. A trustee is not liable to a beneficiary to the extent that the trustee acts in substantial compliance with the standard or in reasonable reliance on the express terms and provisions of the governing instrument.

The trustee must exercise reasonable care, skill and caution to make and implement investment and management decisions "as a prudent investor would for the entire portfolio. . . ." THIS IS KEY.

Further, among the things a trustee must do in executing these duties is to ". . . diversify assets unless the trustee reasonably determines that it is in the interests of the beneficiaries not to diversify, taking into account the purposes and terms and provisions of the governing instrument." THIS IS ALSO KEY.

"Expected total return," "consideration of the entire portfolio," "consideration of risk and return," "acceptance of risk in relation to anticipated return," "the role that each investment or course of action plays within the overall portfolio"—all are new concepts in New York since 1995.

What law there is that is helpful in understanding the *Act* is derived from its history, *e.g.,* the *Restatement* commentaries. The Comment on § 227 states in part:

> g. Risk and the requirement of diversification
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> * * *
>
> Events affecting the economy do not affect the value of all investments in the same way. *Thus, effective diversification depends not only on the number of assets in a trust portfolio but also on the ways and degrees in which their responses to economic events tend to cancel or neutralize one another.* Consequently, an otherwise dubious, volatile investment can make a major contribution to risk management if the shifts in its returns tend not to correlate with the movements of other investments in the portfolio. *This is a major reason why diversification is valued and why the prudence of a trustee's investment is to be judged by its role in the trust portfolio rather than in isolation. See Comments e and f, above.*
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> * * *
>
> The rationale of the *trust law's requirement of diversification is more than conservatism or a duty of caution, which admonishes trustees not to take excessive risks*—that is, not to take risks higher than suitable to a trust's purposes, return requirements, and other circumstances. The *general duty to diversify further expresses a warning to trustees, predicated on the duty to exercise care and skill, against taking bad risks*—ones in which there is unwarranted danger of loss, or volatility that is not compensated by commensurate opportunities for gain. Thus, while risk-taking cannot realistically be forbidden, or subjected to an arbitrary ceiling, it is required to be done prudently. A central feature of such prudence ordinarily is the reduction of uncompensated risk through diversification.
>
> This generalization does not apply to non-diversifiable, compensated risk. In constructing a portfolio, the degree of such risk in a trust's investment program is properly a matter of conscious decision to be made by the trustee, influencing, for example, the ratings of bonds to be held in a portfolio of debt securities and the risk level of a stock portfolio. *The trustee has an obligation to make this strategic decision after careful consideration of the risk-reward tradeoffs involved and after considering the potential cash-need consequences of the risk element in that choice*. This decision making is to be done with the general and flexible fiduciary duty of caution in mind. See Comment *e* above. [Emphasis added]

What is the reward for following these principles? The ACTEC Journal referred to above states it succinctly:

> The Rule is a test of conduct, not performance. Thus, if a fiduciary chooses a risk level that is appropriate under the terms of the trust and constructs a portfolio that is [prospectively] efficient and the resulting portfolio suffers losses, the fiduciary should not be liable for damages. (p. 174)

Diversification: How Much Is Too Little?

Clearly *Janes*, *Saxton*, *Rowe* and *Dumont* did not contain diversified portfolios. Would *Janes* and *Dumont* have been diversified if they had added only IBM? Would *Saxton* and *Rowe* if they had added only Kodak? Undoubtedly not.

How much diversification do you need to be diversified? As to this, the law provides no answer.

Again referring to comment *g* to § 227 of the Restatement:

> Significant diversification advantages can *be achieved with a small number of well-selected securities representing* different industries and having other differences in their qualities. Broader diversification, however, is usually to be preferred in trust investing. Broadened diversification may lead to additional transaction costs, at least initially, but the constraining effect of these costs can generally be dealt with quite effectively through pooled investing. *Hence, thorough diversification is practical for nearly all trustees*. The ultimate goal of diversification would be to achieve a portfolio with only the rewarded or "market" element of risk. [Emphasis added]

The mantra is the avoidance of "concentration" and to achieve enough variety or asset allocation so that concentration in a single company, industry, type of asset—is avoided.

The *Third Report* states:

> 5. *Diversification*: The bill considers *diversification as generally appropriate because it can limit the specific risks of particular investments*. A combination of investments can have offsetting risks. The bill does not define diversification specifically because *many different investment combinations could be appropriate* for various fiduciary funds, depending on their purposes. Mutual funds and bank collective investment vehicles are well recognized methods of obtaining diversification. *The bill also permits a fiduciary to make a reasonable determination not to diversify, and also to take into account any special relationship or value of an asset to some or all of the beneficiaries. For example, if the purpose of a trust is to preserve a closely held business for family members, the standard would not impose an obligation to sell the business*. [Emphasis added]

This example—to preserve a closely held business interest—is described in the *Third Report* as one instance when the "purposes" of a trust would relieve the trustee of a duty to diversify. Another example referred to in the *Restatement* is the duty to minimize costs. This militates against selection of expensive diversification strategies. Prudent trust administration also requires consideration of the tax cost of selling low-basis assets. The *Restatement* also suggests that the trustee may take into account special skills of or available to the trustee and particular asset holdings that are preferred or encouraged by the terms of the trust. See also *New York Civil Practice*—EPTL ¶ 11-2.3(6).

And of course the *Act* permits the trustee to rely upon express provisions defining or limiting diversification as set forth by the Grantor or Testator.

No quantitative objective test exists, *e.g.*, 15 different stocks is good but 10 is not good. Many professional investors—common trust fund trustees, for example, are bound by self imposed rules or mandated by the Banking Law that no single investment will make up more than, say, 10% of a fund. Is more better? What about Index Funds? What about tracking the Dow, with 30 stocks? Or the NASDAQ 100? Or the S&P 500? Or the Russell 2000 or 3000? Or the Wilkshire 5000, really 7000?

It was remarked by one commentator:

> One thing is certain: In the years to come, more than one court will be called upon to consider how far below the diversification level of the average index fund is too far. *Loring, op cit*, p. 353.

Diversification will become for the trust lawyer what obscenity is for the First Amendment lawyer. As Justice Potter Stewart once said: "I shall not today attempt further to define [pornography]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it. . . ."

Where Does This Leave Us?

Fortunately, the new law continues the rule that conduct matters—how we go about the job of being trustee, not how it comes out. It is "How?" not "How Much?" that is the test.

Further, we shall be judged by our prudence. Mere lack of judgment will not suffice to warrant surcharge. We have to show that we read the research, we looked at the literature and analyses, for example, and that we acted reasonably in a well planned way having the Act and the beneficiaries and our trust instrument in mind—and if the investment still went south, there should be no surcharge. Ignore these precepts at your risk.

Some guides through this morass:

(1) Know what the *Prudent Investor Act* requires and permits. This is no longer the buy-and-hold and maintain-the-dollar-value approach of the "good old" days of the Prudent Person who eschewed all risk.

(2) Develop a plan. Follow it. Review it. Modify it as needed.

(3) Get help. The statute allows a trustee—even a professional trustee—to enlist help and to delegate responsibility to advisers who have special skills. And future courts may penalize the "do it all" trustee who does not seek such outside help.

(4) Since no investment is *per se* prudent or imprudent, in appropriate cases more sophisticated investments and strategies may be called for. And the sophisticated trustee who does not at least consider them—if only to decline to use them—may be risking surcharge.

(5) Keep good records: What did you read? What did the reports conclude? What were the prevailing indications? Trends? What were the

experts saying? If you are a Bank, and you have a governing investment policy, violate it at your peril or have a good explanation.

(6) If you are able to draft the document you will act under, recognize special cases. For example, will the testator be handing you 100% of the shares of the family business? Or a substantial position in a business that will be difficult to sell if necessary? The investment statutes are default statutes. Suitable language can be drafted to fit your case. It worked in *Dumont*—so far!

