REPORT OF THE CHAIR

BY AARON H. FOX, ESQUIRE | PENNSYLVANIA TRUST

As I sat down to write my final column for our quarterly newsletter, I got to thinking how a person who had a long history of never volunteering for anything ended up as Chair of a Bar Association section with 500+ lawyers. The journey actually began in a conference room at 1650 Market Street when my then-boss, Dave Schwartz, asked if any of the young lawyers in the room would like to accompany him to an Education Committee meeting he was going to attend later that afternoon. True to form, I remained silent. That, however, didn’t stop Dave from singling me out and gently “suggesting” I tag along.

As a member of that Committee, my recollection is that I spoke up perhaps twice in the first four years (the first occasion may have been when role was taken.) Basically, I was just trying not to embarrass myself or my employer; sounding smart was a benchmark that seemed too ambitious. But as the old adage goes, just showing up is half the battle, and before too long I found myself chairing the Committee and eventually was asked to start the officer rotation.

In the eighteen years between that first meeting in 1998 and now, I have had the good fortune to meet and work with terrific people and have been exposed to countless experiences that never would have happened but for my involvement with the Bar Association. I recall waiting in line to get a drink at the annual meeting last December, and realizing that I could name just about every person at the meeting.

In the last few years, the Officers and Executive Committee have made a conscious effort to bring in new people and get them engaged in the activities of the Section. Having gone through the process myself and knowing what an honor it has been to serve, I know that all of these new folks will find the experience to be as rewarding as I have found it. I look forward to seeing how these dedicated new members continue to change and improve the Section as it evolves in the years to come.

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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30 YEARS
JEWEL INSIDE THE NEW JERSEY UNIFORM TRUST CODE

BY GLENN A. HENKEL, ESQUIRE | KULZER & DIPADOVA, P.A.

On January 19, 2016, Governor Chris Christie signed Assembly Bill 2915/Senate Bill 2035 known as the New Jersey Uniform Trust Code, Public Laws 2015, Chapter 276. This massive bill includes 82 provisions dealing with a codification of the New Jersey trust rules. In New Jersey, trust law has been developed over 150 years and, thus, the need for a trust code in New Jersey was not as prevalent as other jurisdictions where there were only a few trust cases ever decided. In New Jersey, our population has been making challenges and litigating various issues related to trusts for a long time and, as such, the case law is extensive.

The New Jersey Uniform Trust Code ("NJUTC") was the project of an ad hoc committee of trust and estates lawyers in the New Jersey Bar Association who tried to adapt the Uniform Trust Code ("UTC") to be consistent with New Jersey's common law. This article is not about the NJUTC, per se, but instead, about a provision included in the NJUTC involving the concept of a “directed trust.”

The NJUTC was a product of the New Jersey Bar Association, principally the Real Property. In many of the other roughly 30 states that have enacted versions of the UTC, bankers were a significant moving force. In order to engender support within the legislature for the provisions, the Bar reached out to the New Jersey Banker’s Association for consideration. The Bankers’ lobbyists turned to their constituency to see whether the bankers should support this project or not. The bankers requested that the Bar make New Jersey’s trust law “more like Delaware.” Like the corporate arena, Delaware trust law has always been viewed as progressive and pro management. The ad hoc committee considered this request and focused on two particular aspects to Delaware law that could have been considered.

The first is the concept of a “qualified domestic trust,” which is a provision in the trust law authorizing an individual to create a “self-settled” “spendthrift” trust. In other words, in some foreign jurisdictions an individual could transfer assets to a trust for his or her benefit and after a period of time and assuming the transfer was not a “fraudulent conveyance,” the trust assets would be outside the reach of the settlor’s creditors. This is the opposite of a long standing New Jersey statute N.J.S.A. 3B:11-1 and likely against public policy. While Delaware, Alaska and about 10 other states have enacted this “qualified domestic” trust legislation to provide benefits to individuals who will want to set aside a family nest egg and protect it from the reach of creditors, based upon the New Jersey statute cited above as well common law, this did not appear to be an appropriate or likely fit with New Jersey law.

