



Probate and Trust Law Section Newsletter

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IN THIS ISSUE

REPORT OF THE CHAIR

BY JUDY STEIN, ESQUIRE | BNY MELLON

I am honored and privileged to be Chair of the Probate and Trust Law Section of the Philadelphia Bar Association. Note the second part of that sentence—"of the Philadelphia Bar Association". I have been active in both the Section and the Philadelphia Bar Association as a whole during my legal career, so I have taken for granted that everyone understands how and where the Section fits in to the Bar Association. I have recently discovered that I am wrong! Therefore, this column will be a brief tutorial that puts our wonderful, active and successful Section in context.

The Philadelphia Bar Association, founded in 1802, is the oldest association of lawyers in the United States. Those associated with the legal profession, including attorneys, judges, and politicians, look to the Philadelphia Bar Association for an organized meeting ground for professional support and information sharing and sometimes for guidance on controversial legal issues. Non-lawyers of the Philadelphia community count on,

and look to, the Philadelphia Bar Association for general information on how to address their legal issues and where they can go to find additional information and help. The Philadelphia Bar Association also administers the Commission on Judicial Selection and Retention, which vets and then makes recommendations to the public for all Philadelphia judicial candidates for Common Pleas Court and Municipal Court. As Chair of the Section, I am participating in that process this year. Like other organizations, the Bar Association has an Executive Director, Mark Tarasiewicz, and is governed by a Board (the Board of Governors, sometimes known as BOG) and officers. The Bar Association has ten Sections, including ours. Ours is one of the largest. See Diagram A.

The Probate and Trust Law Section has four officers: the Chair, the Chair-Elect, the Vice-Chair and the Secretary. In 2015, those offices are being filled respectively by me, Aaron Fox, Laura Stegossi and Rise Newman. The Section is governed by the Executive Committee, but

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NEWSLETTER ARTICLES

Would you like to see something in future issues of the Probate and Trust Law Section Newsletter? Then why don't you write it? If you are interested, please contact the Editor:

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REPORT OF THE CHAIR, CONTINUED

the real business of the Section is done in its nine Committees, as you have heard many times in the past. See Diagram B.

There are many opportunities to get involved in our Section. All of us who have been active over the

years can attest to the fact that it has enhanced our law careers and practices (and sometimes our incomes!), both personally and professionally. If you are not already participating in one of the Sections, I invite you to join. I can assure you

that you will get out of it much more than you put in, and you will be part of carrying on the great tradition of the Philadelphia Bar Association.

To get involved, please feel free to contact me directly at judith.stein@bnymellon.com; 215-553-2328.

Diagram A

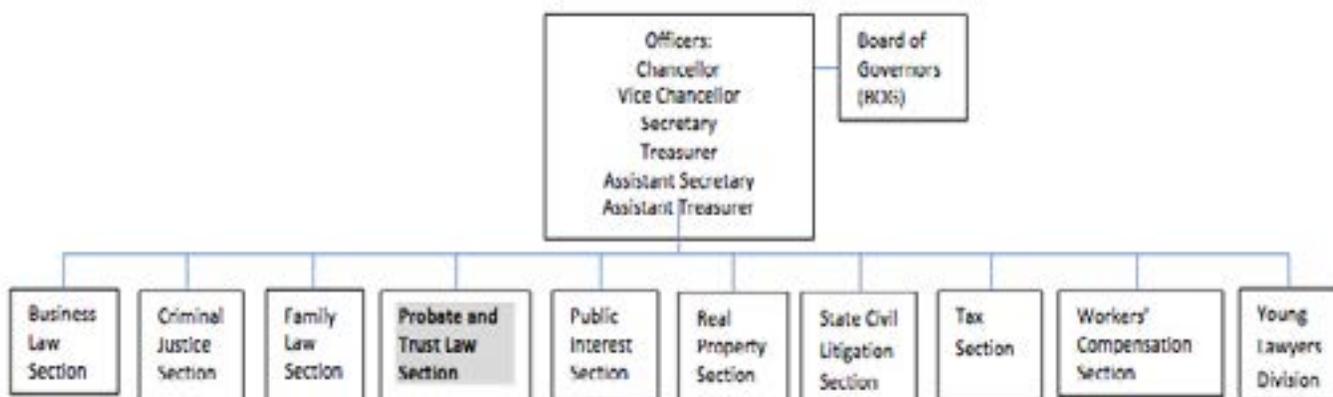
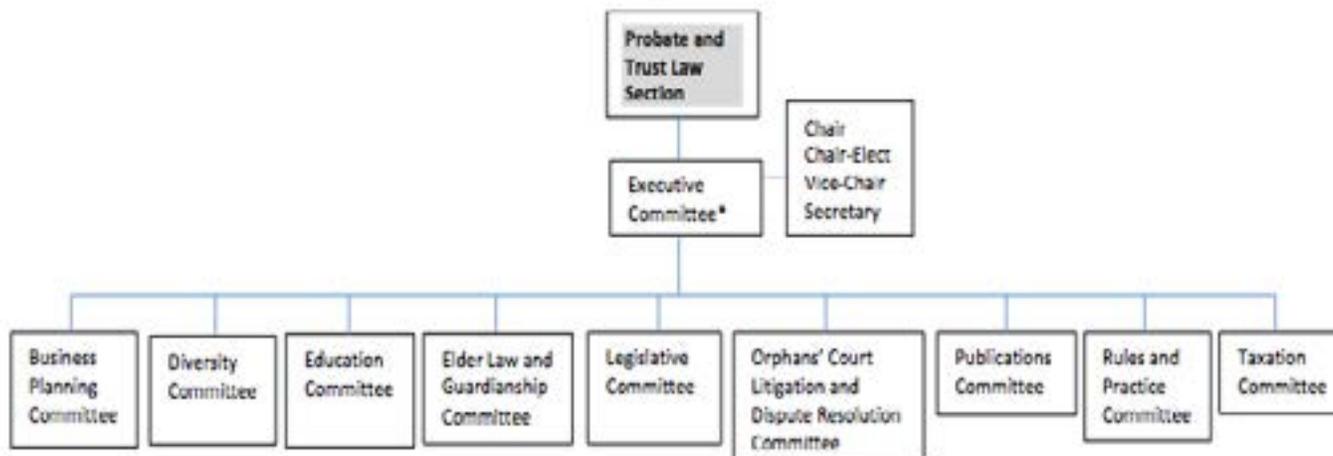