(7) Consider change of situs to a “friendlier” investment milieu.

(8) For what they are worth, get consents or ratifications or approvals of investment decisions. They will not bind unborns or infants or persons under disability, but consider their use.

(9) Communicate with the beneficiaries. Account more frequently.

(10) Have a rational plan, a reason for what you do on which your judgment is based. Make sure that your conduct is active, attentive, based on reason and considered judgment with the trust’s purposes and terms in mind and the beneficiary’s needs taken into account. That is responsible trustee conduct.

(11) Lastly, always follow the infallible *Prudent Investor Rule*: “Invest only in assets that increase in value!”

Endnotes

1. 4 Misc. 3d 1003(A), 791 N.Y.S.2d 868 (Surr. Ct. Monroe Co. 2004).
2. *Sub nom. In re Chase Manhattan Bank*, 26 A.D.3d 824, 809 N.Y.S.2d 360 (4th Dep’t 2006).
3. 28 A.D.3d 1257, 813 N.Y.S.2d 689, N.Y. Slip. Op. 03419 (4th Dep’t 2006).
4. 7 N.Y.3d 824, 822 N.Y.S.2d 753 (2006).
5. 40 N.Y. 76 (1869).
6. 26 Mass. 446, 9 Pick 446 (1830).
7. 165 Misc. 2d 743, 630 N.Y.S.2d 472 (Surr. Ct. Monroe Co. 1995), *aff’d as modified*, 223 A.D.2d 20, 643 N.Y.S.2d 972 (4th Dep’t 1996), *aff’d*, 90 N.Y.2d 41 (1997).
8. 179 Misc. 2d 681, 686 N.Y.S.2d 573 (Surr. Ct. Broome Co. 1998), *aff’d as modified*, 274 A.D.2d 110, 712 N.Y.S.2d 225 (3d Dep’t 2000).
9. 274 A.D.2d 87, 712 N.Y.S.2d 662 (3d Dep’t 2000), *lv. to appeal denied*, 96 N.Y.2d 707 (2001).

Charles J. Groppe is a partner in the firm Putney, Twombly, Hall & Hirson LLP.

Snowbird News: Repeal of the Florida Intangible Personal Property Tax

By Tara Anne Pleat

The Intangible Personal Property Tax, which has been under attack by the Florida legislature over the last couple of years, was officially eliminated on July 27, 2006 when Governor Jeb Bush signed legislation permanently repealing the tax.[1] The repeal is effective January 1, 2007, meaning that the last intangible tax return that requires filing is for the 2006 tax year (the deadline for which was June 30, 2006).[2]

The Intangible Personal Property Tax

Prior to its repeal, the Intangible Personal Property Tax was an annual tax on all intangible personal property owned by Florida residents or persons doing business in Florida. The tax was based on the current market value of the intangible personal property as determined by the Florida Statutes at a rate of $.50 per $1,000.[3] For individual filers, business entities, estates and certain trusts, the first $250,000 of total taxable assets was exempt and for joint filers the first $500,000 of total taxable assets was exempt from the tax.[4]

The most common types of assets which were subject to this tax were: stocks, mutual funds, money market funds, interests in limited liability companies, commodity futures, futures contracts, bonds, lines of credit and promissory notes.[5] Assets such as cash-on-hand, checking and savings accounts, certificates of deposit, annuities, qualified retirement plan monies, individual retirement accounts and Florida municipal bonds were exempt from the tax.[6]

What Does Repeal Mean for Florida Residents or Persons Looking to Become Florida Residents?

In an effort to eliminate payment of the Intangible Personal Property Tax, many Florida residents utilized trusts commonly referred to as "FLINT" Trusts (Florida Intangible Tax Trusts), which are Trusts that were officially sanctioned by the Florida Department of Revenue.[7] Prior to the end of a year, a Florida resident would title all of his or her intangible assets to this Trust so that as of January 1st the resident would not own any intangible personal property and thus could circumvent payment of the Intangibles Tax. Commonly, these Trusts were created in such a manner that they would continue in existence for a number of years, and prior to January 1st the Florida resident would move his or her intangible assets into the Trust and then a month or two later (after January 1st) the resident would move their assets back out of the Trust. Less frequently, short-term FLINT Trusts would be created to avoid the tax in a particular year and would be drafted to terminate and distribute the assets back out to the Trust creator sometime after January 1 of the year following the year in which the Trust was created.

The repeal of the Intangibles Tax means that the use of these Trusts is no longer necessary. Since FLINT Trusts are not often drafted to provide any benefit beyond circumvention of the Intangibles Tax, if a practitioner has clients who have these types of trusts in existence, the trust terms should be reviewed so that a determination can be made as to what, if any, action should be taken in order to move any remaining assets out of the Trusts and to terminate them.

Many Florida residents who did not take advantage of these Trusts due to the cost of their creation and administration would structure their holdings in bonds, notes and other obligations of the State of Florida so that they would be exempt from the tax. The repeal of the Intangibles Tax now also eliminates the need for this type of structuring.

For clients considering Florida residency, the repeal of the Intangibles Tax is the newest in the line of tax-friendly policies to be enacted in Florida. At current, Florida does not impose a state income tax, estate tax or inheritance tax. That said, the decision to change residency should not be entered into lightly and all aspects of a clients' overall circumstances should be carefully reviewed to ensure that the decision to change residency is a prudent one.

Endnotes

1. 2006 Fla. Laws ch. 2006-312 and 2006-291.
2. *Id.* Fla. Stat. ch. 199.042 (2005).
3. Fla. Stat. ch. 199.103 (2005). In 2005, legislation was enacted to reduce the Intangible Personal Property Tax from $1.00 per $1,000.00 to $.50 per $1,000 beginning on January 1, 2006.
4. Fla. Admin. Code 12C-2.004 (2006).
5. Fla. Admin. Code 12C-2.002 (2006).
6. Fla. Admin. Code 12C-2.003 (2006).
7. Fla. Admin. Code 12C-2.0063 (2006).

Tara Anne Pleat is an attorney with Jones & Wilcenski, PLLC in Clifton Park, New York. Ms. Pleat is admitted to practice in both New York and Florida and devotes her entire practice to trust and estate tax planning and trust and estate administration.

Estate Planning in World Mythology

By G. Warren Whitaker

Every human culture has its unique myths and legends which express that culture's character and values. Scholars from Carl Jung to Joseph Campbell have studied the myths of cultures throughout the world and across the centuries and have discerned in them recurring themes which represent fundamental patterns of human interaction. Many of these themes involve the stewardship of family wealth and status in difficult times, such as during absence or incapacity, upon the occasion of marriage, and at death. This recurrence shows that concern about the protection of family property is a universal human trait. And as mythical protagonists struggle to manage and pass on their wealth, they must frequently obtain counsel from loyal advisors. This article will examine certain well-known myths, examine the estate planning issues they raise and consider what advice modern advisors might have given in today's world.

Greece: The *Iliad* and *Odyssey* of Homer relate the classic tale of the wanderings of the Greek hero Odysseus. At the outset Odysseus was a successful local figure living on the island of Ithaca with his wife Penelope and his son Telemachus. One day Odysseus was called away on a business trip to the distant city of Troy. He consulted the Oracle, said farewell to his family and departed on what he thought would be a brief sojourn. Unexpectedly, the business at Troy required ten years to conclude, and Odysseus then spent a further ten years trying to make the connections back to Ithaca.

During this long and unanticipated absence, Penelope tried to maintain the family home and business with the help of her young son, but the existence of a vacuum soon became apparent to all. Suitors filled the Odysseus household, offering legal, financial, and insurance services to Penelope, who was unaccustomed to selecting professional advisors. As Odysseus's absence continued, the suitors became more brazen in their efforts to insinuate themselves into the family business, each trying to convince Penelope that he alone could offer her expert advice and that the others wanted only to take advantage of her.