The second provision in the revision of the Delaware UTC law did seem particularly appropriate in New Jersey. The concept of “a directed trust” is a movement which seemed to be catch and hold. If a settlor creates a trust and wants to provide for specific terms to bifurcate responsibility for a particular asset between two “fiduciaries,” New Jersey law has always followed the “probable intent” of the Testator. This was such well settled case law that it was codified in 2004. See N.J.S.A. 38:3-33.1; Fidelity Union Trust Company v. Robert, 36 N.J. 561 (1962); Engle v. Siegel, 74 N.J. 287 (1977); in Re Estate of Branigan, 129 N.J. 324 (1992). Since 1986, Delaware has had a statute which gave the trustee (usually a corporate trustee) the ability to take direction from another individual serving as an investment advisor. Typically, this will allow for a lower fee for a trust that holds a “difficult asset,” such as a residence or business. This, the ad hoc committee felt, would be an appropriate mechanism for New Jersey law because of the probable intent doctrine.

In the legislative process it was proposed that the bankers would support the NJUTC if the Bar Association would support the directed trust statute. This was accomplished and the directed trust continued on page 4
statute now gives greater authority to New Jersey clients to include provisions that authorize a trustee to direct investment functions to another individual.

The NJUTC included a provision which generally authorized direction in similar circumstances. This provision is now codified in N.J.S.A. 38:31-61, whereby a trust can confer upon another trustee the ability to let a trustee follow the direction of a third party. This power under N.J.S.A. 38:31-61(c) can be even as broad as the power to direct the modification or termination of the trust. However, the bill annexed an additional provision called “powers to direct investment functions” which is very similar to the Delaware directed trust statute contained in 12 Del. Code § 3313. See N.J.S.A 38:31-62.

This provision has an operative provision that authorizes a trustee to be obligated to a third party investment advisor direction or consent. Such a “investment advisor” is a fiduciary, meaning that he or she will have typical fiduciary roles. Moreover, the New Jersey statute goes on to provide that the trustee would not be liable for acts except in the cases of “woeful misconduct or gross negligence on the part of the fiduciary so directed.” The “gross negligence” standard is broader than the Delaware statute and it appears to be very pro trustee. Moreover, absent clear and convincing evidence, the directed trustee is not responsible for taking administrative steps to review the activities of the investment advisor and the directed trustee has no duty to monitor the conduct of the investment advisor or provide advice to the investment advisor or communicate or apprise beneficiaries with respect to the directed investment.

Why would a directed trust provision be helpful? In some circumstances, when an individual wants to utilize a corporate fiduciary, there could be a concern on the part of the corporate fiduciary to the underlying assets that are particular to the family. Often, a family business or vacation residence will constitute a part of the corpus of the trust by having a third party investment advisor responsible for this particular asset, a corporate fiduciary can accept a trusteeship without the obligation to diversify. Several cases in recent decades outside New Jersey have dealt with a circumstance where the trustee was told to maintain a particular investment such as stock in Eastman Kodak Company and because of the direction, the trustee did not pay attention to the decline in value. Upon subsequent suit for damages by beneficiaries, the courts (again, outside New Jersey) held that a trustee was responsible for such circumstance. With a directed trust statute, a third party can be told to monitor the particular investment thereby allowing the corporate fiduciary to be free from the burden of this particular asset.

If an investment advisor is named in a document as an investment advisor, be wary that that individual will continue to have fiduciary duties as related to that investment. This can be problematic if the investment is a business interest or vacation home. However, typically, the individual serving as investment advisor will be closer to the family and will be aware of the goals and objectives of the family maintaining that asset.

In sum, the enactment of the New Jersey directed trust statute in N.J.S.A. 38: 31-62 is a welcome addition to New Jersey’s trust law for those critics of this provision who feel that it can result to a bad result, simply draft away from its use.
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LESSONS FROM PRINCE’S LACK OF A WILL

BY BRUCE STEINER, ESQUIRE | KLEINBERG, KAPLAN, WOLFF & COHEN, P.C.,

EXECUTIVE SUMMARY

Estate planners can learn some lessons from Prince’s lack of a Will.