Diagram B



ACT 95: PENNSYLVANIA'S NEW POA LAW – A VIEW FROM THE FIDUCIARY LITIGATION TRENCHES

BY TIMOTHY J. HOLMAN, ESQUIRE | SMITH KANE HOLMAN, LLC

As one who spends significant time in the Orphans' Court dealing with the carnage wrought by wayward Agents under Powers of Attorney, my review of Pennsylvania's new Act 95 (which amends Title 20, Chapter 56 (20 Pa. C.S. §§ 5601-5612)) focuses on its attempts to clarify the rights and obligations of Principals and Agents. Did the new statute get everything right? Not if you ask me. Is it a marked improvement over prior law? It sure is. Will it end all litigation related to powers of attorney? No. Will it create even more litigation related to powers of attorney? I tend to think so.

In this article, I will address a few of the aspects of the new law relevant to fiduciary litigation, and will suggest ways that estate planners and financial institutions may avoid, or at least better position themselves for, litigation related to powers of attorney and their abuse. This article is a preview of my upcoming presentation at the March 3, 2015, Philadelphia Bar Association Probate and Trust Law Section CLE entitled "The New Pennsylvania Power Of Attorney Statute: What You Need To Know NOW."

Should You Draft Your Power of Attorney Documents to Confer Standing upon Third Persons to Review the Agent's Conduct/ Transactions During the Principal's Lifetime?

Under Pennsylvania's new Power of Attorney (at times, "POA") law, "[e]xcept as otherwise provided in the power of attorney, an agent shall not be required to disclose receipts, disbursements or transactions conducted on behalf of the principal unless ordered by a court or requested by the principal, a guardian, conservator, another fiduciary acting for the principal, governmental agency having authority to protect the welfare of the principal or, upon the death of the principal, the personal representative or successor in interest of the principal's estate." 20 Pa. C.S. § 5601.3(d)(1).

This provision essentially codifies long-standing law limiting the class of folks with the legal right to learn anything about actions by an Agent during the Principal's lifetime. Indeed, standing issues pervade power of attorney dispute litigation. See, e.g., *Griggs Estate* (No. 2), 2 Fiduc. Rep. 3d 354 (O.C. Chester County 2012) (holding that only the Executor of Decedent's Estate or the Trustee of Decedent's Trust had standing to compel Decedent's Agent under a Power of Attorney to Account – expressly denying standing to Decedent's widow, who was not a beneficiary of her husband's Estate, but was the beneficiary of her husband's Revocable Trust, and in all events

could have taken an elective share).

Please focus, however, on the language, "except as otherwise provided in the power of attorney," because the Legislature thereby emphasized to planners that planners can modify their POA documents to suit the individual situation, including by giving a third person the right to receive information during the Principal's lifetime about the Agent's actions. As someone who deals regularly with the tragedies which unfold from un-checked Agents, I believe that every estate planner should speak with every client about whether the client wishes to give the right to his or her children (or other relatives or trusted persons) to receive information before Decedent dies about the Agent's conduct on behalf of the Principal.

Any given client may have a valid need or preference that the Agent be allowed to conduct the Principal's affairs without interference from or requests by children or others for information. By expressly authorizing others to inquire into these matters, however, a Principal may protect herself and her ultimate heirs, because otherwise, no one is monitoring the Agent – particularly once the Principal has lost capacity, which, in my experience, is when things tend to get interesting.

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ACT 95, CONTINUED

Once the Principal loses capacity, the Agent is truly a “free Agent,” and unless your client has empowered another person to at least look over the Agent’s shoulder by reviewing financial records periodically, then no one will likely ever find out what the Agent is up to until the Principal dies. If the Agent has, in the meantime, looted and spent the Principal’s assets, then an uncollectible surcharge verdict will seem rather dissatisfying to the Estate beneficiaries who would have received an inheritance but for the Agent’s misconduct.

To avoid creating a scenario where the designated “extra set of eyes” abuses that privilege, consider placing limits on that right in terms of timing. For example, you might suggest to your client that the Principal’s designated relative or trusted friend would have the right only every six (6) months or even annually to receive copies of records documenting the Agent’s conduct. You can use Pennsylvania’s new statutory language as a springboard for a conversation with your client about this critical issue.

To get to the heart of the issue and to help your client understand the stakes, it seems to me that you could ask your client, “If you are hit by a bus tomorrow and rendered fully incapacitated under the law, but will live another ten years, do you want your chosen Agent to be the only person during that ten

years who knows what is happening to your money and other assets? Or do you want to consider giving someone else you trust the ability to look over the Agent’s shoulder by getting receipts from the Agent and being advised of transactions?”

In addition to authorizing a designated person to review receipts or receive some sort of informal accounting, planners might consider customizing the POA to state expressly that the Principal also confers standing upon the Principal’s designated third person to seek and receive a Court Accounting of the Agent’s conduct. Without such language in the POA itself, I tend to think that the Orphans’ Court judges will still likely deny standing to anyone other than the Principal during Principal’s lifetime to compel an Agent to file an Account.

But even if a Principal chooses not to authorize a third party to compel the Agent to file an account during the Principal’s lifetime, if the Principal has at least designated a third person to receive financial information, then that person will not be without a remedy if the information received is questionable or not received at all. Indeed, if the Agent fails to produce the required information or produces shady information, then the Principal’s designated third person would then have a solid basis upon which to file a guardianship action. Among traditional oppositions to guardianship petitions is that the alleged incapacitated person

previously identified an Agent, who steps up in Court as the proposed Guardian. But if that Agent has already proven that he is incapable or unwilling to provide essential information about his conduct as Agent, then he would seem to be ill-suited to serve as Guardian.

Provided that you help your clients understand the stakes when they name Agents, and establish a logical and fair protocol for the periodic oversight of the Agent by another trusted person, then many of your Principal clients might well want their Agents to “account” periodically to that trusted person. Agents unwilling or unable to provide the requisite level of detail of their actions and expenditures on a regular basis should not be Agents at all, and ensuring via the Power of Attorney that you draft that one or more trusted persons would receive that information would surely spare many families significant heartache, disappointment, financial ruin and, frankly, litigation.