When Odysseus finally returned from his lengthy travels he found his house filled with advisors he had not chosen. In a climactic scene, he confronted and killed the suitors and regained control of his household and family business.

This is a myth about the unavailability of the decision-maker and its consequences for him and his family. In earlier times when travel was dangerous and communication difficult, unavailability was most often brought about by a long voyage. (This explains the laws still on the books in many states that address the situation of a missing person who is declared dead, his will probated and his estate administered, and who then returns to claim his property. *See*, *e.g.*, NY SCPA Section 2226.) In today's world, unavailability is more likely to be caused by mental infirmity due to advanced age. In some countries the possibility of kidnapping or imprisonment must also be taken into account.

Unavailability differs from death in one important respect: the looming, if inchoate, presence of the property owner. When a person dies, many others may fight over his property, but one thing is certain: the decedent no longer owns it. With unavailability, the owner cannot easily communicate his wishes, but his ownership right to the property remains superior to that of any family member, and all others are confronted with the fact that he may return, regain capacity, or be released from captivity.

What advice could the Oracle have given Odysseus before he left Ithaca to address this possible dilemma? ("Oracle" is a Greek word meaning "family attorney.") Odysseus was undoubtedly advised to see that his testamentary estate plan was in place, but the Oracle appears not to have told him about the importance of addressing his unavailability. At the very least Odysseus should have executed a durable financial power of attorney naming an agent who could act for him in the event that he was *hors de combat*. (A "springing" power that only became effective upon his mental incapacity would not have been activated in this case, so he should have executed a presently effective power before departing on his trip.)

Odysseus could have named Penelope as his sole agent. However, in light of the extent and complexity of his holdings, he might have concluded that this would impose a great burden on her, and that he would be helping her by selecting a co-agent to act with her. This could have been a friend or relative (Telemachus was too young to take on this role at the time of Odysseus's departure), but a better choice might have been an experienced professional such as the family attorney or accountant.

The Oracle might have told Odysseus that if he wanted to make more thorough preparations for his potential unavailability, he should create a revocable trust and transfer his business in Ithaca and his other assets into it. Odysseus could have been the sole trustee with all investment powers for as long as his messages could reach home. However, the trust agreement could have provided that once he was unable to communicate, Penelope and a co-trustee, such as Ithaca Trust Company, would be appointed as his successors. (A careful definition of unavailability to encompass the settlor's inability to communicate, as determined by the successor trustees, would avoid the need for Penelope to go to court to have him declared absent.) The powers and duties of trustees are clearly delineated under local law, and Odysseus would have provided Penelope with the advisor of his choice, rather than leaving her open to the entreaties of suitors and con artists hawking their wares.

What about gifts? When Odysseus was in charge in Ithaca he could have made his own decisions about how best to provide for his family members. He would have no choice but to provide for gifts of his property effective at his death; otherwise the state will give it away for him under the intestacy rules. But what standard should have applied during the twilight period when Odysseus was alive but unavailable, and his needs were unknown while those of his family were pressing? Should his assets have been conserved for his future use if he returned, or for nursing home care, with only minimal amounts paid to provide for the family? Or should funds have been spent lavishly on his wife and son, or even depleted to save estate taxes and possible Medicaid claims? And what about the risk that substantial gifts to Penelope could wind up in the hands of one of the suitors instead of passing to Telemachus? The Oracle should have urged careful consideration of these questions, a trust agreement that named trusted advisors to make these decisions and a letter of wishes providing them with guidance for their actions.

Fortunately, Odysseus returned home, regained the reins of power and was reunited with his family. By the end of the story the only open issue, which might require matrimonial counsel to resolve, is this: will Penelope suspect that Odysseus came home late because he stopped off to visit an attractive woman named Calypso, or will she believe him when he says, "You see, honey, there was this Cyclops. . ."?

Arabia: *The Thousand and One Arabian Nights* is a collection of fantastic Middle Eastern tales filled with geniis, jewel-encrusted caves and flying carpets. Many of these tales revolve around family succession issues. A typical story tells of a wealthy and elderly Sultan whose daughter, the young and beautiful Princess, has fallen in love with a plucky commoner named Aladdin. The Sultan wants the Princess to be happy, but he is understandably concerned that Aladdin may be interested in her primarily as a means of attaining status and power over the caliphate that she will someday inherit. What advice should the Vizier give the Sultan under these circumstances? ("Vizier" is an Arabic term meaning "family attorney.")

Above all, the Vizier should under no circumstances try to dissuade the Princess or Aladdin from going through with their planned marriage. Direct intervention of this kind will only turn both of them against him, and may even prompt the Princess to proceed with the wedding as an act of defiance despite any private reservations she might harbor. And while the Sultan may be implacably opposed to the marriage now, in five years when he is dandling his new grandchildren on his knee he may accept Aladdin into the family and even make him an active participant in the governance of the caliphate. If the Vizier tries to obstruct the marriage, his intrusion will never be forgotten by the Princess, Aladdin or possibly even the Sultan and may lead to his eventual eclipse as the family advisor.

Instead, the Vizier might recommend that the Princess enter into a prenuptial agreement with Aladdin. Such an agreement could provide that the Princess's assets, including inheritances from the Sultan, and the income and increases in value of those assets, will remain her separate property to dispose of as she wishes during the marriage, in the event of divorce and upon her death.

Prenuptial agreements are an important legal tool and an appropriate precaution in many situations. However, they also have their drawbacks. Negotiating a prenuptial agreement can create a strain between the parties, particularly with a young couple about to enter into a first marriage. Moreover, if Aladdin were asked to waive claims against the Princess's assets, he (or his attorney) will probably insist in return that she waive any claims against his current and future property, which may work to her disadvantage if he later becomes a successful investment banker. And if the Vizier tries to pressure the Princess to enter a prenuptial agreement against her wishes, he again runs the risk of earning the enmity of all parties concerned.

A prenuptial agreement is often an essential prophylactic measure, but in this instance the Vizier can offer a better solution. The Princess does not yet have significant assets; rather it is the Sultan's property for which protection is sought after his death. Therefore, instead of focusing on an agreement between the Princess and Aladdin, the Vizier should encourage the Sultan to reexamine his own estate plan. The Sultan could leave his assets in a long-term discretionary trust for the benefit of the Princess and her descendants rather than bequeathing them outright to her. He would thus insulate them from divorce claims and the spousal right of election at her death in most jurisdictions. He could name the Princess as one of the trustees, but to protect her from undue influence he should name a co-trustee, perhaps Baghdad Trust Company, and he might also name the Vizier as Protector with the power to change trustees. This would give the Princess a voice in the management of the assets together with a professional institution and a trusted family advisor, while putting the assets beyond Aladdin's reach.

With such a plan in place the Princess and Aladdin can proceed happily with their wedding plans, the Sultan may rest assured that the caliphate has been protected, and the Vizier will avoid being portrayed as a sinister, mustachioed villain in animated feature films. (*See, e.g.,* Disney Studios, *Aladdin (*1992*))*

United States: The archetypical American myth tells of the rise of a hard-working youth from rags to riches and the passing of his wealth and his work ethic to the next generation. And the quintessential retelling of this myth is the *Godfather* saga as related in the book by Mario Puzo and the films by Francis Ford Coppola.

Vito Corleone was an ambitious immigrant who, through grit and determination, had built a substantial family business engaged in beverage distribution, financial services, home and business security systems and leisure time activities. As the story opens, Corleone Enterprises is a resounding success and Vito is at the peak of his powers, respected by colleagues, competitors and political figures throughout the country. However, the future for his sons Fredo, Sonny, and Michael and daughter Connie is uncertain. Corleone Enterprises faces fierce competition and enormous pressure to diversify into new fields such as pharmaceuticals. Vito no longer has the energy to lead the family in these new and perilous times, and he must anoint a successor who is up to this demanding task. Fredo does not possess the requisite leadership qualities. Sonny is bold but reckless, and lacks the dispassionate judgment needed to guide the family business successfully. Connie's husband, Carlo, offers his services to the family but proves to be disloyal to its interests as he sides with a competitor.