FACTS

Prince Rogers Nelson (Prince) died on April 21, 2016. He was 57 years old. He was a singer, songwriter and musician, record producer and actor. He was a resident of Minnesota where he was born.

Prince left a large estate. Several news stories reported that he was worth $300 million. Given the nature of his assets, his estate could be worth substantially more or less than that.

Prince married the singer and dancer Mayte Garcia on February 14, 1996. They had a son, Boy Gregory, on October 16, 1996, but he died a week after he was born. Prince and Mayte Garcia were divorced in 1999. Prince then married Manuela Testolini in 2001, but they were divorced in or about 2006. Prince did not leave a surviving spouse or any issue.


Prince did not leave a Will. His sister, Tyka Nelson, filed a petition for administration in Carver County, Minnesota, requesting that Prince’s bank, Bremer Trust, be appointed as administrator. All of his siblings except John Nelson consented.

COMMENT

In some states, a relative by the half-blood receives one-half of the share that a relative by the full-blood would receive. However, in Minnesota, a relative by the half-blood is treated the same as a relative by the full-blood. Therefore, each of Prince’s six siblings, and the daughter of his predeceased sibling, will each receive one-seventh of Prince’s estate.

If Prince’s estate is $300 million, and the estate taxes are $150 million, each beneficiary’s one-seventh share will be about $20 million after estate taxes and expenses.

Prince should have had a Will. By having a Will, Prince could have saved transfer taxes for his family, protected his siblings’ and his niece’s inheritances, avoided a guardianship for his niece, and named executors and trustees of his choice.

Assets passing to Prince’s siblings outright will be included in their estates for estate tax purposes, and will be subject to their creditors and spouses. Since Prince’s siblings are in his generation, if they have issue, they can disclaim some or all of their shares without triggering any GST tax. To the extent they are confident they will never need the money, they should consider disclaiming their shares, assuming that it is reasonably appropriate for their children to receive the disclaimed property outright.

If Prince had a Will, he could have provided for his siblings and his niece Victoria in trust rather than outright. In that way, their inheritances would not have been included in their estates, and would have been protected from their creditors and spouses. He could have given each sibling effective control over his trust, and Victoria effective control over her trust beginning at a specified age. In other words, each sibling, and Victoria upon reaching a specified age, could have been a trustee, and could have had the power to remove and replace his or her co-trustee (provided the replacement trustee was not a close relative or subordinate employee). Each beneficiary could have had the broadest special power of

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appointment (in Victoria’s case after a specified age in the case of an exercise during lifetime), so he or she could have appointed (given or left) the trust assets to anyone he or she wanted (except to himself or herself, or his or her estate or creditors).

Since Prince’s siblings were in his generation, upon a sibling’s death, there would not have been any GST tax if the trust assets passed to or in further trust for the sibling’s children (Prince’s nieces and nephews).

To the extent of Prince’s remaining GST exemption, this would have sheltered the beneficiary’s inheritances, and the income and growth thereon, from transfer taxes for several generations.

We do not know whether Prince had any remaining GST exemption, or whether he used his GST exemption during his lifetime, perhaps in 2012 when it was scheduled to revert to $1 million in 2013. However, since he did not leave a Will, it is unlikely that he used his GST exemption during his lifetime.

The trustees could have divided each sibling’s trust and Victoria’s trust into a GST taxable trust and a GST exempt trust. Distributions could then be made to them out of their GST taxable trusts. Upon a sibling’s death, distributions could be made to his or her children (Prince’s nieces and nephews) out of their GST taxable trusts, and to his siblings’ grandchildren and more remote issue out of their GST exempt trusts.

Each sibling would have had several choices with respect to his or her GST taxable trust.

- To the extent a sibling’s children (Prince’s nieces and nephews) will not have taxable estates, the sibling could have appointed the GST taxable portion to them outright. This provides simplicity, and avoids the compressed income tax brackets for trusts. It also provides another basis step-up at the nieces’ and nephews’ deaths. However, it would expose the assets to the nieces and nephews’ creditors and spouses.