Will You be Immune or Liable for Accepting a Power of Attorney and Following the Agent’s Instructions?

Tension has always existed between the need and desire for Agents to act, at times promptly (if not immediately), and the countervailing need of financial institutions or anyone else presented with a Power of Attorney to satisfy themselves of the validity of the Power of Attorney before accepting

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ACT 95, CONTINUED

it. In *Vine v. Commonwealth*, 607 Pa. 648 (2010), the Pennsylvania Supreme Court held that a third party that acts in accordance with the instructions set forth in a facially valid Power of Attorney can be held liable to the Principal if it turns out that the Agent procured the Power of Attorney by fraudulent or improper means. But how would a third party know that a document which on its face complies with Pennsylvania law was obtained improperly? The *Vine* decision created significant uncertainty in a system which craves absolute certainty.

In direct response to the *Vine* conundrum, on the one hand the new POA law immunizes from liability those who accept a facially valid Power of Attorney, provided that they lack knowledge that the power of attorney document is void, that the Agent is exceeding his authority or otherwise. 20 Pa. C.S. § 5608(d). On the other hand, the new POA law allows anyone with concerns about the validity of the document or the proposed conduct of an Agent to insist upon receipt of: (1) an Agent's certification under penalty of perjury of any factual matter concerning the principal, agent, or power of attorney, (2) a translation of the power of attorney if it contains a language other than English, and (3) an opinion of counsel relating to whether the Agent is acting within the scope of

the authority granted by the Power of Attorney. 20 Pa. C.S. § 5608(e)

My sense is that customers assume that their financial institutions, which seem to pay awfully close attention to their credit card activity to root out fraud, also pay attention to transactions in their customers' checking and savings accounts – especially when the Bank knows that an Agent is acting in lieu of the Principal. Pennsylvania's new POA law authorizes an alert financial institution to request from the Agent the types of information that could nip a catastrophic problem in the bud by preventing improper transactions from ever occurring. How long will it take before a fiduciary litigator is confronted with a case presenting an opportunity to test any given financial institution's claim that it "lacked actual knowledge" that a power of attorney was void or that an Agent exceeded her authority in making certain transactions? Not long, I don't think.

Any given bank employee may profess during litigation after the fact to have lacked "actual knowledge" about Agent misconduct, but the computer systems of the banks often contain much information about recent conduct by Agents (including electronic transfers from home) before those Agents happened to present themselves in person to the Bank to attempt to implement their next scheme involving the Principal's assets. Because that information

is readily available to the Bank employees who choose to pull up the screen, that seems to me a lot like "actual knowledge" - whether any given Bank employee chose to pull up the account history or not. Indeed, the new statute further states on this point, "an employee has knowledge of a fact if the employee has actual knowledge of the fact or acts with conscious disregard or willful ignorance regarding the existence of the fact." 20 Pa.C.S. § 5608.2(2) (emphasis added).

The New POA Law Contains Many Other New Changes

This article addresses a very small sampling of the many important and substantive changes under Pennsylvania's new POA law. I lacked the space to discuss other important statutory changes related to an Agent's so-called "waivable duties," "hot powers," and more. On March 3, 2015, I will be a co-panelist at the March 3, 2015, Probate and Trust Section CLE on Act 95 – The New POA Law. I will be joined by Peter J. Johnson, Esquire, Senior Vice President of Pennsylvania Trust, who will provide insight from his perspective as counsel to a trust company, and Bradley D. Terebelo, Esquire, of Heckscher, Teillon, Terrill & Sager, P.C., who has prepared an outstanding outline addressing all of the statutory changes, and who will speak specifically to the estate planning issues presented by the new statute.

LIVE SEMINAR

Learn more about the new power of attorney act on on March 3, 2015 at 2:30 pm. during a live seminar titled “The New Pennsylvania Power of Attorney Statute: What You Need to Know NOW.”

Panelists will include:

Jonathan D. Sokoloff, Esq., Diamond Polsky & Bauer, Philadelphia

Laura E. Stegossi, Esq., Weber Gallagher, Philadelphia

Timothy J. Holman, Esq., Smith Kane Hollman, LLC, Malvern

Peter J. Johnson, Esq., The Pennsylvania Trust Company, Radnor

Bradley D. Terebelo, Esq., Heckscher Teillon Terrill & Sager, P.C., West Conshohocken

To Register:

<http://www.legalspan.com/pbi/calendar.asp?UGUID=&ItemID=20141211-229194-95014>

JOIN A COMMITTEE

The Section's Committees depend on the steady flow of people, energy and ideas. Join one!
Contact the Section Chair:

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215-553-2328

TAX UPDATE

BY MARGERY J. SCHNEIDER, ESQUIRE | ROSENN JENKINS & GREENWALD , LLP

THE FEDERAL GIFT

Valuation

Estate of Elkins v. C.I.R., No. 13-60472, 2014 WL 4548527 (5th Cir. Sept. 15, 2014)

On appeal, the Fifth Circuit reversed the Tax Court's opinion in *Estate of Elkins v. Commissioner* (140 T.C. No. 5, March 11, 2013) and accepted the discounts, ranging from 52 percent to 80 percent, that were offered at trial by the Estate's expert witnesses. The Estate received a \$14 million estate tax refund.

At his death in 2006, James Elkins owned a 73% interest in 61 works of art and a 50% interest in three works of art, all of which were primarily located in his house or office. His children owned the remaining interests in the artwork during his lifetime and inherited their father's interest at his death.

The IRS denied the 44.75 percent fractional interest discount claimed by the decedent's Estate in valuing his interests and claimed that no discount was applicable because there was no recognized market for the sale of the decedent's fractional interest. The IRS offered no expert testimony as evidence of the appropriate discount.

The Tax Court held that the interests should be valued using the hypothetical "willing buyer/willing seller" test, but concluded that the

decedent's children would ask for little or no discount in purchasing the decedent's interest. It ruled that a 10% discount was appropriate.

The Fifth Circuit agreed with the Tax Court that fractional ownership discounts are applicable to interest in artwork. The Fifth Circuit stated that because the IRS had not upheld its burden of proof, the Tax Court's judgment should have been for the estate. It noted that the Tax Court lacked any evidence or legal arguments to support its decision that a 10% discount was appropriate and, furthermore, that the Tax Court's reasoning that the children, motivated solely by their desire to consolidate their ownership interest in the artwork, would be willing to pay a higher price than an unrelated buyer, was flawed because it disregarded the other factors that would affect the price that hypothetical buyers and sellers would agree on.