Michael, who had been expected to pursue a professional career, is drafted into the business against his father's wishes when no one else is available to take up the family standard. Through unexpectedly forceful actions he succeeds in carrying Corleone Industries into a new era, but the cost is high. Sonny is destroyed by the competitive forces that confronted the family. Michael pushes Fredo and Carlo aside, and his immersion in the business leads to his estrangement from Connie and from his wife, Kay. By the end of the tale Michael has saved Corleone Enterprises and led it to new heights, but Vito's family has been virtually destroyed.

What planning advice could Tom Hagen, the family *consigliere,* have offered to Don Corleone to help him avoid this result? ("*Consigliere*" is a Sicilian word whose meaning the reader can guess.) Hagen might have told the Don that it was not obligatory for Corleone Enterprises to remain as a unified, active family-owned business for another generation, and that in fact it might have been unwise for the Don to aim for this goal. Continuity of a family business can be more a matter of the founder's ego and his wish to create a monument to himself than a farsighted plan for the welfare of future generations. Some of the most successful American families sold their core businesses decades ago, and some of those core businesses have ceased to exist. Knowing when to cash out of a business and diversify investments (and family energy) is just as critical as knowing how to build a fortune.

Vito could have engaged an investment banker to take Corleone Industries public; alternatively, he might have sought a private placement of the business with the Tattaglia family or sold it to a private equity fund organized by Salazzo the Turk. Vito could then have divided the proceeds among his children so that they could each pursue their separate careers and interests. Sonny might have followed his instincts and used his share to enter the pharmaceutical field—although he would start from a smaller base, he would not be placing the family's entire fortune into play and so could take the risks necessary to succeed in an emerging industry, which a fiduciary who is acting for others cannot and should not take. Fredo, who has always rankled at being passed over by the family, could have started a new career for himself in the Las Vegas casino industry, independent from and freed of constant comparisons to his more dynamic brothers. Michael might have achieved his father's dream of becoming a respected banker or accountant, and used his share of the family fortune to buy new uniforms for his children's soccer teams. And Connie could have asked that a portion of her inheritance be paid to a charitable foundation that would address the social issues Vito ignored as he clambered to the top, such as the prevention of cruelty to horses.

Conclusion: These myths and stories from around the world demonstrate how the family attorney, by whatever name he or she is known, can help the client-protagonist to resolve the age-old problems that inevitably arise in providing for the protection of family wealth and its passage to future generations.

G. Warren Whitaker is a partner of Day, Berry & Howard LLP in New York. He is the former chair of the Trusts and Estates Law Section of the New York State Bar Association, is a member of ACTEC and its International Committee, and is the Chair of the New York branch of the Society of Trust and Estate Practitioners (STEP).

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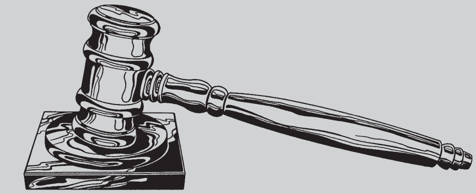
By Ira Mark Bloom and William P. LaPiana



FIDUCIARIES

Executors; SCPA 2307-a Does Not Apply to Paralegal Employed by Drafter of Will Nominated as Executor

Decedent's will nominated a paralegal employed by the drafter of the will as executor. The decedent did execute the disclosure statement required by SCPA 2307-a which was witnessed by the attorney. The Surrogate found that proper execution of the disclosure statement was required if the executor was to receive full commissions because of the relationship between the nominated executor and the drafter and that to be properly executed the disclosure would have to be witnessed by someone other than the attorney. The Surrogate then reduced the executor's commissions by 50%. The Appellate division reversed, holding that because the paralegal is not an attorney SCPA 2307-a is not applicable; the "plain language" of the statute makes the provision applicable only to attorneys who are nominated as executor. *In re Wagoner*, 30 A.D.3d 805, 816 N.Y.S.2d 599 (3d Dep't 2006).

INTESTACY

Kinship; DNA Testing May Be Ordered to Prove Maternity

Decedent's son and his purported half-brother cross-petitioned for letters of administration. The purported son moved for an order directing the decedent's son and the purported father to submit to DNA testing. The motion with respect to the purported father was denied because he was not properly before the court and no subpoena had issued to him as a non-party witness. The motion with respect to the decedent's son was granted. After finding that DNA testing to determine maternity is valid where the only persons who can provide samples are siblings or half-siblings, the Surrogate noted that DNA testing to establish maternity has been accepted by courts in New York and in other states, and that compelled production of a DNA sample in a civil proceeding has been permitted where there was a *prima facie* showing of a reasonable possibility of a match. The Surrogate then held that the affidavit and exhibits submitted by the purported son of decedent were held sufficient to present the required *prima facie* showing and ordered that the decedent's son provide a sample for DNA testing. *In re Gaynor*, 13 Misc. 3d 331, 818 N.Y.S.2d 747 (Sur. Ct. Nassau Co. 2006).

Non-marital Children; Right to Inherit from Father's Niece Determined as of Niece's Death

At her death in 2003, decedent was survived by four paternal first cousins and two maternal first cousins, the non-marital children of an uncle who died in 1953. Under the law at that time, non-marital children could never inherit from or through their father. After a kinship hearing the Surrogate determined that only the paternal first cousins were decedent's distributees, holding that the maternal first cousins' inheritance rights were determined by the law in effect at their father's death. The Appellate Division modified the Surrogate's order by ordering half the estate distributed to the paternal first cousins and half to the maternal first cousins. After reviewing the history of inheritance rights of non-marital children in New York, the court distinguished the case relied on by the Surrogate (*In re Malavase*, 133 A.D.2d 759, 520 N.Y.S.2d 49 (2d Dep't 1987)), which held that the 1981 amendments to the law (now EPTL 4-1.2(a)(2)(C)) expanding the methods of proving paternity could not be applied retroactively to allow a non-marital child to inherit from his father who died before the amendments became effective. The rights of the maternal cousins to inherit from decedent were fixed at the decedent's death in 2003, not at the death of their father in 1953. There is no retroactive application of the statute and no vested rights of the paternal first cousins are involved. *In re Uhl*, 33 A.D.3d 181, 818 N.Y.S.2d 403 (4th Dep't 2006).

JOINTLY HELD PROPERTY

Joint Accounts; Release of Accounts of Administrator Does Not Establish Status as Convenience Accounts

Decedent's daughter was the beneficiary of joint bank accounts created by herself and her mother. Mother was the source of all but $5,000 of the funds in the accounts. After mother's death daughter signed a document in which she agreed to release control of the joint accounts (from which she had withdrawn the $5,000 she contributed) to the estate fiduciary, the Public Administrator. Daughter then filed objections to the Public Administrator's accounting, which showed that the accounts were convenience accounts and belonged therefore to the estate. The Surrogate dismissed the objections except for the claim that some of the money the daughter had spent from the joint accounts beyond the $5,000 she contributed was used to pay debts of the estate and ordered a hearing on the objection. The Appellate Division modified the Surrogate's order, directing that the hearing determine whether or not the decedent intended to create joint accounts with right of survivorship. The daughter's release of the accounts to the estate fiduciary could not determine the nature of the accounts the decedent intended to create. *In re Constantino*, 31 A.D.3d 1097, 818 N.Y.S.2d 394 (4th Dep't 2006).

