Session 408: Estate Planning: What Every NAPABA Member Needs to Know Personally and Professionally

According to a 2013 Pew Research Center article, Asian Americans are "the best-educated, highest-income, fastest-growing race group in the country." But unlike other groups, there is a lack of proper, timely estate planning in the APA community. Even in cases where there is some estate planning, it is often poorly done, fails to effectuate the testator's intent, and leads to disputes among surviving family members. The purpose of this program is to proactively address those issues. This program is intended not just for trusts and estates practitioners but for all NAPABA Convention attendees. Inevitably, all attendees, whether professionally or personally, will face the topics covered in this program, including the need for estate planning, the basic nuts-and-bolts of an estate plan, strategies for wealth preservation, gifting, philanthropy, and legacy building, practical tips on advising clients on estate planning, dealing with multiple representation and conflicts issues, handling post-death administration issues, and managing fiduciary responsibilities. Through the use of real-life scenarios, the highly experienced group of panelists will cover each of these topics, which are critical for the immediate and generational success of our clients and their progeny. These are topics that APA attorneys in all fields will encounter directly or peripherally at some point in their practice. The program will conclude with an open Q&A period during which time attendees can pose their estate planning, private wealth management, and fiduciary litigation questions to our panel of expert practitioners.

Program Chair:
Jonathan H. Park, Associate, Holland & Knight LLP

Moderator:
Vivian L. Thoreen, Partner, Holland & Knight LLP

Speakers:
Julie Min Chayet, Senior Vice President and Market Trust Director, U.S. Trust, Bank of America Private Wealth Management
Eric M. Tokuyama, Senior Counsel, Holland & Knight LLP
Eric S.T. Young, President, Law Offices of Eric S.T. Young, ALC
NAPABA 2014

Friday, November 7, 2014
3:30 PM - 4:45 PM

Session 408

Estate Planning: What Every NAPABA Member Needs to Know Personally and Professionally, including Strategies for Preserving Wealth and Building a Family Legacy

AGENDA

3:30 pm – 3:35 pm  Panel Introduction – Jonathan Park, Chair

3:35 pm – 3:45 pm  Short Primer on Basic Estate Planning – Eric M. Tokuyama, Panelist

3:45 pm – 4:00 pm  Case Study 1 (“Gifting Strategies”) – Vivian L. Thoreen, Moderator + Panelists

4:00 pm – 4:15 pm  Case Study 2 (“Multiple Representation and Conflicts of Interest”)

4:15 pm – 4:30 pm  Case Study 3 (“Post-Death Administration and Fiduciary Responsibilities”)

4:30 pm – 4:45 pm  Q&A – Vivian L. Thoreen, Moderator + Panelists
ESTATE PLANNING
(CALIFORNIA)
BASICS OF CALIFORNIA ESTATE PLANNING

PRESENTED BY

ERIC M. TOKUYAMA

I. Estate Planning - General Overview

A. Process. Estate planning involves your family and friends, and, in many cases, charitable organizations. It also involves your assets (your property) and the various forms of ownership and title that those assets may take. Estate planning also addresses your future needs in case you ever become unable to care for yourself.

B. Benefits of Estate Planning:

1. Defines how your assets will be managed during your lifetime if you ever become incapacitated.

2. Defines who will care for your minor children if you should become incapacitated.

3. Defines when and under what circumstances your assets can be distributed during your lifetime.

4. Defines how and to whom your assets will be distributed after your death.

5. Defines how and by whom your personal care will be managed and how health care decisions will be made during your lifetime if you become incapacitated.

6. Defines how your remains should be handled after you pass.

C. Planning. Estate planning not only involves the preparation and execution of a living trust and/or a will, but also involves financial, tax, medical and business planning.
II. Estate Planning For All Kinds

A. Small Estates. If your estate is small, you may simply focus on who will receive your assets after your death, and who should manage your estate, pay your last debts and handle the distribution of your assets.

B. Large Estates. If your estate is large, you will also want to focus on various ways of preserving your assets for your beneficiaries and of reducing or postponing the amount of estate tax which otherwise might be payable after your death. You might also want to think about asset protection, income tax planning and property tax planning.

C. Consequences of Not Having an Estate Plan. If you fail to plan ahead, your assets will be distributed to your heirs according to a set of rules known as intestate succession. Your relatives and, in some cases, the relatives of your spouse may receive your assets. An estate plan gives you much greater control over who will inherit your assets after your death. You don't want to risk having your assets going to some heirs that you may not even know exist.

III. Real Property and Personal Property

A. Assets. Your assets include real and personal property held in your name alone or jointly with others. Examples of assets are bank accounts, real estate, stocks, bonds, furniture, cars and jewelry. Your assets may also include life insurance proceeds and retirement accounts

B. Estate Taxes. The value of your gross estate is equal to the fair market value (based on qualified appraisals) of all of your various types of property. The value of your estate is important in determining whether your estate will be subject to estate taxes after your death and whether your beneficiaries could later be subject to capital gains taxes. Liquidity planning is an essential part of the estate planning process, so that you can know that any and all estate taxes can be paid from your assets.

IV. Will

A. What assets are subject to the provisions in your Will. Most of your assets in your name alone at death will be subject to the provisions found in your Will. However, assets with designated beneficiaries such as bank accounts, life insurance policies, retirement accounts, IRAs and some annuities may not be subject to your Will. Additionally, joint tenant assets and assets subject to a revocable trust are not subject to the provisions in your Will. Disposition of trust assets and other non-probate transfers will be discussed below.

B. Statutory Will. A California Statutory Will (a fill-in-the-blanks form) may be sufficient for some people. However, please be aware that you must execute your will in the manner required by California law. If you fail to comply with the procedures set forth in the Probate Code, your will may be deemed invalid.

V. Revocable Trust

A. Revocable Trust. A revocable trust will be established by you and administered for your benefit during your lifetime, and upon your death any remaining trust assets will be
distributed in accordance with the provisions set forth in your trust. Unlike with a will, a court does not have to be involved to administer the trust, which is a key feature of a revocable trust. As with a Will, you can revoke or change any terms of the trust at any time as long as you are still competent.