- To the extent the nieces and nephews will not have taxable estates, the sibling could leave the GST taxable portion to them in trusts in which they will each have a general testamentary power of appointment. This provides another basis step-up at the nieces’ and nephews’ deaths, though the compressed income tax brackets for trusts will still apply. Whether the trust assets would be protected from the nieces’ and nephews’ creditors, subject to their creditors to the extent the niece or nephew exercises the power, varies depending on state law.

- If the inclusion of some or all the GST taxable portion in the niece’s or nephew’s estate might not result in any estate tax, the child could have a general power of appointment over that portion of the trust based upon a formula. The IRS has approved a formula provision in at least one private letter ruling. However, drafting the formula can be complicated, especially if a child leaves a surviving spouse.

- The trustees could be given the power to grant the child a general power of appointment over a portion or all of the trust. The trustees would have to monitor this. One commentator has suggested that if the trustees have the power to grant a general power of appointment then the beneficiary is treated as already having a general power of appointment.

- To the extent a niece or nephew has a taxable estate, the GST tax is often

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preferable to the estate tax. The niece or nephew could then appoint some or all of the trust assets to or in further trust for his or her grandchildren, moving the assets down two generations at the cost of only one transfer tax. If the niece or nephew has a surviving spouse, he or she could postpone the GST tax by appointing the trust assets in further trust for his or her spouse.

With six siblings, there are likely to be a large number of nieces and nephews. With a $5,450,000 (indexed) Federal estate tax exclusion amount and portability, some of the nieces and nephews may not have taxable estates, even if their GST taxable trusts were included in their estates.

By having a Will, Prince could have named executors and trustees of his choosing. The choice of executors is particularly important in an estate of this size and nature. The executors will control the estate tax proceedings, including the selection of appraisers and any dealings with the Internal Revenue Service. The executors will also control the exploitation of Prince’s intellectual property, including his unreleased recordings. Presumably Prince would have known who he would have wanted to control his estate.

Since Victoria is a minor, a guardian of the property may have to be appointed for her. Guardianships are generally cumbersome. Depending upon state law, a guardian may have to post a bond and file court accountings. A guardian may need court approval for expenditures for the minor. A guardian may not be able to invest prudently, or may need to obtain court approval to be able to invest prudently, and in order to obtain court approval to invest the assets prudently may be forced to incur a greater level of investment expenses than would otherwise be necessary. By having a Will, Prince could have left Victoria’s share in trust, and the trustees could have administered the trust without the need for a guardian. By having a Will, even if he didn’t want to provide for Victoria in trust, Prince could have authorized his executors to distribute Victoria’s share to a custodian under the Uniform Transfers to Minors Act.

Minnesota law authorizes an administrator of an intestate estate to distribute the minor’s share to a custodian under the Uniform Transfers to Minors Act, but only with court approval if the amount is more than $10,000. Since Victoria’s share is likely to be about $20 million, the administrator may not be able to obtain court approval to distribute it to a custodian.

It is noteworthy that Tyka Nelson sought the appointment of Bremer Trust as administrator rather than herself. Usually petitioners seek their own appointment as administrators.

Under Minnesota law, if there is a disagreement among the heirs as to the appointment of an administrator or administrators, the court may appoint an administrator who is acceptable to heirs having a majority in interest in the estate. If no one is acceptable to heirs having a majority in interest in the estate, then the court may appoint any suitable person as administrator. Perhaps Ms. Nelson was unable to obtain a consensus among Prince’s siblings and Victoria for the appointment of one or more of them, but was able to obtain a consensus for the appointment of a corporate administrator. Or perhaps none of them wanted to take on the task of administering an estate of that size and complexity.

Prince presumably worked with lawyers, accountants and other advisors in connection with his entertainment activities. They should have encouraged him to sign a Will, and could have referred him to appropriate lawyers who could have prepared a Will for him.

It is not possible to prove that a decedent did not have a Will. However, in Prince’s case, if he had a Will, presumably the law firm that prepared the Will would have contacted the named executor or the court.