POWER OF ATTORNEY

Self-dealing; Express Grant of Power to Make Gifts to Attorney-in-Fact Can Only Be Exercised in Best Interests of Principal

The Court of Appeals reversed the Appellate Division in *In re Ferrara* (22 A.D.3d 578, 802 N.Y.S.2d 471 (2d Dep't 2005)), in which the intermediate court affirmed the Surrogate's holding that a gift of the principal's property made by the attorney-in-fact to himself was authorized by language in the power of attorney specifically authorizing such gifts. The Court of Appeals held that the requirement in GOL § 5-1502M that an attorney-in-fact exercise the limited gift giving authority granted by the section "only for purposes which the agent reasonably believes to be in the best interest of the principal," specifically including the minimization of taxes, also applies to any additional authority to make gifts granted in the power of attorney in accordance with GOL § 5-1503. The attorney-in-fact, therefore, could make the gifts to himself authorized in the power of attorney only in the principal's best interest "to carry out the principal's financial, estate or tax plans." Although the attorney-in-fact testified that the principal wanted to give the attorney-in-fact his assets, best interests does not include "such unqualified generosity," especially where the gifts virtually impoverish the principal and are contrary to the principal's estate plan evidenced by a recent will. The case was remanded for further proceedings. *In re Ferrara*, 7 N.Y.3d 244, 852 N.E.2d 138, 819 N.Y.S.2d 215 (2006).

TRUSTS

Trustees; Informal Rejection of Trusteeship Overcome by Subsequent Actions

Creator of lifetime trust named herself and one of her two daughters as trustees. The co-trustee and another daughter became beneficiaries on the creator's death. On the creator's death, creator's lawyer (not the drafter of the trust) was named as successor trustee. The trust required a trustee to resign by written instrument and authorized an existing trustee to name a successor trustee after all the named parties failed to qualify or ceased to act. After creator's death, the surviving trustee asked the named successor to resign so that she could appoint her future husband as co-trustee. The Appellate Division upheld the judgment of the Supreme Court that the successor trustee did not disclaim the trusteeship in spite of orally agreeing to do so. His conduct after learning of the provisions of the trust and the possible ramifications of his renunciation—his attempts to obtain a copy of the trust agreement, his contact with the non-trustee beneficiary, her request that he serve so that her interests would be protected, and his numerous efforts to obtain the trust records—indicates his clear intention to accept the office of co-trustee. In addition, the appointment as co-trustee of the future husband of the co-trustee/beneficiary thereby giving him the power to invade trust principal "equally or unequally" in favor of either beneficiary would not further the intent of the creator of the trust. In view of all of the circumstances the successor co-trustee "unequivocally" accepted the office. *Sankel v. Spector*, 33 A.D.3d 167, 819 N.Y.S.2d 520 (1st Dep't 2006).

Principal and Income; Interested Trustees May Make Retroactive Unitrust Election

Decedent's testamentary trust provided that all income was to be paid to his widow. The trustees were his sons by a previous marriage who together with their sisters are the remainder beneficiaries. In February of 2003 the trustees elected unitrust treatment for the trust retroactive to the effective date of the unitrust statute (EPTL 11-2.4), January 1, 2002. Before the election the widow received the entire trust income of approximately $190,000 a year. The 4% unitrust interest pays approximately $70,000 a year. Widow's daughter and attorney-in-fact moved for summary judgment to annul the unitrust election. The Surrogate denied the petition but granted the petitioner summary judgment to annul the retroactive application of the election and the Appellate Division upheld the Surrogate but reversed the annulment of the retroactive application (23 A.D.3d 61, 800 N.Y.S.2d 207 (2d Dep't 2005)).

The Court of Appeals affirmed the Appellate Division. The court held that there is no statutory barrier to the making of a unitrust election by an interested trustee. Although the Legislature prohibited the exercise of the power to adjust by an interested trustee (EPTL 11-2.3(b)(5)(C)(vii)), there is no such prohibition on a unitrust election and there is statutory presumption in favor of unitrust application (EPTL 11-2.4(e)(5)(A)). Nor is there any violation of the absolute prohibition in New York law against self-dealing. The trustees owe fiduciary duties to the income beneficiary and to the non-trustee remainder beneficiaries. "That these beneficiaries' interests happen to align with the trustees' does not relieve the trustees of their duties to them." The question of propriety of the unitrust election by these trustees for this trust, therefore, must be evaluated by the Surrogate "by applying relevant factors" including those set forth in EPTL 11-2.4(e)(5)(A). Summary judgment was not appropriate.

The court also held that the unitrust election could be made retroactively. The statute unambiguously allows the trustees to specify the effective date of the election (EPTL 11-2.4(d)(1)). In addition, EPTL 11-2.4(b)(6) directs a trustee who elects unitrust status to determine the unitrust amount for any preceding period unless the election is expressly made prospective and to recover overpayments or remedy underpayments, indicating that the election can be made retroactively to the effective date of EPTL 11-2.4, January 1, 2002. *In re Heller*, 6 N.Y.3d 649, 849 N.E.2d 262, 816 N.Y.S.2d 403 (2006).

Self-Dealing; Parent May Exercise Discretion as Trustee to Pay Expenses of Secondary and Higher Education for Beneficiary Child

Testator created a testamentary trust for his granddaughter, making her father and his lawyer co-trustees and giving them broad discretion to make distributions to the beneficiary or to apply "for her sole benefit" income and principal, in their discretion, for "her proper support, education, maintenance, and general welfare." The trust terminates when the beneficiary reaches 30 years of age at which time principal and accumulated income are to be distributed to her. Two years before the testator's death, the beneficiary's parents divorced. From the testator's death in 1997 until 2003 when the beneficiary obtained an order directing the trustees to account, expenditures were made from the trust primarily for the beneficiary's secondary school and college expenses, although some health care expenses and the beneficiary's personal allowance were paid from the trust. In the meantime, in August 2000 the Supreme Court issued an order modifying the beneficiary's father's child support obligation by directing that the trust pay for normal and customary college expenses.

The beneficiary objected to the accounting. The Surrogate dismissed the objections to the expenditures for college expenses which were authorized by the 2000 order. The Surrogate sustained as a matter of law the objections to the expenditures for secondary school and health care expenses and for the payment of beneficiary's personal allowance on the grounds that the father/co-trustee could not avoid his support obligation by using his child's trust fund.

The Appellate Division affirmed the dismissal of the objections to expenditures for college expenses but reversed on the objections to the expenditures made during minority. First, the trustees did not violate their fiduciary duties by administering the trust in accordance with its terms. Second, the terms of the trust cannot be "disregarded or nullified" if applying them would relieve a trustee of parental duty to support a beneficiary. Third, even if the parent/co-trustee could not make distributions for the secondary school expenses because of EPTL 10-10.1, the participation of the co-trustee cured any problem. *In re Wallens*, 30 A.D.3d 962, 816 N.Y.S.2d 793 (4th Dep't 2006).

Constructive Trusts; Alleged Surviving Domestic Partner May Be Entitled to Constructive Trust of September 11 Victim's Compensation Award

After increasing the initial award from the September 11 victims' compensation fund to recognize the loss suffered by the decedent's surviving domestic partner, the fund distributed the entire award to the administrator of the decedent' estate, her brother, who then distributed the entire award to himself as sole distributee. Surviving domestic partner sued and the Supreme Court denied the administrator's motion to dismiss for failure to state a claim.

The Appellate Division affirmed, finding that under the compensation scheme the plaintiff was clearly entitled to at least the increased portion of the award, and holding that the complaint, therefore, was sufficient to state causes of action for breach of fiduciary duty, unjust enrichment, and the imposition of a constructive trust, which remedy is available whether or not the administrator is guilty of wrongdoing. *Cruz v. McAneney*, 31 A.D.3d 54, 816 N.Y.S.2d 486 (2d Dep't 2006).