B. **Trustees.** In most cases, you will name yourself as trustee during your lifetime. As the trustee, you remain in control of the assets during your lifetime. A successor trustee will be named in the trust, and that named person will take over as the trustee and manage the trust’s assets if you should ever become unable to do so. The successor trustee would also administer your trust upon your passing, to ensure that any remaining trust assets get distributed in accordance with the trust provisions.

C. **Pour-Over Will.** Generally, a separate Will is executed in conjunction with the revocable trust. The Will (usually called a pour-over Will) acts as a backstop for your assets in the event that you fail to properly fund your trust during your lifetime. The Will simply states that any and all assets subject to the Will will be distributed to the trustee of the revocable trust and administered in accordance with the provisions found in the revocable trust.

VI. **Probate**

A. **Appointment of Executor or Administrator.** If you do not have a revocable trust and only a Will, or you pass away without any estate planning document, your assets will be subject to the probate process. Probate is a court-supervised process for transferring a deceased person’s assets to the beneficiaries listed in his or her Will or the heirs of the decedent if there is no Will. Someone, either an executor named in your Will or a relative, will begin the probate process by filing a petition in court and seeking appointment as personal representative. Your personal representative controls your assets, pays your debts and, after receiving court approval, distributes the rest of your estate to your beneficiaries.

B. **Small Estates.** Simpler procedures are available for transferring property to a spouse or for handling estates in which the total assets amount to less than $150,000.

C. **Advantages and Disadvantages.**

1. **Advantages.** The probate process is subject to a set of defined rules. Additionally, a probate court can help protect a beneficiary’s interest.

2. **Disadvantages.** Probates are public. Additionally, depending on the size of the estate, legal fees and executor/administrator fees may be more as compared with the legal fees and trustee fees incurred with a revocable trust. Finally, a probate proceeding usually takes much longer than the administration of a revocable trust.

VII. **Beneficiaries of Your Estate**

A. **Primary Beneficiaries.** Once you have decided who should receive your assets, it is very important that you correctly identify those chosen individuals and charitable organizations in your Will or trust.
B. **Alternate Beneficiaries.** Alternate beneficiaries should be named in the event that your primary beneficiaries do not survive you.

C. **Minor or Incapacitated Beneficiaries.** If a beneficiary is too young or disabled and cannot receive or handle a bequest, you should consider setting up a trust for his or her benefit under your Will or revocable trust.

VIII. **Minor Children**

A. **Guardian.** It is important for you to nominate a guardian to supervise and care for your child (and to manage the child’s assets) until he or she turns 18 years old. Your nomination of a guardian could avoid a conflict among well-intentioned family members and others, who may fight for custody of your children. The guardian that you choose does not have to be the same person, and many times it is not, that controls your child's trust or custodial account.

B. **Custodial Accounts or Trusts.** Upon your passing, you may choose to leave assets designated for a minor beneficiary in a custodial account under the California Uniform Transfers to Minors Act to be held for the child until he or she reaches age 18, 21 or 25. Or you might consider setting up a trust to be held, administered and distributed for the child’s benefit for his or her lifetime.

IX. **Estate and Gift Taxation**

A. **Estate Taxation.** Assets left to persons other than your spouse and qualified charities—even your children—will be taxed if gross estate for estate tax purposes totals more than $5.34 million. For estates that approach or exceed these amounts, significant estate taxes can be saved by proper estate planning before your death.

B. **Gift Taxation.** You can give away $5.34 million during your lifetime without incurring any gift tax. The estate and gift tax system is unified, so the amount of unused gift exemption at your death will be applied to your estate for estate tax purposes. In addition to the lifetime gift exemption, you can give away $14,000 a year to anyone without having to use any of your gift tax exemption. You may also pay a beneficiary’s college tuition or medical costs free of gift tax—but only if the payments are made directly to the educational institution or medical provider (this amount may exceed the $14,000 annual exclusion limit).

X. **Title of Assets**

A. **Community property and separate property.** If you are married or a registered domestic partner, assets earned by either you or your spouse or domestic partner while married or in the partnership and while a resident of California will be community property, unless there is a prenuptial agreement that states otherwise. As a married individual or registered domestic partner, you may continue to own certain separate property as well. A gift or inheritance received during the marriage or partnership is considered separate property. Separate property can be converted to community property and community property can be converted to separate property by a written agreement signed by both spouses. Please be aware, however, that transmutations can have significant tax and other consequences (including significant consequences on
termination of a marriage or domestic partnership), so it is imperative to seek advice of counsel, and often times separate counsel, before any party enters into a transmutation agreement.

B. **Tenants-in-common.** If you own property as tenants in common and one co-tenant (co-owner) dies, that co-tenant’s interest in the property would pass to the beneficiary named in his or her Will. This would apply to co-tenants who are married or in a domestic partnership as well as to those who are single.

C. **Joint tenancy with right of survivorship.** Co-owners of property can hold title as joint tenants with right of survivorship. If one tenant dies, the property passes to the surviving joint tenant without being affected by the deceased person’s Will. There are necessary steps that need to be taken to assert ownership as the surviving joint tenant, but a probate is not required to administer joint tenant property.

D. **Community property with right of survivorship.** If you are married or in a registered domestic partnership, you and your spouse or partner can also hold title to property as community property with right of survivorship. If your spouse or domestic partner dies, the property passes to surviving spouse or domestic partner without being affected by the deceased person’s Will. However, as with joint tenant property, there are necessary steps that need to be taken to assert ownership, but a probate is not required to administer community property with right of survivorship.

XII. **Power of Attorney and Advance Healthcare Directive**

A. **Power of Attorney.** A power of attorney is a written legal document that gives another person the right and authority to act on your behalf. The power of attorney can be limited to special circumstances or it can be general. Such authority will end if you become incapacitated—unless you have a durable power of attorney. A durable power of attorney will remain in effect while you are incapacitated. This means that if you were suddenly unable to handle your own affairs, someone you trust may do so for you. You can also set up a springing
power of attorney, which will only become effective at a specified future date or event, such as incapacity. A power of attorney expires when you die.