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Minnesota has both a state income tax and a state estate tax. The top Minnesota income tax rate is 9.85%, and the top Minnesota estate tax rate is 16%. Since Prince had a large estate, he could have moved to a state that doesn’t have a state estate tax, or perhaps to a state that has neither a state income tax nor a state estate tax.

The Proposed Regulations, if finalized, will impact the valuation of close-held family entities for federal estate, gift and generation-skipping transfer tax purposes. They would eliminate certain minority discounts when valuing interests in closely held family businesses for the purposes of federal gift tax, federal estate tax and generation-skipping transfer tax and close other valuation loopholes.

The Proposed Regulations clarify the application of IRC §2704 to limited liability companies (LLCs) and other business arrangements, including disregarded entities. Proposed Regulation §25.2701-2 defines control of an LLC or other entity that is not a corporation or partnership as either holding at least 50% of the capital or profits interest of the entity or holding an equity interest that has the power to cause full or partial liquidation.

The Proposed Regulations would add a three-year lookback period under §2704(a) to transfers of an interest subject to lapsing voting or liquidation rights on the part of an individual with a controlling interest in a closely held entity. The lapse of the liquidation rights would now be considered to take place at the taxpayer’s death and their value would be included in the determination of the value of an interest held by a decedent’s estate if they occur within three years of death. This proposal would prevent the estate of a shareholder in a family-owned business from claiming a lack of control discount when a shareholder with a majority interest transferred just enough shares on his or her deathbed to turn the interest into a minority interest and thereby enable his or her estate to claim a lack of control discount.

The Proposed Regulations provide that if, as the result of a transfer of an interest, any rights or powers associated with that interest are restricted or eliminated, the transfer is considered a lapse of the liquidation rights associated with that interest and is thus a taxable gift. This provision would apply to a transfer from a partner which creates an assignee interest.

Under the Proposed Regulations, “Applicable Restriction” under §2704(b)(2) would be redefined and strengthened. Applicable Restrictions are those that restrict the liquidation of an entity under state law. The agreement of family members would no longer be able to override state law restrictions on the liquidation of an entity. Moreover, the Proposed Regulations would eliminate any tax value advantage produced by reliance on state law, in that the category of Applicable Restrictions would be redefined to include

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restrictions imposed both under the governing document and under state law, whether or not the governing document includes a provision superseding state law. The comparison to local law liquidation limitations would be eliminated by removing the exception limiting the definition of Applicable Restrictions to limitations that are more restrictive than state law limitations.

The Proposed Regulations would establish a new and additional category of “Disregarded Restrictions.” The “Disregarded Restrictions” would limit many of the ways of obtaining minority discounts upon the transfer or minority interests in the business. If a restriction is disregarded, the entity is valued as if the Disregarded Restriction did not exist in either the governing document or in applicable law. Under §25.2704-3(b)(1) there are four categories of Disregarded Restrictions:

1. Provisions that limit or permit the limitation of the holder’s ability to compel liquidation or redemption of the interest;

2. Provisions that limit or permit the limitation of the amount that may be received by the holder of the interest on liquidation or redemption of the interest to an amount that is less than minimum value;

3. Provisions that defer or permit the deferral of the payment of the full liquidation or redemption proceeds for more than six months after the date the holder gives notice to the entity of the holder’s intent to have the holder’s interest liquidated or redeemed;

4. Provisions that authorize or permit the payment of any portion of the full liquidation or redemption proceeds in any manner other than in cash or property.

In each category, the restriction will be ignored if the restriction lapses after the transfer or if any family member of the transferor has the right to remove it.

Section 25.2704-3(b)(4)(i) of the Proposed Regulations provides that the restrictions included in the category of Disregarded Transactions are also in effect when an insubstantial interest in an entity is transferred to a non-family member. The term “insubstantial interest” includes an interest which has been held less than three years before the date of the transfer, (2) constitutes less than 10 percent of the value of all of the equity interests, (3) when combined with the interests of other non-family members constitutes less than 20 percent of the value of all the equity interests, or (4) lacks a right to put the interest to the entity and receive a minimum value.