FEDERAL GIFT TAX

Merger of Family Businesses

Cavallaro v. Commissioner, T.C. Memo. 2014-189 (September 17, 2014)

The Tax Court held that the tax-free merger of two family-owned businesses resulted in a large taxable indirect or constructive gift under IRC § 2511. The gift consisted of intellectual property that had been

developed and financed by the parents' company.

The parents incorporated Knight Tool Co. ("Knight"), a machine tool business, in 1976. Eleven years later, their sons formed Camelot Systems ("Camelot") to improve on and produce a proprietary product developed by Knight. Knight and Camelot merged in 1995. The taxpayers claimed that the transfers of the intellectual property required to produce the product took place at the time that Camelot was formed, but the Court found that the evidence showed that the intellectual property belonged to the parents' company until the merger and that Camelot acted purely as a sales agent for the proprietary product, which Knight engineers continued to improve upon.

The Court held that the "fiction of a 1987 transfer [was] concocted by the taxpayers' attorney at the time of the merger." T.C. Memo 2014-189 at 24. The companies' attorney and accountant created affidavits and a "Confirming Bill of Sale" which purported to show that the product technology was transferred to Camelot in 1987.

The parents received 19% of the stock and the sons received 81% upon the merger of the two companies in 1995. The merged company was sold for \$57 million in 1996.

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TAX UPDATE, CONTINUED

The court found that the 1995 merger was not an arm's length business arrangement and that the stock was substantially overallocated to the sons and underallocated to the parents in the merger. It held that the taxpayers had made a gift of \$29.6 million to their sons because of the disproportionate allocation and should have filed a gift tax return.

The taxpayers avoided penalties by demonstrating their good-faith reliance on the advice of professional tax advisers, however misguided.

Taxable Gift Under IRS § 2701

CCA 201442053 (October 23, 2014)

The IRS ruled that, under IRC § 2701, a taxpayer made gifts to her children when she recapitalized a family-owned LLC. Section 2701 applies to recapitalizations in which a taxpayer holds an "applicable retained interest" that is subordinate to the transferred interests and receives property as a result of the recapitalization.

Here, the taxpayer, who was the sole member to have made a capital contribution, gifted membership shares to her children and grandchildren. The initial operating agreement, which provided that distributions, profits and losses were to be allocated pro rata to the members according to their membership interests, was

amended to state that all profits and losses were to be allocated to the two sons in exchange for their agreement to manage the LLC. The taxpayer and the grandchildren retained the right to distributions in proportion to their capital account balances. This right was senior to the right to the profits and losses that was transferred to the sons, and the agreement to manage the LLC was the consideration received by the taxpayer in the recapitalization.

The value of the gift to the sons, as determined by the subtraction method, was calculated by subtracting the fair market value of the interests carrying distribution rights from the full value of the company. The distribution rights transferred to the sons was the proportion of their relative ownership as compared to that of the grandchildren.

Reformation of Trust for Gift Tax Purposes

PLRs 201442042 – 201442046
(October 17, 2014)

In these five Private Letter Rulings the taxpayers asked the IRS to approve a trust reformation made by a state court to correct a "scrivener's error" and to effectuate the intent of the grantor.

The state court ruling enabled the trust assets to be excluded from the taxpayer's estate. The IRS agreed to respect the trust reformation

because there was clear and convincing evidence that the reformation corresponded to the taxpayer's original intent.

The grantor created two GRATs whose remainder interests were to be transferred to a trust for the benefit of the grantor's children. The grantor was designated trustee of the children's trust. By its terms the children's trust was a revocable trust, and the grantor retained a right to amend, modify or revoke it. The accountant preparing the gift tax returns informed the drafting attorney that the remainder would be includible in the grantor's estate, but the attorney stated that there would be no tax problem. The accountant filed the gift tax return showing the transfers as completed gifts. Sometime later, another attorney noticed the problem and successfully petitioned to reform the trust under state law to correct the scrivener's error of the drafting attorney which rendered the trust contrary to the grantor's intent and to make the trust irrevocable ab initio. The attorney sought a ruling from the IRS concerning the tax consequences of the court's ruling.

The IRS accepted the state court's ruling and confirmed that the children's trust would not be includible in the grantor's estate and that the transfers to the GRATs were completed gifts.

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VALUATION OF MARCELLUS SHALE NATURAL GAS ROYALTY RIGHTS

BY EDWARD A. WILUSZ, ASA, CFA, | VALUE MANAGEMENT INC.
AND PATRICIA M. MCMULLEN | VALUE MANAGEMENT INC.

A common estate planning technique used by property owners in the Marcellus Shale ("Marcellus") area has been to separate the upfront lease payment received for the surface real estate from the subsurface mineral estate. Oftentimes, the royalty rights are placed into a limited liability company (LLC) or a family limited

partnership (FLP) for estate planning or other purposes. Then, LLC membership interests or limited partnership interests are transferred (gifted or sold) to future generations.

The appraisal of the gas royalty rights relating to the Marcellus is a challenging task. The valuation approach typically used is the income approach: determining the present value of the anticipated royalty revenue stream.

This method is based on a number of variables, including: the estimated ultimate recovery ("EUR") of the amount of gas in place; the timing of when, if ever, the wells will be drilled and producing, and the risk or uncertainty associated with the above. This uncertainty is reflected in the timing of when it is assumed that royalties will be generated and in the rate of return that a potential buyer of these royalty rights would require.

Once these factors are determined and the risk properly assessed, a present value is calculated. Properly employing this approach generally requires the expertise and judgment of geologists and valuation experts. The following article will discuss the valuation of the gas royalty rights and the factors impacting value.

Production

As recently as 2005 there was very little interest in leasing properties

for the Marcellus gas production. It was not considered to be an important gas resource and a technology for tapping it had not been demonstrated. At that time there was a high level of uncertainty and the signing bonuses were a few dollars per acre. The Marcellus potential is now being realized due to the implementation of the horizontal drilling technique that allows following the contours of the shale bed. Signing bonuses have increased and had reached as high as \$5,500 per acre; they have since dropped. Gas royalty rates have ranged from 12.5 percent (the Pennsylvania state minimum) to 20 percent. While the up-front bonuses can be significant, the royalty rights can be much greater.