B. **Advance Health Care Directive.** An advance health care directive contains your wishes concerning such matters as life-sustaining treatment and other health care issues and instructions concerning organ donation, disposition of remains and your funeral. It is a good idea to provide copies to your health care agent, alternate agent, doctor, health plan representatives and family. An advanced health care directive will avoid problems over your care if you should become incapacitated. It is your agent’s duty to carry out your wishes as designated in the health care directive.
ESTATE PLANNING

(HAWAII)
I. BASIC WILL DRAFTING

A. CHECKLIST FOR GATHERING CLIENT INFORMATION

The initial step in the estate planning process involves the gathering of personal and financial information from the client. A checklist given to the prospective client to complete before the initial consultation can assist the estate planner in better preparing for the initial meeting. The checklist will give the estate planner the information that he or she needs to know in order to focus on issues that are particularly relevant to that client. A comprehensive checklist should include the following:

1. Identification. Obviously, a checklist should start with the prospective client’s identifying and contact information, including his or her full legal name (as it appears in official vital statistics documents, e.g., birth or marriage certificates) and any aliases, residence and mailing address(es), business address, residence and business telephone numbers, social security number, citizenship, birth date, and occupation. The same information should be obtained for the client/spouse.

2. Family Information. The checklist should request the full legal names of the client’s “heirs-at-law”, which could include his or her children, grandchildren, and parents. Also obtain their residence addresses and birth dates. The checklist may request general information about the health of the client and beneficiaries. This often serves as a starting point for the identification of special issues that need to be
addressed in the estate planning process, such as guardianships for minor children and the applicability of “special needs” trusts for disabled children or beneficiaries.

3. **Beneficiary Information.** In most cases, the beneficiaries will be the client’s heirs, but not always. Obtain the names and residence addresses of all beneficiaries. If a charity is to be named as a beneficiary, obtain the charities legal name and contact information.

4. **Prior marriages.** It is very important to find out about prior marriages, especially whether any children resulted from the marriage. Also, if the client is divorced, obtain a copy of the divorce decree to determine whether the estate plan is subject to any provisions thereof.

5. **Fiduciaries.** Obtain the names and addresses of those that will be nominated to serve as fiduciaries, such as personal representatives, successor trustees, attorneys-in-fact, guardians of the person and/or property, custodians under the Hawaii Transfers to Minors Act (HRS Ch. 553A), and as agents under an Advance Health Care Directive.

6. **Assets and Liabilities.** Obtain accurate and complete information about the client’s estate. The checklist should request information about the types of assets owned by the client, such as cash, checking and savings accounts, money market accounts, stocks, bonds, mutual funds, real estate, life insurance, tangible personal property (such as cars, boats, antiques, art, collectibles), annuities, retirement, pension and profit-sharing plans, individual retirement accounts ("IRAs"), “Section 529” college savings plans, time shares, business interests (partnerships, closely-held corporations,
LLCs), intellectual property (copyrights, patents, trademarks), etc. Likewise, obtain information about the client’s debts, including mortgage loans, home equity loans, student loans, auto loans, and promissory notes.

B. FORMS OF OWNERSHIP

Before recommending an appropriate estate planning vehicle to the client, the estate planner must analyze the manner in which the client holds title to assets. In Hawaii, ownership may take one of four forms: (1) sole ownership (otherwise referred to as tenancy in severalty); (2) tenancy in common (sometimes abbreviated “T/C”); (3) joint tenancy with rights of survivorship (sometimes abbreviated “J/T” or “JTWROS”); and (4) tenancy by the entirety (sometimes abbreviated “T/E”).

1. **Sole Ownership.** Sole ownership exists where there is only one person on title. The owner may unilaterally transfer his or her rights in the property to another. Solely-owned property is generally reachable by the owner’s creditors. Property solely-owned is subject to probate administration regardless of whether the individual owner has a will or dies intestate. Corporations, partnerships, and LLCs may own property as tenants in severalty.

2. **Tenancy in Common.** Tenancy in common is a form of co-ownership. Ownership is characterized by a percentage or fractional interest in the property (e.g. “20%” or “one-third”), without survivorship rights. Each tenant retains the right to occupy the entire property and is said to own an “undivided interest” in the whole. The co-owner may freely transfer his or her fractional share without the consent of the other co-owners. If the tenant wishes to sever his or her interest from the other
joint tenants, in the case of real property, the tenant may subdivide the property or seek judicial partition. HRS § 668-1.

Property conveyed to two or more persons will be “construed to create estates in common and not in joint tenancy or by entirety, unless it manifestly appears from the tenor of the instrument that it was intended to create an estate in joint tenancy or by entirety.” HRS § 509-1.

Property owned as a tenant in common is generally reachable by the tenant’s creditors. At death, each individual owners’ interest is subject to probate administration. Corporations, partnerships, and LLCs may own property as tenants in common.

3. **Joint Tenancy With Rights of Survivorship.** JTWROS is a form of ownership in which the co-tenants own equal undivided interests with a right of survivorship. Upon the death of a joint owner, the surviving owners inherit the decedent’s interest in equal shares by operation of law.

For example, Kahala Beach Lot 1 is owned by A, B, C as joint tenants with rights of survivorship. Each owns an undivided one-third of the property. Upon the death of A, B and C inherit A’s one-third share (or one-sixth to each) by operation of law. B and C would end up owning undivided one-half interests in the whole. Upon the death of B, C would inherit B’s interest and would own 100% of the property. C’s ownership interest has converted to tenancy in severalty, meaning that upon C’s death, the property will be subject to probate, regardless of whether C has a will.
A joint tenant may freely transfer his or her interest in the property, and therefore, the interest is generally reachable by creditors and may be subject to partition. HRS § 668-1. Corporations, partnerships, and LLCs may not own property as joint tenants with rights of survivorship.