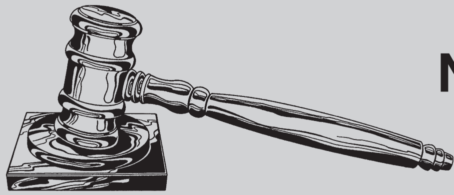
WILLS

Lapse; Substitute Taker under Anti-lapse Statute Also Takes Lapsed Portion of Residue

Decedent's will gave 25% of the residue to each of three siblings "per capita, absolutely and forever" and gave the remaining 25% to six named nieces and nephews. A sister predeceased the decedent, dying without issue. A brother also predeceased the decedent, survived by a son who was one of the named nieces and nephews. The Surrogate held, first, that neither the words "per capita" nor the words "absolutely and forever" created a substitution gift, that the anti-lapse statute (EPTL 3-3.3) therefore applied and the nephew takes his late father's 25% of the residue. Second, the share of the residue given to the predeceased sister passes to the other residuary beneficiaries under EPTL 3-3.4. Third, because the anti-lapse statute and the statute abolishing the no residue of a residue rule are both remedial, they must be construed so that the dominate purpose of both will be best served. The required construction, therefore, gives the nephew a share of the lapsed portion of the residue both in his own right as one of the nieces and nephews who share 25% of the residue and as substitute taker for his father. *In re Edwards*, 13 Misc. 3d 210, 818 N.Y.S.2d 744 (Sur. Ct. Nassau Co. 2006).

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 current authors of Bloom and Klipstein, *Drafting New York Wills* (Matthew Bender) (Bloom as principal author; LaPiana as contributing author).



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

By Ilene Sherwyn Cooper

Attorneys Fees

Plaintiff law firm sought the full amount, rather than the compromised amount, due from the defendant client, on an account stated and *quantum meruit* basis, arguing that she had defaulted in paying the compromised fee. The defendant counterclaimed for a certain sum alleging that various appeal costs should not have been charged to her.

The court found that plaintiff and his associate were experts in the field of trusts and estates and that the defendant never objected to the invoices for fees requested by the plaintiff, or that the invoices had ever been returned to the sender. In addition, the court held that because defendant had made partial payment of plaintiff's fees, her retainer constituted an acknowledgment of the validity of plaintiff's bills.

Further, the court held that plaintiff was also entitled to recover under a theory of *quantum meruit*, inasmuch as it had established that it performed legal services in good faith, that defendant had accepted these services, and that it had expected compensation as evidenced by the invoices tendered. Further, the court noted that plaintiff had provided defendant with the requisite skill, ability and experience to prevail in the Appellate Division under "*quantum meruit*."

Accordingly, judgment was granted in plaintiff's favor.

Seth Rubenstein PC v. Hojanidov, N.Y.L.J., July 20, 2006, p. 24 (Sup. Ct., Kings Co.) (Justice Schack).

Attorney-in-Fact

In an action commenced in Supreme Court, the executrix of the decedent's estate sought to recover assets, including but not limited to a parcel of real property, that was allegedly withheld, misused or conveyed by the decedent's son, in his capacity as the decedent's attorney-in-fact.

The defendant alleged that he had transferred the assets in question for estate planning purposes in order to preserve his mother's assets from Medicaid. He maintained that he merged the decedent's assets with his own for convenience, but that he utilized the monies and the income therefrom for his mother's benefit during her lifetime.

Nevertheless, after the decedent's death, the defendant retained the assets for himself. Moreover, he admitted that he transferred the realty in the exercise of his own judgment, and not with the knowledge or direction of his mother, who was suffering from Alzheimer's disease. Additionally, the defendant testified that he made the transfers to himself, despite his awareness that his mother's Will had equally divided her estate between her two children. Indeed, he admitted that when he had asked his mother to change her Will she became upset with him.

The court opined that an attorney-in-fact has the duty to act in good faith towards his principal in accordance with principles of loyalty and fair dealing. Consistent with this duty, an agent may not make a gift to himself or a third party of the money or property entrusted to his charge which is the subject of the agency relationship. In the event such a gift is made, a presumption of impropriety is created, which can only be rebutted with a clear showing that the principal intended to make the gift.

Based upon these principles, the court concluded that the defendant's explanation, that he merged his mother's assets with his own for convenience, was insufficient to rebut the presumption of impropriety. The court found that there was no necessity for the defendant to put his mother's assets in his own name in order to pay her expenses, when he could do so as her attorney-in-fact.

Moreover, the court held that there was nothing in the record, apart from the defendant's self-serving statements, which indicated that the decedent intended to make a gift of all of her property to the defendant, or that she was even competent at the time the transfers were made in order to make such a decision.

Consequently, the court determined that the defendant's conduct, in making the transfers of real and personal property to himself, amounted to a breach of duty and self-dealing in contravention to the decedent's desires, expressed in her Will, that her assets be divided equally between her children, and directed that the funds and property be restored to the plaintiff estate.

Musacchio v. Romagnoli, N.Y.L.J., June 16, 2006, p. 25 (Sup. Ct., Westchester Co.) (Justice Colabella).

Constructive Trust

In a contested proceeding pursuant to SCPA 2103, the Appellate Division, Second Department, affirmed an Order of the Surrogate's Court, Suffolk Co. (Czygier, J.), which dismissed the petition pursuant to CPLR 3211(a)(5) and (7).

The executor of the decedent's estate instituted the proceeding to discover, and to have delivered, certain real property that had been transferred to the respondent, his brother, by his deceased parents, and which he alleged his brother promised to hold for the benefit of his five siblings. The property had been the subject of a Supreme Court action instituted against the respondent by another sibling, who sought the imposition of a constructive trust, which had been dismissed on the basis of documentary proof that had established that the property had never been owned by the parties' parents.

The Surrogate's Court dismissed the proceeding on the basis of collateral estoppel, the statute of limitations and failure to state a cause of action. The Appellate Division affirmed finding, *inter alia*, that the petition failed to state a cause of action for the imposition of a constructive trust, i.e., a promise and a transfer in reliance thereon. Specifically, the Court held that the affidavits submitted by the petitioner contained only conclusory assertions and were contradicted by the documentary evidence, which revealed that the petitioner's parents never owned the property in question when it was conveyed.

Moreover, the Court found that the cause of action was barred by the doctrine of collateral estoppel, inasmuch as the identical issue was litigated in the prior Supreme Court action, and that the petitioner and the plaintiff, who had a full and fair opportunity to be heard in that action, were in privity with each other, as they were asserting the same right to the property.

In re Noble, N.Y.L.J., July 24, 2006, p. 39 (App. Div. 2d Dep't).

Elective Share

In a contested proceeding to determine the validity of an elective share, the petitioner, the 92-year-old widow of the decedent, moved for summary judgment dismissing the answer of the preliminary executrix who claimed that the petitioner, her mother, had abandoned the decedent prior to his death. The respondent cross-moved for an order compelling her mother to give further deposition testimony.

The record revealed that the decedent died in 2002, survived by the petitioner, his wife, and two children, an adult son and daughter. Pursuant to the pertinent provisions of his Will, the decedent left the bulk of his estate to his daughter, her husband, and her children. The widow's only interest under the instrument is a life estate in one-half of the income of a pre-residuary trust, together with an interest in so much of the principal of said trust as the trustee should decide. The decedent's daughter is the trustee. The Will contains an *in terrorem* clause.

The petitioner did not file objections to probate but filed a notice of election against the Will. The preliminary executrix opposed alleging that after 60 years of marriage her mother had abandoned her father, the decedent, prior to his death. Because of her age and health, an open commission was issued to preserve the petitioner's testimony through a deposition in California. The deposition proceeded for several hours over the course of two days.

Initially, the court rejected the respondent's contention that the petitioner's elective share should not be addressed until such time as the propounded Will was probated. The court opined that the widow's inheritance rights would be affected whether the Will was probated or not.

With respect to the petitioner's motion for summary judgment, the court concluded, upon review of the record, that a "myriad" of factual issues existed that precluded judgment in petitioner's favor. Specifically, the court noted that the nature of the decedent's relationship with the petitioner subsequent to heir separation, the circumstances under which the decedent left the marital home, and the impetus for the petitioner's move to California were matters that affected the issue of abandonment, and required an assessment of the credibility of the parties and witnesses on their behalf.