Not all Marcellus regions are equally productive. The richness of the Marcellus is dependent on more than a dozen geological parameters including thickness, depth of burial, degree of faulting, porosity, permeability, total organic carbon, thermal maturity, gas composition, gas pressure, clay content, silica content, water saturation, and other less important factors. Taken together, these parameters may be integrated in the EUR which is provided by a geologist.

A high EUR does not guarantee the receipt of high royalties. Before the gas companies can even start physical preparations for drilling,

TAX UPDATE, CONTINUED

2015 TAX ADJUSTMENTS

Revenue Procedure 2014-6, I.R.B. 2014-47 (Nov. 17, 2014)

Among the tax items adjusted for inflation, effective January 1, 2015, are the following:

- The unified credit for estate and gift tax under IRC §2505 and §2010 is \$5.43 million.
- The GST tax exemption under IRC §2631 is \$5.43 million.
- The gift tax annual exclusion under IRC § 2503 is still \$14,000.
- Under IRC § 2032A, in the case of decedents dying in 2015 the executor's election to use the special use valuation method for qualified real property results in an aggregate decrease in the value of the property which may not exceed \$1.1 million.

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ROYALTY RIGHTS, CONTINUED

they must obtain permission from one of the river basin commissions ("RBC"). To date, there has been much drilling activity in the Susquehanna River Basin but there is still a drilling moratorium in effect the Delaware River Basin (until it adopts regulations that specifically address this activity). The RBCs regulate not only where gas companies can get water for hydraulic fracturing ("fracking") and how much they can take from each source, but also the conveyance, transport and storage of water.

Drillers have to shatter the Marcellus to release the gas trapped in the rock. This is accomplished through fracking, fracturing the shale with high pressure injections of water, chemicals and sand. The sand is pushed into tiny fissures in the shale allowing the gas to escape. The sand lodges in the cracks to keep the fissures open. A frack typically includes additives such as surfactants to keep the sand suspended, polymer friction reducers that speed the mixture and biocides to prevent bacteria.

The development of each production well uses, on average, between 4 and 7 million gallons of water. The RBCs play an important role as they regulate water withdrawals and consumptive water uses in their respective areas. The RBCs require natural gas companies to monitor their water use on each drilling pad on a daily basis and provide quarterly reports of water usage.

Most gas leases permit the pooling and/or unitization of the leased tracts for purposes of applications for well permits and efficient operation of a producing reservoir. While technological advances have increased the horizontal drilling distance, most units are limited to 640 acres (one square mile). The royalty rights holders receive their pro rata share of the royalties generated by the production in that unit. E.g., the owner of the royalty rights connected to 88 acres included in a 640 acre unit will be entitled to royalties on approximately 13.8 percent of the unit's production.

Multiple horizontal wells can be drilled from a single pad which may encompass four to five acres. This helps reduce the impact of drilling on the surface land while providing access to natural gas production from 200 to 400 acres.

Effective March 22, 2010, companies are required to report production data every six months (released the 15th of August and February). The August 15, 2014 report covered January 1 through June 30, 2014.

In the first six months of 2014, Pennsylvania produced 1.94 trillion cubic feet ("tcf") of natural gas, up 14 percent from the second half of 2013 (1.697 tcf), and up 38 percent from the first six months of 2013 (1.406 tcf). Nine of the top ten wells were in Susquehanna County and were drilled by Cabot Oil & Gas. The top five producing Pennsylvania

counties were: Susquehanna, Bradford, Lycoming, Washington and Greene.

Timing

A question having a significant impact on the value of the gas royalty rights is: when will royalties be generated? This is dependent on the drilling activity (or lack thereof) in the area, the time requirements to apply for drilling permits, have permits issued, begin drilling, and complete drilling. Also, before a well can begin production it must be tied into a gas transportation system through a gathering system pipeline. Hence, the proximity of the property to the pipeline impacts timing.

A unit is typically developed over a period of time. Generally, operators will first drill one or two exploratory wells. After analyzing the production from these wells, among other factors, the operator will determine whether or not additional drilling is feasible. Even if operators decide to continue to develop the site, additional drilling may not commence until the necessary gathering system pipeline is in place. Considering the time required to apply for permits, have permits issued and complete a well, subsequent wells may take years to be drilled.

Natural gas production is not evenly distributed over the life of the well. Decline curve models predict the rate of flow as a function of time, initial production rate, and

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ROYALTY RIGHTS, CONTINUED

a parameter that has the units of inverse time. Because there is limited public data to define a Marcellus decline curve precisely, initial information is based on data available in the public domain. It is estimated that the best fit curve for Marcellus wells follow a power-law rate decline. Under this curve, it is estimated that approximately 20 percent of the EUR will be produced in the first 12 months of drilling and 50 percent by year 6. While a well may produce for 50 years, its economic life may be 25 to 30 years.

Risk Factors

There are numerous uncertainties surrounding the potential royalties that a property might generate. Some uncertainties relate to the property itself. Others are more market driven. All have some impact on value. Some of the more pertinent factors are discussed below:

- The speculative nature of the subsurface and mineral estate.
- Inherent uncertainties in interpreting engineering data. There is substantial uncertainty in projecting future production rates. No one can measure underground accumulations of natural gas in an exact way. Accordingly, natural gas reserve engineering requires subjective estimations of those accumulations.

- There is no guarantee that the drilled wells will yield the EUR.
- Operating hazards, including mechanical, technological and/or other operational problems.
- Delays or cancellations of drilling operations for a variety of reasons.
- The potential that laws, such as the FRAC Act, make fracking illegal or commercially impractical. Without fracking, "unconventional" shale plays such as the Marcellus would not be feasible.
- Changes in regulations that RBCs continue to amend to address concerns regarding adverse impacts to water resources.
- Volatility in natural gas prices. The U.S. wellhead price (wholesale/spot) per thousand cubic feet ("mcf") fluctuated between \$3.35 and \$4.27 in 2011 and averaged \$3.91. In 2012¹, the range dropped to between \$1.89 (April 2012) and \$3.35 (November 2012) and the average price per mcf dropped to \$2.64. Wellhead prices continued to fluctuate in 2013. They started at \$3.11 per mcf in January and ended at \$4.05 per mcf in December 2013; the price per mcf averaged \$3.52 in 2013. After reaching a high of \$5.86 per mcf in February 2014, the natural gas wellhead price fell to \$3.27 per mcf by December 2014 and averaged \$4.20 per mcf for the year. Rising prices spur interest.