4. **Tenancy by the Entirety.** Tenancy by the entirety is a unique form of ownership available only to a husband and wife. Both spouses are said to be “jointly seized of property such that neither spouse can convey an interest alone nor can one spouse’s creditor attach the property to satisfy a debt.” Traders Travel International, Inc. v. Howser, 69 Haw. 609, 613, 753 P.2d 244, 246 (1988); see also Sawada v. Endo, 57 Haw. 608, 561 P.2d 1291 (1977); and Security Pacific Bank Washington v. Chang, 80 F.3d 1412 (Haw. 1996). Although tenancy by the entirety may exist in personal property, it must “manifestly appear that the spouses intended to create such an estate.” Id.; HRS §§ 509-1 and 509-2.

An obligation arising against one spouse cannot reach the T/E property, even if the tenancy is thereafter severed. Sawada, 57 Haw. at 617, 561 P.2d 1297. Thus, assume that husband and wife own their residence in T/E. Thereafter, H incurs a debt obligation to Creditor A. H & W then transfer the residence to W. Creditor A may not void the transfer or reach the interest in property conveyed to W. Id. However, if the debt arises after the tenancy has been severed, the debt may be satisfied out of the tenant’s share. For example, assume that husband and wife convey their residence to their respective revocable living trusts, thus severing T/E. Each trust now holds title in T/C. If husband now becomes indebted to Creditor A, Creditor A may

Although Sawada remains good law in Hawaii, T/E will, in all likelihood, not protect property from the reach of a federal tax lien against either spouse, even if the lien arises after the creation of the tenancy.  U.S. v. Craft, 2002 WL 561332 (S. Ct. 4/17/02)(in which the U.S. Supreme Court ruled that a Michigan T/E statute would not bar the reach of a federal tax lien against one spouse, notwithstanding the fact that the lien arose after the creation of the tenancy.

5. **Community Property.** Estate planners need to be aware of a fifth form of ownership that was at one time but no longer is available in Hawaii, namely “community property”. Community property is defined as property acquired by either or both spouses during marriage, except by inheritance or gift which is deemed “separate property”. Property owned prior to the marriage is considered separate property.

Each spouse is presumed to own an equal share in all property accruing to either spouse during marriage. Hawaii recognizes community property rights that arise under the laws of other states, which include California, Arizona, Washington, Idaho, New Mexico, Nevada, Texas, Louisiana, and Wisconsin.

C. **PROBATE AND NON-PROBATE PROPERTY**

Before recommending an estate planning vehicle to a client, the estate planners must be able to recognize which forms of property ownership are subject to probate administration.
1. **Probate Property.** As noted above, property solely-owned or owned by tenants in common will be subject to probate administration upon the owner’s death.

2. **Non-Probate Property.**
   
   a. **Jointly-Owned Property.** As noted above, JTWROS and T/E property avoids probate upon the deaths of all joint tenants except the last survivor. Remember that although joint tenancy and tenancy by the entirety property avoid probate by operation of law upon the death of the owner, the last surviving tenant or the surviving spouse will become a sole owner (a tenant in severalty) and property owned in the owner’s individual name will be subject to probate administration upon death.

   b. **Contractual Interests That Have a Designated Beneficiary.** Contractual interests that provide for the designation of a beneficiary may avoid probate if the proper beneficiary is designated. The beneficiary designated must be alive at the owner’s death and should not be the owner’s estate (the latter of which will necessitate probate). Examples of such contractual interests include life insurance policies, IRA’s, retirement, pension and profit-sharing plans (including 401k’s and 457 deferred compensation plans), and annuities with a death benefit.

   Upon the owner’s death, the asset administrator will pay death benefits due to the named beneficiary, if living. For example, decedent owned a life insurance policy with a face value of $100,000 at death. Decedent designated spouse as the primary beneficiary and child as the contingent beneficiary. Upon presentation of a certified copy of the decedent’s death certificate and the completion of appropriate forms,
the insurance company will pay directly to spouse the death benefit amount. If spouse had predeceased the decedent, the payment would be made to child. If both spouse and child predeceased the decedent, and no other contingent beneficiary had been named, a probate would have to be instituted to determine who the decedent’s beneficiary or heirs-at-law are.

Some financial institutions authorize the creation of “pay-on-death” or “P.O.D.” accounts that serve the same function.

c. **Trusts.** Assets owned by a trust continue to be administered pursuant to the terms of the trust after the owner’s death and thus avoid probate.

**D. PROBATE ADMINISTRATION**

If probate is required, the estate planner must be able to advise the client regarding the procedures and advantages and disadvantages of probate administration.

1. **Collection by Affidavit.** The tangible personal property of a decedent may be collected via a simple affidavit provided that the gross value of the decedent’s estate does not exceed $100,000 (not including automobiles, which may be transferred regardless of value) and does not include real property. HRS §§ 560:3-1201 et. seq.

2. **Small Estates.** A proceeding may qualify for administration by the Small Estates and Guardianships Division of the Circuit Courts of the State of Hawaii, if the gross value of the decedent’s estate does not exceed $100,000 (not including automobiles) but does include Hawaii real property. The probate will be
administered by the clerk of the probate court of the judicial circuit in which the decedent owned property or was domiciled. HRS § 560:3-1205.

3. **Informal and Formal Probate Proceedings.** Probate estates that have gross values in excess of $100,000 must be administered either formally or informally. Formal probates are administered by the probate court while informal probates are administered by the court’s registrar. HRS §§ 560:3-301 and 3-401. In either case, the duties of the personal representative are the same: to (1) locate, identify and inventory all of the decedent’s assets and liabilities; (2) pay all of the decedent’s debts and taxes; (3) pay all probate administration expenses; (4) protect, and in some cases, make productive, assets held by the estate; (5) account to the beneficiaries of the estate; and (6) distribute the net probate estate to the decedent’s heirs and/or devisees.

The principal expenses of probate administration include: (1) attorneys’ fees and costs; (2) personal representative’s fees and costs (which are often waived if the nominated personal representative is a family member or beneficiary); (3) accountant’s fees and costs; (4) realtor’s commissions and costs (if applicable); and (5) court filing fees. Probate administration can be completed in as short a period as six months or as long as many years in cases involving property in multiple jurisdictions and/or litigation.