The Proposed Regulations explicitly exclude “commercially reasonable restrictions” on liquidation from the categories of “applicable restrictions” and “disregarded restrictions” in making a valuation analysis, thereby permitting consideration of restrictions placed by an unrelated person, as defined in the Proposed Regulation, from providing capital in the form of debt or equity to an entity for the entity’s trade or business operations.

Public hearings are scheduled for December 1, 2017. For some provisions, the effective date would be the date when the regulations become final. For other provisions, the effective date would be 30 days after the regulations become final.

**FEDERAL ESTATE TAX VALUATION**

**ESTATE OF GIUSTINA V. COMMISSIONER, T.C. MEMO. 2016-114 (JUNE 13, 2016)**

On remand from the Ninth Circuit (unpublished decision, December 5, 2014), the Tax Court reconsidered its 2011 valuation of a 41.128 percent limited partnership interest in a corporation owning approximately 48,000 acres of Oregon timberland.

In its 2011 decisions, after the IRS issued a notice of deficiency and assessed a $2.5 million accuracy-related penalty, the Tax Court used a combination of two methods to value the minority interest.
value the 41.128 percent limited partnership interest held by the Estate of Natalie B. Giustina in a timberland company. Applying an overall 40% discount for delays expected to be caused by the sale of the timberland, the court bifurcated its valuation, assigning a 75% weight to the value under the discounted cash flow method and a 25% weight to the value under the asset method. The court then applied a 25% discount for lack of marketability to the discounted cash flow share and no discounts for lack of control or marketability to the 25% share.

The court ruled that the value of the estate’s interest was $27.5 million, instead of the $13 million contended by the estate at trial. Because the reported value of the limited partnership interest was less than 50 percent of the correct value, this would normally have been considered a substantial estate tax valuation understatement under IRC § 662. But since the executor had hired a lawyer to prepare the estate tax return and the lawyer had engaged the services of a professional appraiser to value the LP interest, the court ruled that in filing the return the executor reasonably relied on the professional appraisal and thus acted in good faith. The court concluded there was reasonable cause for the underpayment of tax and therefore refused to assess a penalty for substantial understatement of valuation.

The Ninth Circuit rejected the Tax Court’s discount methods. It held that the entire valuation should be determined under the discounted cash flow method and rejected the Tax Court’s decision to reduce by one-half the company-specific risk premium recommended by the estate’s expert. On remand, the Tax Court applied the full company-specific risk premium of 3.5 percent. The Tax Court determined that the new value of the 42 percent partnership interest was only $14 million, close to one-half of the value in its original decision.

UNIFORM TRUST CODE

NEW JERSEY UNIFORM TRUST CODE (Effective July 17, 2016)

New Jersey’s version of the Uniform Trust Code (the NJUTC) applies to both existing and new trusts. The NJUTC differs from the UTC in several major respects.

• Trustee removal: Under the NJUTC, a trustee may be removed only for cause, including neglect, embezzlement or waste of assets by a trustee, refusal to file an accounting ordered by a court, refusal to follow a court order, mental incapacity of a trustee, or a co-trustee’s hindering of the administration of the trust. The NJUTC does not include two grounds for the removal of a trustee found in the UTC: a) when, because a trustee has failed to administer the trust effectively, removal is in the best interest of the beneficiaries; and b) when a court finds that removal is in the best interests of the beneficiaries because of a substantial change of circumstances or because the removal has been requested by all of the qualified beneficiaries.

• Trust modification and termination rules under the NJUTC:

- a noncharitable irrevocable trust can be modified or terminated by consent of the trustee and beneficiaries when the modification is not inconsistent with a material purpose of the trust;

- a noncharitable irrevocable trust can be terminated by the consent of all beneficiaries when a court rules that the continued existence of the trust is not necessary

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CASE SUMMARY FROM THE ORPHANS’ COURT LITIGATION COMMITTEE

Warriner Trusts, 6 Fid. Rep. 3d 223 (O.C. Susq. 2016)

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

The existence – or not – of a “fiduciary exception” to the attorney-client privilege has long been a hot button topic in Orphans’ Court litigation. The question centers around whether a beneficiary of a trust or estate may obtain information (including documents) about communications between the fiduciary and his, her or its counsel.