The lower prices have impacted the drilling activity.

- Changes in governmental regulations or taxation:

The Pennsylvania Legislature enacted a Marcellus Shale overhaul that gave counties the ability to adopt a local impact fee on shale drillers. All 27 counties with producing shale wells, along with another 16 that do not currently have active shale wells, have agreed to assess the fee. The fee, based on the price of natural gas and the Consumer Price Index, will vary from year to year.

The new Pennsylvania governor, Tom Wolf, supports a state tax on Marcellus production.

All of the above are taken into consideration in selecting the rate of return that an investor would require.

Publicly-traded oil and gas companies must use standardized measure of discounted future net cash flows, including a "safe-harbor" discount rate of 10 percent, to value reserves (Accounting Standards Topic 932). This is done to ensure comparability among companies. However, the 10 percent discount rate does not adequately reflect market risks and is oftentimes lower than the publicly-traded oil and gas companies weighted average cost of capital (range from 10.8 percent to 14.4 percent source: Texas Comptroller of Public Accounts 2013

ETHICS COLUMN

BY PAUL C. HEINTZ, ESQUIRE | OBERMAYER, REBMANN, MAXWELL & HIPPEL LLP

May a non-lawyer serving as a fiduciary initiate or defend legal proceedings in the Orphans' Court or any other court on behalf of an estate, trust or principal as agent named in a Power of Attorney without being represented by counsel?

The Pennsylvania courts have consistently held that non-lawyer fiduciaries must be formally represented by counsel during court proceedings.

Of course, the requirement that individuals, when appearing on behalf of entities, must be represented by counsel, is not new. Over thirty years ago the Superior Court held that a corporation must be represented by counsel. *Walacavage v. Excell 2000, Inc.*, 480 A.2d 281 (Pa. Super. 1984). As the Superior Court stated, "The underlying concern behind the rule is not the protection of the shareholders, but

rather the administration of justice. Furthermore, persons who accept the advantages of incorporation must also bear the burdens, including the need to retain to counsel to appear in court."

However, the Commonwealth Court has held that an individual partner in a conventional partnership or as the general partner of a limited partnership may appear on behalf of the partnership interest without counsel. *Petition of Lawrence County Tax Claim Bureau*, 998 A.2d 675 (Pa. Comwlth 2010).

The Superior Court has specifically held that agents appointed by Power of Attorney must generally be

represented in court by a lawyer. *Kohlman v. Western Pennsylvania Hospital*, 652 A.2d 849 (Pa. Super. 1994). The Commonwealth Court has held that administrators of estates, and presumably executors of wills, must be presented by counsel during court proceedings. *Petition of the Tax Claim Bureau of Westmoreland County*, 84 A.3d 337 (Pa. Comwlth. 2013). More recently, a trial court judge held that a trust and its individual trustee must generally be represented in court by counsel. *Straban Twp. v. Hanoverian Trust and Heywood Becker, trustee*, Court of Common Pleas of Adams County (Civil Division), March 24, 2014.

ROYALTY RIGHTS, CONTINUED

Property Value Study). In addition to the required rate of return, the timing of the cash flows can have a major impact on value.

In summary, numerous variables impact the value of the gas royalty rights. Similar-sized properties can have significantly different values attributed to these rights. A defensible valuation generally requires the expertise and judgment of engineers, geologists and valuation experts.

Edward A. Wilusz, ASA, CFA is the Managing Director of Value Management Inc. VMI, a business valuation and merger & acquisition firm, has developed an expertise in the preparation of Marcellus Shale related appraisals.

¹ Effective December 2012, the U.S. Energy Information Administration ("EIA") stopped tracking the wellhead price. However, based on information provided by the EIA, beginning in December 2012, the well head price was arrived at by subtracting \$0.32 from the reported Henry Hub spot price per mcf.

In the 2013 *Westmoreland County* case, the Court cited a Pennsylvania Supreme Court case holding there must be a determination on a case-by-case basis in these situations of what constitutes the practice of law with the public interest of primary concern in the determination. *Harkness v. Unemployment Compensation Board of Review*, 920 A.2d 162 (Pa. 2007). In *Harkness*, a non-lawyer was permitted to represent an employer in an unemployment compensation case before a referee. The criteria the Supreme Court held to be applicable in determining what constitutes the practice of law include (1) whether

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ETHICS COLUMN, CONTINUED

the proceedings are brief and informal and not intensely litigated, (2) whether evidentiary rules apply, (3) the amounts generally at issue in proceedings of that type, (4) whether there is pre-hearing discovery, (5) whether normally only questions of fact and not complex legal issues are involved, and, finally, (6) whether the fact-finder is not required to be a lawyer. Applying the criteria, it does appear that representation by counsel will always be required in Orphans' Court proceedings.

Although the issue of a fiduciary appearing in court pro se involves the unauthorized practice of law and is not an ethical question or a matter governed by the Rules of Professional Conduct, it is certainly within the realm of protecting the public and the integrity of the legal profession.

Accordingly, when an Orphans' Court practitioner is faced with an attempt by an individual fiduciary, who is a non-lawyer, attempting to represent himself or herself in a court proceedings without formal representation, the practitioner should file a motion to compel that fiduciary to obtain legal counsel.

WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

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Obermayer, Rebmann,
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1617 JFK Boulevard
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CASE SUMMARY FROM THE ORPHANS' COURT LITIGATION COMMITTEE¹

In re Foundation for Anglican Christian Tradition, 103 A.3d 425, 5 Fiduc. Rep. 3d 1 (Pa. Cmwlth. 2015)

BY ADAM T. GUSDORFF, ESQUIRE | HECKSCHER, TEILLON, TERRILL & SAGER, P.C.²

Whether a party has standing to enforce a charitable trust is a frequently litigated issue, but the Commonwealth Court, considering an appeal from a decision of the Orphans' Court of Montgomery County, recently addressed in a case of first impression whether the donor of a charitable gift could enforce conditions placed on that gift.