E. **SELECTING THE VEHICLE**

1. **Intestate Succession.** “What happens if one does no estate planning?” or “Estate planning by operation of law”.

By law, “any part of a decedent’s estate not effectively disposed of by will passes by intestate succession as prescribed” by statute. HRS § 560:2-101(a).

Hawaii’s scheme for intestate succession is summarized in the following tables:
**TABLE 1 - IF SPOUSE SURVIVES**

<table>
<thead>
<tr>
<th>Survivors</th>
<th>Share of Spouse</th>
<th>Share of Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 spouse</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>no descendants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>no parents</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 spouse</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>descendants of decedent &amp; spouse</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 spouse</td>
<td>First $200,000 + 75% of the balance</td>
<td>25% of the balance to parents</td>
</tr>
<tr>
<td>parents</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 spouse</td>
<td>First $150,000 + 50% of the balance</td>
<td>50% of balance to decedent’s and spouse’s descendants</td>
</tr>
<tr>
<td>spouse’s descendants by a prior marriage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>decedent and spouse’s descendants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 spouse</td>
<td>First $100,000 + 50% of the balance</td>
<td>50% of balance to decedent’s descendants</td>
</tr>
<tr>
<td>decedent’s descendants by prior marriage</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**TABLE 2 - IF NO SPOUSE SURVIVES**

<table>
<thead>
<tr>
<th>Survivors</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 descendants</td>
<td>100%</td>
</tr>
<tr>
<td>2 parents*</td>
<td>100%</td>
</tr>
<tr>
<td>3 siblings &amp; children of deceased siblings</td>
<td>100% to descendants of parents</td>
</tr>
<tr>
<td>4 grandparents &amp; their descendants</td>
<td>50% to paternal grandparents or their descendants; 50% to maternal grandparents or their descendants</td>
</tr>
<tr>
<td>5 none of the above</td>
<td>State of Hawaii</td>
</tr>
</tbody>
</table>
*If the decedent is a minor, a parent inherits nothing if the parent deserted the child, failed to communicate with the child for one year when child in the custody of another, or violated a child support order to provide care and support for the child for one year. HRS § 560:2-103(2).

a. **Advantages.** None. While it may be said that doing no estate planning is the cheapest alternative, as noted below, the cost of “clean-up” often greatly exceeds what would have been the planning costs.

b. **Disadvantages.**

   (1) **Loss of Control.** The decedent, by failing to implement an estate plan with at least a simple will, has lost the opportunity to control the manner of the disposition of his or her estate. As noted in the tables above, the intestacy statute was designed to provide an “average” or “normal” and equitable pattern of disposition. Rarely, however, does the “one size fits all” approach reflect one’s testamentary intent.

   **A note on joint tenancy** - A notable circumstance includes the situation where a husband and wife, each with children by a prior marriage, either die intestate or have wills drafted, but title all of their assets in joint tenancy or tenancy by the entirety. If wife predeceases husband, husband inherits everything by operation of law (regardless of whether wife had a will or not). Husband, then, may leave all of their assets exclusively to his descendants, to the exclusion of her descendants, which in most cases would not have been wife’s intent.
(2) **Lost Opportunity For Tax Planning.** The estate and gift tax system is described below in Part III. Suffice it to say that the intestacy statute was not designed to address the consequences of federal estate, gift and generation-skipping taxation, and that a married couple may lose the opportunity to eliminate an otherwise avoidable tax burden.

(3) **Lost Opportunity to Select Guardians of the Person and Property of Minor Children.** If one has minor children, a will serves the important function of designating guardians of the person and property of the children. State statutes provide priority to the persons nominated in a will in any contested guardianship proceedings. HRS § 560:5-204.

(4) **Lost Opportunity to Select Fiduciary.** Similarly, a person nominated under a will gives the nominee statutory priority for appointment as personal representative of the estate. Because the personal representative is given legal authority to control the decedent’s probate estate, it is important to nominate a trustworthy and competent person to serve. The statutory priority for the appointment of a personal representative is as follows:

- (a) decedent’s nominee by will;
- (b) surviving spouse-devisee;
- (c) other devisee;
- (d) surviving spouse;
- (e) heir; and
- (f) any creditor, 45 days after death.

HRS § 560:3-203(a).
(5) Lost Opportunity to Create Generation-Skipping and/or Spendthrift Trusts for Descendants. Many people would not want their children to inherit property until their children reach a “mature” age. Under Hawaii law, the age of majority is eighteen. A popular device that provides for the administration of assets for a beneficiary beyond the age of majority is a trust. A trust can take the form of a revocable or irrevocable trust or may be incorporated into a will (in which case it is referred to as a testamentary trust). A trust may be designed to protect a beneficiary from himself (through the use of a “spendthrift” provision, described in Part III), and to minimize the payment of federal estate and generation-skipping taxes (described in Part III).

(6) Probate. Intestacy does not avoid probate.

2. Simple Will. The primary functions of a simple will are to provide (1) for the disposition of the decedent’s probate estate, (2) instructions regarding the payment of debts, taxes and expenses of administration, and (3) for the appointment of personal representatives and guardians of the person and property for children.

   a. Advantages. A simple will can eliminate the disadvantages of dying intestate. See Part I.F.1.B. above. It also relatively inexpensive and simple to create.

   b. Disadvantages.

      (1) Probate. A will does not avoid probate.

      (2) Lost Opportunity For Tax Planning. In many instances, a spouse’s primary testamentary intent involves providing for the surviving
spouse. Under a will, the spouse would then be designated as the primary beneficiary of a whole or significant part of the estate. This may not result in the minimization of federal estate and generation-skipping taxes. See Part III.

(3) **Lost Opportunity to Create Trusts for Descendants.** By definition, a simple will does not include trust provisions.