Finally, with regard to the respondent's cross-motion, the court concluded that the petitioner's deposition was unduly interrupted by repeated and improper objections and instructions not to answer. The court referred to recent amendments to the Uniform Rules for Trial Court which state that a lawyer may only direct a witness not to answer where the question is plainly improper and would, if answered, cause significant prejudice.

Accordingly, the court denied petitioner's motion for summary judgment, and allowed a further examination of the petitioner limited to areas that were not covered in her first examination because of "inappropriate" instructions not to answer.

In re Estate of Arrathoon, N.Y.L.J., August 30, 2006, p. 29 (Surrogate's Court, New York Co.) (Surr. Roth).

Gift

Before the court were causes of action in which, *inter alia,* the plaintiff sought return of a diamond engagement ring that he gave the defendant in contemplation of marriage, and sought $40,000 from her, the value of the ring, for unjust enrichment.

The court held that inasmuch as plaintiff was still married at the time he gave defendant the ring, his causes of action under Civil Rights Law Section 80-b to recover gifts in contemplation of a marriage that did not occur had to be dismissed. An agreement to marry, when one of the parties is still married, is void as against public policy, and it is not rendered valid by the fact that the married party contemplates divorce.

Callahan v. Parker, N.Y.L.J., August 1, 2006, p. 22 (Sup. Ct., New York Co.) (Justice Acosta).

Gift

In *In re Estate of Hoffman*, the issue before the court was the validity of an *inter vivos* transfer of real property. The petitioner, executrix of the estate, maintained that the realty was conveyed by the decedent to one of her children with the intent that she hold it for the benefit of all the decedent's children. The respondent maintained that the property was conveyed to her unconditionally.

The record revealed that the decedent met with her attorney after the death of her husband in order to discuss the settlement of his estate as well as the disposition of her own assets. At that meeting, the decedent discussed her displeasure with all of her children, but for the respondent whom she stated was taking care of her. A subsequent meeting was scheduled, at which time counsel and the decedent explored the possibility of leaving the decedent's home to the respondent or anyone else. Counsel testified that the decedent wanted to make sure that the respondent got her home, subject to a life estate, and to remove the respondent from her Will. Thereafter, the requisite documents were executed, together with a power of attorney in favor of the petitioner and the respondent.

The court opined that the respondent had the burden of proving a valid gift of the subject realty, and that as a result of the confidential relationship between the parties, the transfer would be subject to strict judicial scrutiny. To that extent, the court noted that although complete divestiture of title is requisite to a valid gift, such divestiture will not be impacted even when the donor retains a life estate. Additionally, acceptance will be presumed where the gift is of value, and symbolic delivery can be found through the execution of a deed.

Within this context, and based upon the testimony at trial, the court held that the respondent had established the elements of a valid gift of the subject realty by clear and convincing evidence, and that the conveyance was not the product of fraud, duress, or undue influence. To the contrary, the evidence revealed that the decedent struggled for months over the best method to achieve her stated objective of transferring her home to the child she believed was spending the most time with her after her husband's death.

In re Estate of Hoffmann, N.Y.L.J., July 31, 2006, p. 49 (Surrogate's Ct., Suffolk Co.) (Surr. Czygier).

Probate-Undue Influence

In a contested probate proceeding, the petitioners moved for summary judgment dismissing the objections to the propounded Will on the basis of undue influence.

In support of her claim of undue influence, the objectant pointed to the fact that the instrument offered for probate disinherited her as the only natural child of the decedent, and gave the entire estate to charity. The objectant maintained that the decedent was not prone to be charitable and did not make any sizable gift or donation to Israel or Israeli entities.

Petitioners, however, produced a prior testamentary document executed by the decedent in which she also disinherited the objectant, and, in the event her spouse predeceased her, left her entire estate to Israel and its Prime Minister. Further, in this instrument, the decedent named her attorney at the time to serve as the executor. Seven subsequent instruments, but for one, also disinherited the objectant, and the instrument that did not was drafted by her personal attorney, and left her only a nominal amount in addition to naming her co-executor.

The court rejected the objectant's claim that the nomination of the decedent's attorney as executor and trustee was the equivalent of a bequest to him under the instrument.

Further, although objectant alleged that he was planning on calling a physician at trial in support of her claim, an affidavit as to what he would be testifying to was omitted.

Accordingly, the court held that objectant had failed to raise a triable issue of fact in opposition to summary judgment in petitioners' favor, and the objections to probate were dismissed.

In re Estate of Coopersmith, N.Y.L.J., July 27, 2006, p. 28 (Sur. Ct., Queens Co.) (Surr. Nahman).

Revocation of Will

The decedent and her husband executed mutual Wills in 1982, wherein they each agreed that neither would revoke the respective documents. After her husband's death, the decedent executed a 1989 Will that slightly varied the bequests in the 1982 instrument.

The petitioner sought to probate a copy of the 1982 Will claiming that the original had been lost. The guardian *ad litem* appointed to represent the interests of missing and unknown distributees objected to the petition, while a guardian *ad litem* appointed to represent the interests of an incapacitated legatee consented.

The court found that the 1982 Will had been revoked by the 1989 Will both by its express terms and by operation of law. It was the execution of this instrument and not its probate that effected the revocation.

The court further found that the execution of the 1989 Will had been supervised by an attorney and contained an attestation clause, which created a presumption that the statutory requirements for due execution had been complied with.

Accordingly, the court dismissed the petition for probate of the 1982 Will, and directed the petitioner to commence a proceeding for probate of the 1989 instrument.

In re Estate of De Lutri, N.Y.L.J., June 22, 2006, p. 27 (Sur. Ct., Nassau Co.) (Surr. Riordan).

Undue Influence

In a contested proceeding for the appointment of an Article 81 guardian, the issue before the court was, *inter alia,* the validity of a conveyance of the AIP's home to her son, a cross-petitioner for guardianship, and his son's wife, subject to a life estate. The petitioner maintained that the conveyance took place at a time when the AIP lacked capacity, and that it was the product of undue influence.

The court held that while, in the ordinary case, the burden of proving undue influence is on the party asserting it, if a confidential relationship exists, the burden shifts to the beneficiary of the transaction to establish by clear and convincing evidence that the transaction was fair and freely made. Nevertheless, the existence of a close family relationship does not, in itself, create a presumption of undue influence, nor could such a presumption be found despite the AIP's dependence upon her son and his wife due to her declining health. Indeed, the court concluded that the proof established by clear and convincing evidence that the AIP had desired to give her home to her son, and that the subject conveyance was the result of gratitude for the care he had and would be continuing to provide for her, rather than undue influence.

As to the issue of the AIP's capacity at the time of the transfer, the court opined that persons suffering from a disease are not presumed to be wholly incompetent, but rather, are presumed competent until the contrary is shown. To this extent, the court found persuasive the testimony of the AIP's treating physician, who stated that the AIP was able to understand the nature of the transaction, despite her mental frailties, and that she was lucid at the time of the execution of the deed. In contrast, the court accorded less weight to the testimony of the physician called by the petitioner, who had evaluated the AIP on a single occasion, eight months after the transfer. Further, the court found the testimony of the attorney who supervised the execution of the deed to be credible of the AIP's capacity at the time of the transfer.

Accordingly, based upon the record, the court held that notwithstanding the AIP's affliction with senility of the Alzheimer's type, the petitioner had failed to meet her burden of rebutting the presumption of competency or overcoming the proof of the AIP's lucidity at the time of the challenged transfer.

The validity of the contested conveyance was therefore sustained.

In re Margaret S., N.Y.L.J., July 14, 2006, p. 23 (Sup. Ct., Richmond Co.) (Justice Giacobbe).

Ilene S. Cooper, Esq., Partner Farrell Fritz, P.C., Uniondale, N.Y.

Section Committees & Chairs

The Trusts and Estates Law Section encourages members to participate in its programs and to contact the Section Officers or Committee Chairs for information.