In Follansbee v. Gerlach, 56 Pa. D. & C. 4th 483, 22 Fid. Rep. 2d 319 (C.D. Allegh. 2002), the Allegheny County Court of Common Pleas determined that the attorney-client privilege between a fiduciary and its counsel does not apply to all communications. Starting with the precept that “where a request is made in good faith, the beneficiary is entitled to inspect ‘all documents in the hands of the trustee pertaining to the trust[,]’” the court concluded that a trustee “cannot withhold from any beneficiary documents regarding the management of the trust, including the opinions of counsel procured by the trustee to guide the trustee in the administration of the trust[,]” 22 Fid. Rep. 2d at 322 (quoting In re Rosenblum’s Estate, 328 A.2d 158, 166 (Pa. 1974)) (emphasis added). In adopting this “fiduciary exception” to attorney-client privilege in Follansbee, the court suggested that it might be limited by certain factors, such as whether a dispute existed between the fiduciary and the beneficiary at the time the documents at issue were generated, Id. at 320, and whether the fiduciary paid for the legal advice from the fund or from personal or corporate funds. Id. at 322.

TAX UPDATE, CONTINUED

To achieve a material purpose of the trust;

- a noncharitable irrevocable trust can be modified by the consent of all beneficiaries when a court rules that the modification is not inconsistent with a material purpose of the trust.

- Special needs trusts:
  Under the NJUTC, creditors of a “protected person” (a class which includes disabled persons) cannot reach assets held in a special needs trust to satisfy a claim. The NJUTC also provides that a trust cannot be required to repay government assistance unless such support was provided on the basis that the trust would pay the aid upon the death of the protected person dies, or if the trust terminates sooner and the trust instrument calls for such repayment.

HAVE IDEAS OR TOPICS FOR AN ETHICS COLUMN?

Send your questions and ideas to:

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CASE SUMMARY, CONTINUED

While there remain no appellate decisions on this issue, a recent case in Susquehanna County provided support that such an exception exists in Pennsylvania. Warriner Trusts, 6 Fid. Rep. 3d 223 (O.C. Susq. 2016).

In 2014, the individual co-trustee and all beneficiaries filed a petition to remove the corporate trustee (the “Bank”) as trustee of several family trusts and replace it with another corporate trustee. During discovery, the Bank would not provide the petitioners with documents relating to advice from its in-house counsel relating to a beneficiary’s 2011 inquiry about a reduction in distributions. The petitioners argued that the advice was discoverable under the fiduciary exception to the attorney-client privilege, and the court, by the Honorable Linda Wallach Miller (who was specially assigned to the court), directed the Bank to produce the opinions of its in-house counsel. Id. at 224. The Bank did not appeal Judge Miller’s decision. Instead, it filed a motion for reconsideration nearly three months after Judge Miller’s ruling, by which time she had been replaced on the bench by the Honorable Jason J. Legg. Id. at 226.

In denying the Bank’s motion for reconsideration, Judge Legg found the reasoning of Follansbee persuasive. While he initially focused on the source of payment for such legal advice, concluding in essence that beneficiaries are “entitled to the documents that were paid for with trust monies,” Judge Legg observed that “[i]t is difficult to comprehend a scenario where a fiduciary should be permitted to hide anything from the beneficiaries, aside from an active litigation between the parties where the fiduciary relationship has already been impaired.” Id. at 225.

The court dismissed the Bank’s position that the inquiry about a reduction in distributions amounted to a threat of litigation, such that the documents at issue should be protected, reasoning that if a question from a beneficiary transforms the relationship into an adversarial one, then beneficiaries “would never be permitted to understand what, if any, information that the trustee is receiving from counsel relative to the management of the trust.” Id. fn. 1. In response to the Bank’s argument that a ruling requiring disclosure would have a chilling effect on a trustee’s decision to obtain legal advice, the court concluded “that such a chilling effect would only occur where the trustees desired to shield that legal advice from the beneficiaries in the first place. Such deceptive management practices run directly counter to the fiduciary responsibilities that the law imposes upon a trustee.” Id.