3. **Testamentary Trust (Will With Trust Provisions).** A testamentary trust is a will that contains trust provisions that take effect upon the decedent’s death. The designated beneficiary of the will is a trust established for the benefit of the decedent’s beneficiaries. See Form of Testamentary Trust attached hereto as Appendix I-3.

   a. **Advantages.** A testamentary trust avoids the disadvantages of intestacy. A testamentary trust can also be drafted to maximize a married couple’s available credits against federal estate and generation-skipping taxes. Finally, a testamentary trust may contain provide for the administration of the decedent’s estate well beyond the beneficiary’s attainment of the age of majority.

   b. **Disadvantages.**

      (1) **Probate.** A testamentary trust remains subject to probate administration. At the completion of the probate process, the net probate estate is distributed to the trust.

      (2) **Cost.** Generally speaking, due to complexity, the preparation of a testamentary trust will cost more than for a simple will. When compared against a revocable living trust, most clients choose the latter. See Part II.
4. **Pour-Over Will.** A pour-over will is a device exclusively used in conjunction with a revocable living trust. It is essentially a simple will that designates an existing trust (typically, an existing revocable living trust) as the sole residuary beneficiary of the estate.

   a. **Advantages (When Used in Conjunction with a Revocable Living Trust).**

      (1) **Avoid intestacy.** The pour-over will is a “safety device” when used in conjunction with a “funded” revocable living trust. It is intended to provide for the probate administration of any of the decedent’s assets that have not been transferred to trust.

      (2) **Opportunity for Tax Planning.** As noted in Part III below, a pour-over will used in conjunction with a “bypass” or “family” trust can be used to minimize the federal estate and generation-skipping taxes imposed on a married couple’s estate.

      (3) **Opportunity to Create Trusts for Descendants.** A pour-over will in conjunction with a revocable living trust can provide for the administration of assets beyond a beneficiary’s attainment of the age of majority.

      (4) **Avoids Probate.** While the pour-over will itself does not avoid probate, it is as a companion to a revocable living trust which is intended to avoid probate.

   b. **Disadvantage.** A pour-over will and revocable living trust is generally more expensive and time-consuming to create. As noted above, extra effort
is required by the testator to transfer assets to the trust for the purpose of avoiding probate.

F. THE STATUTORY ABC’S -- WHAT IS REQUIRED?

1. Testamentary Capacity. In Hawaii, “an individual eighteen or more years of age who is of sound mind may make a will.” HRS § 560:2-501. Hawaii’s Uniform Probate Code (“UPC”), however, is silent regarding the definition of “sound mind”. In Hawaii, the courts have adopted the common law definition of testamentary capacity, as follows:

Testamentary capacity has been defined as the ability to know: (1) the nature and extent of the testator or testatrix’s estate; (2) the identity of the beneficiaries and their relationship, whether by blood or other circumstances, to the testator or testatrix (i.e., the objects of his or her bounty); (3) the disposition that the testator or testatrix is making; and (4) how these elements relate so as to form a rational and orderly plan for the disposition of the testator or testatrix’s estate.

_Estate of Herbert_, 90 Haw. 443, 455, 979 P.2d 39, 51 (1999) (internal citations omitted) (“[t]he classic test of general testamentary capacity has three elements: to make a will, one must be able to (1) identify the natural objects of one’s bounty and recognize one’s relationship to them, (2) recall the nature and extent of one’s property, and (3) dispose of one’s property understandingly, according to a plan formed in one’s mind”).
It is generally thought that the test for testamentary capacity is a relatively low standard. As noted by the Supreme Court of Maine, the law requires “only a modest level of competence” to execute a will. *Estate of Rosen*, 447 A.2d 1220, 1222-1223 (Me. 1982) (emphasis added).

2. **No Residency Requirement.** There is no requirement that the testator be a Hawaii resident. HRS § 560:2-501.

3. **Execution Requirements.**
   a. **Writing.** A will must be in writing. HRS § 560:2-502(a)(1).
   
   b. **Signed by Testator and Two Witnesses.** A will must be signed by the testator or by someone else in the testator’s conscious presence and at the testator’s direction. HRS § 560:2-502(a)(2). A signature includes a “mark” such as an “X”. Or, if the testator is physically incapacitated, he may direct another to sign the will for him in his “conscious presence”. Being within the testator’s conscious presence means within the range of the testator’s senses, such as hearing. The signer need not be in the testator’s line of sight. 8 Uniform Laws Annotated, Estate, Probate and Related Laws, Uniform Probate Code § 2-502, Comment (1969)(“U.L.A.”).

   A will must be signed by at least two witnesses. Each witness must sign within a reasonable time of either witnessing the testator sign the will or acknowledging his signature or the will. HRS § 560:2-502(a)(3). Note that there is no requirement that the witnesses sign the will before the testator’s death. Of course, it is a good general practice to obtain the signatures of two witnesses contemporaneously with
its execution by the testator. Any individual generally competent to serve as a witness to
the signing of a will may act as a witness (including a beneficiary thereunder). HRS §
560:2-505.

c. **Self-proving Affidavit.** A self-proving affidavit is an acknowledgment by the testator and the witnesses under oath that certifies that the testator (1) signed the will willingly and voluntarily, (2) was 18 years of age and of sound mind at the moment of execution, and (3) was under no undue influence at the time of execution. HRS §560:2-504. While not required, the inclusion of self-proving affidavits is highly recommended. If the validity of the will is challenged, and the will is self-proved, “compliance with signature requirements for execution is conclusively presumed and other requirements for execution are presumed subject to rebuttal without the testimony of any witness upon filing the will . . . unless there is proof of fraud or forgery affecting the acknowledgment or affidavit.” HRS § 560:3-406(b).

d. **Signature Lines.** Although there is no requirement that the signature line appear at the end of the document, like most written documents, the signatory signs at the end, perhaps to bolster the presumption that the entire document was read prior to signing. It is also a good practice to have a testator sign or initialize each page of the will to prevent the fraudulent substitution of pages.