Committee on Charitable Organizations
Richard P. Wallace (Chair)
P.O. Box 1530
Troy, NY 12181

Ronni G. Davidowitz (Vice-Chair)
575 Madison Avenue, 21st Floor
New York, NY 10022

Robert W. Sheehan (Vice-Chair)
101 Park Avenue
New York, NY 10178

Committee on Continuing Legal Education
Marion Hancock Fish (Chair)
1500 MONY Tower I
Syracuse, NY 13221

John G. Farinacci (Vice-Chair)
300 Garden City Plaza
Garden City, NY 11530

Magdalen Gaynor (Vice-Chair)
10 Bank Street, Suite 650
White Plains, NY 10606

Committee on Elderly and Disabled
Robert Kruger (Chair)
225 Broadway, Room 4200
New York, NY 10007

Anthony J. Enea (Vice-Chair)
245 Main Street, 3rd Floor
White Plains, NY 10601

Robert M. Freedman (Vice-Chair)
521 Fifth Avenue, 25th Floor
New York, NY 10175

Lisa K. Friedman (Vice-Chair)
370 Lexington Avenue, Suite 1205
New York, NY 10017

Warren H. Heilbronner (Vice-Chair)
2400 Chase Square
Rochester, NY 14604

Kathryn Grant Madigan (Vice-Chair)
P.O. Box F-1706
Binghamton, NY 13902

Committee on Electronic Filings
Wallace L. Leinheardt (Chair)
300 Garden City Plaza, 5th Floor
Garden City, NY 11530

Committee on Estate Litigation
Jonathan J. Rikoon (Chair)
919 Third Avenue
New York, NY 10022

Karin J. Barkhorn (Vice-Chair)
1290 Avenue of the Americas
New York, NY 10104

Gary E. Bashian (Vice-Chair)
235 Main Street, 6th Floor
White Plains, NY 10601

Hon. John M. Czygier, Jr. (Vice-Chair)
320 Center Drive
Riverhead, NY 11901

Stephen B. Hand (Vice-Chair)
300 Garden City Plaza
Garden City, NY 11530

Barbara Levitan (Vice-Chair)
31 Chambers Street, Room 401
New York, NY 10007

John R. Morken (Vice-Chair)
West Tower, 14th Floor
EAB Plaza
Uniondale, NY 11556

Marilyn Ordover (Vice-Chair)
177 Montague Street
Brooklyn, NY 11201

Committee on Estate Planning
Ian William MacLean (Chair)
100 Park Avenue, 20th Floor
New York, NY 10017

Susan Taxin Baer (Vice-Chair)
399 Knollwood Road, Suite 212
White Plains, NY 10603

Philip A. DiGiorgio, Jr. (Vice-Chair)
20 Corporate Woods Boulevard, 3rd Floor
Albany, NY 12211

Richard E. Schneyer (Vice-Chair)
900 Third Avenue
New York, NY 10022

Linda J. Wank (Vice-Chair)
488 Madison Avenue, 9th Floor
New York, NY 10022

Committee on Estate and Trust Administration
Ilene S. Cooper (Chair)
1320 Reckson Plaza
Uniondale, NY 11556

David J. Arcella (Vice-Chair)
630 Fifth Avenue, 38th Floor
New York, NY 10111

Janet L. Blakeman (Vice-Chair)
1133 Avenue of the Americas
New York, NY 10036

Victoria L. D'Angelo (Vice-Chair)
5888 Main Street
Williamsville, NY 14221

Committee on Governmental Relations
Thomas J. Collura (Chair)
54 State Street, Suite 803
Albany, NY 12207

Thomas E. Dolin (Vice-Chair)
32 Swift Road
Voorheesville, NY 12186

Michael K. Feigenbaum (Vice-Chair)
East Tower, 15th Floor
1425 Reckson Plaza
Uniondale, NY 11556

Committee on International Estate Planning
Beth D. Tractenberg (Chair)
575 Madison Avenue
New York, NY 10022

Gerard F. Joyce, Jr. (Vice-Chair)
452 Fifth Avenue, 17th Floor
New York, NY 10018

Michael Joseph Parets (Vice-Chair)
575 Madison Avenue
New York, NY 10022

Daniel S. Rubin (Vice-Chair)
405 Lexington Avenue
New York, NY 10174

Committee on Legislation
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57 Worth Street
New York, NY 10013

Richard J. Bowler (Vice-Chair)
10 Bank Street, Suite 650
White Plains, NY 10606

Amy Karp (Vice-Chair)
120 Broadway
New York, NY 10271

Richard J. Miller, Jr. (Vice-Chair)
767 Third Avenue
New York, NY 10017

Eric W. Penzer (Vice-Chair)
1320 Reckson Plaza
Uniondale, NY 11556

Lenore W. Tucker (Vice-Chair)
39 Broadway, Suite 2420
New York, NY 10006

Committee on Life Insurance and Employee Benefits
Elizabeth A. Hartnett (Chair)
101 South Salina Street
Syracuse, NY 13221

Robert F. Baldwin, Jr. (Vice-Chair)
100 Clinton Square
126 North Salina Street, Suite 320
Syracuse, NY 13202

Amy J. Maggs (Vice-Chair)
240 Washington Avenue Extension
Albany, NY 12205

Susan B. Slater-Jansen (Vice-Chair)
1221 Avenue of the Americas
New York, NY 10020

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George E. Riedel, Jr. (Chair)
42 Delaware Avenue, Suite 120
Buffalo, NY 14202

Committee on Newsletter and Publications
Austin T. Wilkie (Chair)
195 Broadway
New York, NY 10007

Michael S. Markoff (Vice-Chair)
123 Main Street, Suite 900
White Plains, NY 10601

Committee on Practice and Ethics
S. Jeanne Hall (Chair)
One Rockefeller Plaza, Suite 301
New York, NY 10020

Carl T. Baker (Vice-Chair)
One Broad Street Plaza
Glens Falls, NY 12801

Ralph M. Engel (Vice-Chair)
1221 Avenue of the Americas
New York, NY 10020

Bonnie McGuire Jones (Vice-Chair)
5 Emma Lane
Clifton Park, NY 12065

Jerome L. Levine (Vice-Chair)
345 Park Avenue
New York, NY 10154

Committee on Surrogates Court
Stacy L. Pettit (Chair)
16 Eagle Street
Albany, NY 12207

Maureen A. Conley (Vice-Chair)
6 Pheasant Lane
Delmar, NY 12054

Staci A. Graber (Vice-Chair)
350 Broadway, Suite 515
New York, NY 10013

Robert W. Johnson, III (Vice-Chair)
P.O. Box 1530
Troy, NY 12181

Committee on Taxation
David A. Pratt (Chair)
80 New Scotland Avenue
Albany, NY 12208

Edward Falk (Vice-Chair)
4 Times Square, 23rd Floor
New York, NY 10036

Deborah S. Kearns (Vice-Chair)
29 British American Boulevard
Latham, NY 12110

Georgiana James Slade (Vice-Chair)
1 Chase Manhattan Plaza
New York, NY 10005

Committee on Technology
Gary R. Mund (Chair)
2 Johnson Street, Room 210
Brooklyn, NY 11201

David Goldfarb (Vice-Chair)
350 Fifth Avenue, Suite 1100
New York, NY 10118

Ad Hoc Committee on Multi-State Practice
Amy B. Beller (Chair)
2300 Glades Road, Suite 400 East
Boca Raton, FL 33431

Philip G. Hull (Vice-Chair)
1540 Broadway
New York, NY 10036

Ronald S. Kochman (Vice-Chair)
222 Lakeview Avenue, Suite 950
West Palm Beach, FL 33401

William P. LaPiana (Vice-Chair)
57 Worth Street
New York, NY 10013

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NEW YORK STATE BAR ASSOCIATION
TRUSTS AND ESTATES LAW SECTION
NYSBA One Elk Street, Albany, New York 12207-1002

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