In *In re Foundation for Anglican Christian Tradition*, the Petitioner donated \$157,000 to and helped raise another \$222,400 for the Foundation for Anglican Christian Tradition (the "Foundation") for the purpose of supporting biblical and traditional Anglican Christian principles at The Church of the Good Shepherd (the "Church"). The Foundation subsequently purchased real property next to the Church, which it gave to the Church in exchange for a note and mortgage on the property.

The note was amended at Petitioner's request to provide that the Church shall be in default if

a majority of the members of the Church's vestry were removed and replaced, unless the removal and replacement occurred through annual elections under the Church's bylaws. Upon default, the Foundation had the ability to demand immediate payment of the unpaid balance of principal and interest. Thereafter, a majority of the members of the Church's vestry were removed and replaced with new members outside of annual elections.³ The Church decided to sell the property, and the Foundation declared the mortgage null and void and filed a satisfaction of mortgage without having received any payment of principal or interest.

Petitioner asked the Orphans' Court to strike the satisfaction of mortgage, to declare that the note and mortgage were in default with all payments due, to enjoin the Foundation from making gifts to the Church and to enjoin the Church from using funds it had received or will receive from the sale of the property. The Foundation and the

Church filed preliminary objections, including a preliminary objection that Petitioner lacked standing. The Orphans' Court sustained that preliminary objection and dismissed the petition in *In re Foundation for Anglican Christian Tradition*, 1 Fiduc. Rep. 3d, 341 (O.C. Montg. 2013). The trial court distinguished between the settlor of a charitable trust who has standing to enforce the trust and the donor of a charitable gift.

Petitioner appealed to the Commonwealth Court, where he asserted that the trial court erred in finding that he lacked standing, either as the settlor of a charitable trust or as the donor of a charitable gift. First, the Commonwealth Court concluded that Petitioner had not created a charitable trust. Although it was not mentioned in either the trial court's or appellate court's opinion, it is apparent that Petitioner was not the settlor of Foundation. The petition at issue referred only to gifts and donations, and not a trust. Moreover, Pennsylvania's Uniform Trust Act ("UTA") requires trusts to be in writing, and there

¹ The Orphans' Court Litigation and Dispute Resolution Committee will provide summaries of recent litigation cases in each quarterly newsletter.

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³ The removal and replacement occurred as a consequence of the Montgomery County Orphans' Court's decision in *In re: The Church of the Good Shepherd, Rosemont, Pennsylvania, Inc.*, 1 Fiduc. Rep. 3d 405 (O.C. Montg. 2011).

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CASE SUMMARY, CONTINUED

was no writing. *In re Foundation for Anglican Christian Tradition*, 103 A.3d 425, 5 Fiduc. Rep. 3d 1, 4-5 (Pa. Cmwlth. 2014) (citing 20 Pa. C.S. §§7731, 7732, 7737). The Court found that, even though Petitioner's gift predated the UTA, the common law predating the UTA required clear and unambiguous language indicating the intent to create a trust. 5 Fiduc. Rep. 3d at 4. The Court concluded that none of the purpose of the gift (i.e., to support biblical and traditional Anglican Christian principles), the language of the original note, Petitioner's post-donation insistence that the note be amended or the language of the amendment to the note conferred any rights or duties upon Petitioner. *Id.* at 5 (stating that the note and amendment "do not render his donation, post hoc, dependent upon the Foundation's election to declare the Church in default").

The Court then turned its attention to whether Petitioner had standing as the donor of a charitable gift. The Commonwealth Court generally described the requirement that a party must be aggrieved to have standing (i.e., the party must have a substantial, direct and immediate interest in the outcome of the litigation). *Id.* at 6. Unlike the Orphans' Court, the Commonwealth Court did not expand its discussion of standing to include cases holding that only the Attorney General, a member of the charitable organization at issue or

someone having a special interest in the charitable entity may enforce a charitable trust. See 1 Fiduc. Rep. 3d at 343 (citing *In re Milton Hershey School*, 590 Pa. 35, 42-43, 911 A.2d 1258, 1261-62 (Pa. 2006)). Perhaps the Commonwealth Court omitted that discussion of standing because it had already concluded that there was no charitable trust at issue.

In any event, the Commonwealth Court pointed out that Petitioner's status as donor is insufficient to compel the Foundation to declare a default on the note by the Church. Petitioner was neither a member of the Foundation's Board nor an officer of the Foundation. He was not a party to the note or the mortgage and, therefore, did not personally have the option to declare a default. In short, it found that Petitioner did not have "a specialized interest different from other members of the citizenry." 5 Fiduc. Rep. 3d at 6.

Finally, the Court found that the mere fact that Petitioner had made a gift was insufficient to grant him standing to enforce conditions on the gift, where no conditions were shown to exist. *Id.* The Court observed that inter vivos gifts are generally irrevocable and that when a conditional gift is alleged, the donor has the burden to establish the conditions. *Id.* The Court concluded that the gift was not conditional and pointed out that, to the extent conditions were imposed by the amendment to the note,

such conditions arose after the gift had been made and after the note and mortgage had been executed. Thus, any such conditions did not exist when the gift was made. Accordingly, the Court concluded that Petitioner lacked standing and affirmed the Orphans' Court's decision.

For an example of circumstances under which the donor of a conditional charitable gift might have standing to enforce the gift, see *Adler v. SAVE*, 74 A.3d 41 (N.J. Super. 2013) (granting standing to donor of a conditional gift when the charitable organization was not using the funds for the specified purposes).

PROBATE AND TRUST LAW SECTION COMMITTEE INFORMATION

Business Planning Committee. The Business Planning Committee meets quarterly to discuss topics of interest to trusts and estates lawyers who also provide business counsel to closely held businesses, on subjects including choice of entity and ownership of businesses, business succession planning, asset protection planning and buy-sell agreements. Through panel discussions and outside speakers, the Committee seeks to increase the expertise of trusts and estates lawyers in dealing with a broad range of issues and opportunities faced by business owners. For more information, contact Co-Chairs Dennis Reardon at DReardon@DReardonLaw.com or Bob Louis at rlouis@saul.com.