4. **Holographic Wills.** A will that is not witnessed may still be valid as a holographic will “if the signature and material portions of the document are in the testator’s handwriting.” HRS § 560:2-502(b). Prior to 1996, holographic wills were not allowed in Hawaii. In a will contest, extrinsic evidence that the document was intended by the testator as his will is allowed. HRS § 560:2-502(c).
5. **Writings Intended as Wills.** Even if the execution requirements described above are not met, a writing may be treated as a valid will if the proponent of the writing establishes “by clear and convincing evidence” that the decedent intended the writing as his will. HRS § 560:2-503.

**G. METHODS OF DESIGNATING FIDUCIARIES**

The testator may designate his or her personal representatives using the following language:

I nominate as my Personal Representative, ___________. If ___________, is or becomes unable to serve as Personal Representative or declines to do so, then I nominate ___________ to serve as my Personal Representative.

See Form of Simple Will attached hereto as Appendix I-2.

As noted above, important attributes of a personal representative are trustworthiness and competence. If no such appropriate or qualified person comes to mind, a testator may designate any one of the corporate fiduciaries that are licensed to do business as such in Hawaii.

A personal representative is entitled to receive a reasonable fee for his or her services. HRS § 560:3-719. Because family members or devisees are often willing to waive payment for their services, they are often designated to serve.

**H. DISINHERITANCE AND NO CONTEST CLAUSES + WILL THEY STAND?**

1. **Elective Share.** Is it possible to disinherit a spouse? It has become much more difficult to disinherit a surviving spouse under the UPC. Under prior law, a surviving spouse could opt to receive an elective share instead of whatever
provision was made for the spouse by the deceased spouse. However, under prior law, the spouse could only elect against the decedent’s “probate” estate, which was easily circumvented by consciously avoiding probate.

Current law makes it much more difficult to disinherit a spouse. In Hawaii, the surviving spouse has a right of election to take an elective-share amount “equal to the value of the elective-share percentage of the augmented estate.” HRS § 2-202.

**TABLE 3 - ELECTIVE SHARE**

<table>
<thead>
<tr>
<th>Years of Marriage</th>
<th>Elective-Share Percentage</th>
</tr>
</thead>
<tbody>
<tr>
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<td>3%</td>
</tr>
<tr>
<td>2-3</td>
<td>6%</td>
</tr>
<tr>
<td>3-4</td>
<td>9%</td>
</tr>
<tr>
<td>4-5</td>
<td>12%</td>
</tr>
<tr>
<td>5-6</td>
<td>15%</td>
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<td>18%</td>
</tr>
<tr>
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<td>14-15</td>
<td>46%</td>
</tr>
<tr>
<td>15+</td>
<td>50%</td>
</tr>
</tbody>
</table>

The “augmented estate” consists of the following:

a. the decedent’s net probate estate;
b. the decedent’s non-probate transfers to others;
c. the decedent’s non-probate transfers to spouse; and
d. the spouse’s property and non-probate transfers to others.

HRS §§ 560:2-203 through 2-207.

Note, however, that the right to an elective-share may be waived in whole or in part, either before or after marriage, by a written contract, agreement or waiver signed by the spouse. HRS § 560:2-213(a). Such contracts are referred to as either pre-nuptial or post-nuptial agreements. Such agreements are not enforceable if the spouse proves that: (1) the agreement was not executed voluntarily; or (2) the spouse was not provided with a fair and reasonable disclosure of the property of the decedent, and was therefore, unconscionable. HRS § 560:2-213(b).
2. **Pretermitted Heirs.** The omitted spouse statute provides a mechanism for a spouse to inherit a portion of the decedent’s estate if the spouse married the decedent after execution of the decedent’s will. HRS § 560:2-301. The statute authorizes the spouse to receive as an intestate share, that portion of the decedent’s probate estate not devised to the testator’s child born before the marriage and conceived by someone other than the spouse. Id. The statute can be circumvented in a number of ways, including avoiding probate and specifying in the will that its provisions are meant to be effective notwithstanding subsequent marriage. Id.

Similarly, omitted children born or adopted after execution of a will may take a share of the decedent’s estate, unless “it appears from the will that the omission was intentional”. HRS § 560:2-302(b). This statute can be “drafted around” by clearly stating in the will that any omission to provide for after-born or after-adopted children is intentional. Id.

3. **No Contest Clauses.** A “no contest” or “in terrorem” clause essentially purports to disinherit any beneficiary that contests the validity of the will or its admission to probate. Under the UPC, such clauses are generally unenforceable. See HRS § 560:2-517 (“[a] provision in a will purporting to penalize an interested person for contesting the will or instituting other proceedings relating to the estate is unenforceable if probable cause exists for instituting proceedings”); and see HRS § 560:3-905.

I. **PROTECTIVE CLAUSES FOR MINORS, INCOMPETENT PERSONS AND CHILDREN WITH SPECIAL NEEDS**

A problem arises for the personal representative if the devisee is under a legal disability such as minority or incompetency. For example, if the personal
representative distributes a bequest of $5,000 to a minor or incompetent as directed under the will, notwithstanding the prior appointment of a guardian of the property for each, and the devisee squanders the fund, query whether the personal representative is personally liable to the devisee’s legal representative for negligence.

1. **Distributions to Minors and Incompetent Persons.** If the personal representative knows that a proceeding for the appointment of a guardian of the property is pending for an heir or devisee, the personal representative is required to distribute any devise to the guardian. HRS § 560:3-915(b). In addition, if the heir or devisee is incompetent, the personal representative may distribute to the heir or devisee’s attorney-in-fact, or to the spouse, parent, or other “close relative” with whom the incapacitated person resides without court order, provided that the sum is less than $10,000 per year. HRS § 560:3-915(c). Court approval is required for the distribution of sums exceeding $10,000, and in such cases, the court will likely require the establishment of a guardianship of the property for the protected person. The personal representative is not responsible for the proper application of funds distributed as set forth above or as expressly provided in the will. HRS § 560:3-915.