With respect to the source of payment for the advice at issue, there was nothing in the record to establish whether there had been any cost, to the trust or otherwise, for the opinions obtained from the Bank’s in-house counsel. As such, the court found nothing to exclude the documents from the fiduciary exception to the attorney-client privilege. Id. at 225-26.

In a footnote, the court rejected the Bank’s argument that the statutory nature of the attorney-client privilege prohibits the recognition of a fiduciary exception. Id. at 226, fn. 2. The court instead viewed the trust, the trustee and the beneficiaries collectively as the client with respect to legal opinions related to the administration of the trust. As such, in the absence of litigation between the trustee and beneficiaries, the trustee “owes the highest level of care to the beneficiaries and must act in the beneficiaries’ best interest, and legal advice provided to the fiduciary should be shared with the beneficiaries so that the beneficiaries not only understand the trust’s management but have sufficient information to recognize potential mismanagement by the fiduciary.” Id.

The court then discussed that Pennsylvania law frowns upon one judge of a particular court overruling the decision of another judge of that court absent compelling circumstances or new evidence. Id. at 226-27. The court found no

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compelling circumstances, new
evidence or error of law that would
justify a reversal of Judge Wallach
Miller’s ruling. “Moreover, as the
Court has noted, the reasoning in
Follansbee is sound – there is no
compelling reason in this case for
[the Bank] to essentially hide the
ball from the very beneficiaries to
whom it owes a fiduciary duty.” Id.
at 227. The court denied the motion
for reconsideration and directed the
Bank to produce the documents at
issue within 10 days. Id. at 228.

*     *     *     *     *

A side issue to the above removal
litigation played out in 2014, when,
in connection with the removal
petitions, the individual trustee
and all beneficiaries of the subtrust
for Eloise Warriner Ehert asked
the Susquehanna County court
to accept jurisdiction over that
trust. Warriner Trusts, 4 Fid.
Rep. 3d 254 (O.C. Susq. 2014). The
Bank objected on grounds that there had
not been a proper change of situs
because that requires all trustees
and beneficiaries to consent, and
The Bank had not consented.
Citing the statutes with respect to
situs and nonjudicial settlement
agreements (20 Pa. C.S. §§ 7708,
7710.1), the court concluded that
the situs change required the
Bank’s approval and, therefore,
determined that Montgomery
County was the proper forum to
consider the request to change situs.
Id. at 257.

The Bank filed a petition with the
Montgomery County Orphans’ Court
to confirm the Montgomery County
situs and asking that court to retain
jurisdiction. Warriner Trust, 4 Fid.
Rep. 3d 317 (O.C. Montg. 2014). The
individual co-trustee, who was also
a beneficiary and had the consent
of all other beneficiaries, filed a
response and counter-petition in
which he requested that jurisdiction
be transferred to Susquehanna
County. The court recounted the
procedural history, including a prior
transfer in situs from Susquehanna
County to Montgomery County
in 2011 upon the consent of both
trustees and the beneficiaries. The
court cited 20 Pa. C.S. § 7708(g),
which permits a court to change
situs upon a finding that the
change is “necessary or desirable
for the proper administration of the
trust.” The court further considered
that five other family trusts had
a Susquehanna County situs, the
trust at issue owned real estate in
Susquehanna County, a proposed
trust modification before the
Susquehanna County court could
require interpretation of the trust
instrument, and all parties in interest,
other than the Bank, consented to
the change. Id. at 321-22. Under
those circumstances, the court
approved the situs change because
it was desirable for the proper
administration of the trust, and
would serve judicial economy. Id.
at 322.
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October Luncheon Program
Tuesday, October 18, 2016
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: “Why Can't I Open a Bank Account”
Speaker: M. Read Moore

November Luncheon Program
Tuesday, November 15, 2016
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: “Creative Ways to Obtain a Basis”
Speaker: Mickey R. Davis

Holiday Celebration
Thursday, December 8, 2016
5:30 – 7:30 p.m.
Union Trust
717 Chestnut Street, Philadelphia, PA

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