Diversity Committee. The Diversity Committee works to encourage participation in the activities of the Section by a diverse group of attorneys representing the entire legal community. It promotes inclusion of lawyers of every race, ethnicity, gender, age, national origin, or sexual orientation in the Section's programs and in the work of its committees and leadership. The Diversity Committee holds meetings on an ad hoc basis. For information, please contact Committee Chair Licia M. Ano-Marrone at lamarrone@thlex.com

Education Committee. The Education Committee meets during the year to discuss current topics relevant to the Section. Those topics become the basis for three programs (March, June and October) that provide CLE credits for program attendees. The Committee is responsible for choosing topics, outlining the content of the programs, and then selecting and recruiting qualified panelists to provide a two-hour presentation at the quarterly meetings. After the presentations are completed, the Committee reviews the evaluations that are generated from program attendees and utilizes those evaluations to improve upon future programs. The Committee welcomes suggestions for future program topics, and any interested Section members are encouraged to join the Committee by contacting Committee Chair Justin Brown at justin.brown@flastergreenberg.com.

Elder Law Committee. The mission of the Elder Law Committee is to further the knowledge and practices of members of the legal community having an interest in problems relating to the aging by developing educational programs and the information necessary to stay abreast in this growing and ever changing area of law. Our goal also is to study, review and make recommendations concerning legislation affecting the elder community. We further wish to serve the public generally by developing literature that will provide information about legal issues faced by the elder community and their caregivers. Meetings are generally held the fourth Thursday of the month at the Bar Association from 1-2:30 p.m. Lunch is available if reserved and there is a guest speaker. All Philadelphia Bar Association Members are welcome. For information, please contact Committee Chair Linda M. Hee at lhee@sgtmlaw.com.

Legislative Committee. The Legislative Committee monitors and provides comments on pending and proposed legislation in the areas relating to estate planning, and estate and trust administration. When appropriate, the Committee drafts proposed legislation on behalf of the Section. Currently, the Committee has two active subcommittees involved with proposed legislation. One subcommittee is in the process of receiving comments on a draft of Directed Trustee legislation prepared by members of the subcommittee. The second subcommittee is researching and analyzing the preparation of a proposed legislation regarding fiduciary authority over digital assets. Meetings are generally held the third Wednesday of the month at 4:00 p.m. at Pepper Hamilton at 18th & Arch Streets. Michael Stein is the Chair of the Committee. Michael may be contacted at PNC Bank, 1600 Market Street, Philadelphia, PA 19103, 215-585-8027 or michael.r.stein@pnc.com.

Orphans' Court Litigation Committee. The Orphans' Court Litigation Committee meets monthly on the second Tuesday of each month except for June, July, August, and December. The meetings begin at 8:30 am in the morning at One Liberty

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COMMITTEE INFORMATION, CONTINUED

Place in Center City. An agenda for each meeting usually involves a presentation and a discussion of a recent Orphans' Court case as well as issues and fact patterns that Orphans' Court litigators will frequently encounter. Following the presentation, a lively discussion among the committee members addresses the designated topic, and how the committee members have dealt with the issues and fact patterns in practice. For more information about this committee, please contact Committee Chair, Adam Gusdorff at agusdorff@htts.com.

Publications Committee. The purpose of the Publications Committee is to further the knowledge and practices of members of the legal community through the publication of articles in this Probate and Trust Law Section Newsletter that are current, relevant and informative. The Newsletter generally is published three times per year. The Publications Committee will meet at the offices of Ballard Spahr LLP. For information, please contact Committee Chair Heike K. Sullivan at sullivanh@ballardspahr.com.

Rules and Practice Committee. The Rules and Practice Committee drafts local rules and the forms to accompany them, which are suggested to the Committee by the Judges of the Orphans Court Division of the Court of Common Pleas, local practitioners, or which the Committee determines are needed in connection with practice before the Orphans Court Division or the Office of the Register of Wills. Over the past years this Committee has published the Green Book, Blue Book and Red Book and updated them as needed. It has reviewed and commented upon the new proposed statewide Orphans Court Rules, reviewed the first draft of the Guardianship Manual, and drafted rules and forms for local use which also served as guides for the statewide forms now in effect. This committee also addresses procedural problems which come to its attention for the benefit of the Court and practitioners, and generally resolves such problems. For more information, please contact Committee Co-Chairs Bernice Koplin at bjkoplin@sglk.com or Erin McQuiggan at emcquiggan@nmapc.net.

Tax Committee. The Tax Committee meets monthly on the 4th Tuesday of each month, except for July, August and December. The meetings are typically at 8:15 in the morning in Center City. During the meetings, a written summary of pertinent recent developments in the tax law is distributed and reviewed with a short oral presentation focusing on highlights, and then, at most meetings, a speaker addresses a predetermined tax related topic. The meetings are frequently interactive and periodically include ad hoc discussions on various topics of current interest to committee members related to tax issues. Traditionally, certain monthly meetings have been reserved for specific purposes: January for determining the agenda for the year and discussing The Heckerling Institute programming, October for representatives from the PA Department of Revenue, and November for representatives from the IRS (although none have been available from the IRS in recent years). For more information about this Committee, please contact Committee Co-Chairs, Jonathan Sokoloff at jdstax@dpblaw.com or Marguerite Weese at mweese@wilmingtontrust.com.



The PEPC invites the Philadelphia Bar Association Probate and Trust Law Section to join our Council for membership and programming!

March Luncheon Program

Tuesday, March 17, 2015

11:45 a.m. - 1:45 p.m.

The Union League

140 S. Broad Street, Philadelphia, PA

Topic: "Trust Modifications"

Speaker: Amy E. Heller

Annual Meeting, Seminar & Reception

Thursday, May 7, 2015

3:00 p.m. – 7:30 p.m.

Philadelphia Museum of Art

2600 Benjamin Franklin Parkway, Philadelphia, PA

Topic: "Estate Planning for Business Owners – Maximizing the Value of the Business to Benefit Both Family and Charity"

Speakers: Michael V. Bourland & Christopher R. Hoyt

Golf & Tennis Outing

Wednesday, June 10, 2015

Golf: Sunnybrook Golf Club, Plymouth Meeting, PA

Tennis: Philadelphia Cricket Club, Philadelphia, PA

For more information on joining the Philadelphia Estate Planning Council or to register for any upcoming programs, please visit www.philaepc.org.