It is well worth considering adding language to a will (or trust) to authorize the personal representative (or trustee) to make distributions as provided by the Hawaii Uniform Transfers to Minors Act ("HUTMA") (HRS Ch. 553A) and the Hawaii Uniform Custodial Trust Act ("HUCTA") (HRS Ch. 554B). HUTMA authorizes a personal representative to distribute to a person or trust company as custodian funds otherwise distributable to the minor. HRS § 553A-5. If the will does not specifically authorize the transfer under HUTMA, any transfer exceeding $10,000 must first be
approved by court. Because HUTMA defines a minor as anyone under the age of twenty-one, a minor may prefer the creation of a guardianship of the property which terminates upon the minor's reaching the age of majority, which is defined as eighteen years of age. See e.g., HRS §§ 1-201 and 5-101. Thus, from the perspective of the parent, of course, twenty-one may appear to be a more appropriate age for distribution, and therefore, provision for distribution under HUTMA should be considered.

Transfers to a custodian under HUCTA for the benefit of an incapacitated person, however, require court approval whether authority is specifically provided in the will or not. HRS § 554B-5.

Accordingly, the following language should be considered for inclusion in a will:

**Beneficiaries Under Legal Disability.** If a beneficiary is a minor or otherwise under a legal disability, the Personal Representative may, in the Personal Representative's discretion, make distributions to or for such beneficiary in any of the following ways:

1. directly to or for the benefit of said beneficiary;

2. by making payments to the guardian of the beneficiary's person or property or to any suitable person with whom the beneficiary resides;

3. to a custodian for such beneficiary under the Uniform Transfers to Minors Act or similar statute in force in the state of my domicile or any other jurisdiction, until the age of 21 years if permitted by law (and the Personal Representative is authorized to designate any individual or corporation, including the Personal Representative, as such custodian for the purpose of receiving such distribution). The recipient of any distribution made pursuant to subparagraphs 2 and 3 hereof shall not be required to qualify in any jurisdiction as donee of a power in trust or any other capacity or to post any bond or other security.
2. **Children With Special Needs.**¹ A disabled child that receives government benefits, in particular, Supplemental Security Income (“SSI”) and Medicaid, may benefit from a trust that provides for the child’s “special” or “supplemental” needs without disqualifying the child’s benefit eligibility status.

Generally speaking, any resource that may be used for a person’s food, clothing or shelter is counted as an asset of the person for eligibility purposes. See the Social Security Administration’s Program Operating Manual System (“POMS”) § SI 01120.200. In order to avoid disqualifying a child from receiving SSI or Medicaid, and yet provide for the supplemental needs of the child, it may be advisable to create a testamentary trust for the child’s benefit with the restrictive distributive language.

Sample language for consideration:

1. If in the opinion of the Trustee, Child is in need of additional funds to provide for her health, education and reasonable comfort, Trustee may pay to or for the benefit of Child such amounts from the income or principal of this trust as determined in the Trustee’s discretion to be necessary or appropriate for such purposes.

2. Notwithstanding the foregoing, Trustee shall make no distribution of trust principal or income directly to Child, and shall make no such distributions to others for the provision of food, clothing or shelter for Child. It is the intention of the Testator to provide for a mechanism for the provision of supplemental benefits for Child and not to supplant any governmental or other aid which would otherwise be available to her. The Trustee is authorized to make such distributions for travel, entertainment, education, taxes, supplemental medical care or therapy not

¹ This area of the law is complex and ever-changing and practitioners are well-advised to research applicable federal and state law in connection therewith.
otherwise provided to Child through governmental programs, furniture and furnishings, medical supplies, adaptive aids, and such other items as may be reasonably calculated to improve the quality of Child’s life without affecting her governmental benefits.

3. In the event that Trustee is requested by any department or agency administering public benefits to release principal or income of the trust to or for the benefit of the beneficiary, or to pay for medical equipment, medication, or services which such department or agency is authorized to provide, Trustee is authorized and directed to deny the request and is directed to defend, at the expense of the trust estate, any attack on the nature of this trust.


J. BUILDING FLEXIBILITY INTO THE PLAN + CHECKLIST OF SPECIAL PROVISIONS AND PRACTICAL POINTERS WITH SAMPLE FORMS AND LANGUAGE

1. Dispositive Provisions. The heart of any will is its dispositive provision. Practitioners need to be aware of potential pitfalls that can lead to unintended results upon the testator’s death.

   a. Lapse. A lapse occurs when the intended beneficiary predeceases the testator and the testator failed to provide for a contingent disposition. Thus, for example, let us assume that (1) A has two children, B and C, (2) B and C have three children each, and (3) A’s will left the residuary estate “to my children, A and B, in equal shares.” If C predeceases A, A’s bequest to C lapses, and B inherits the whole residuary estate.

   Many states have adopted an “anti-lapse” statute that provides for a substitute gift to the issue of a predeceased beneficiary. Under Hawaii’s
anti-lapse statute, if the deceased devisee is a grandparent, descendant of a grandparent, or stepchild of the testator, a substitute gift is created in the devisee’s surviving descendants. HRS § 560:2-603(b). Thus, in the foregoing example, the bequest to C would be distributed to C’s three children, who would each receive one-sixth of the testator’s estate.

If, however, the testator, A, does not wish the descendants of C to receive the substitute gift, A, must create “an alternative devise” in order to supercede the anti-lapse statute. Thus, A’s will should be drafted to read, “to my children, B and C, in equal shares, but if C is not then living, then his share shall be distributed to B if she is then living, or if not, then to her issue, per stirpes.”

b. Per Stirpes and By Representation. An obvious problem is created when a devise is simply made to “my descendants”. Literally, the phrase includes all of the testator’s descendants living on the date of the testator’s death. At common law, the term “per stirpes” was devised to indicate a method of distribution to the closest living generation of descendants, in equal shares, and to the living issue of any deceased descendant. As codified, if a will calls for property to be distributed “per stirpes”, the decedent’s property shall be divided into as many equal shares as there are: (1) surviving children of the deceased ancestor; and (2) deceased children who left surviving descendants. Each surviving child is allocated one share and one share is allocated to the collective descendants of the deceased child, and divided in the same manner. HRS § 560:2-710(c).

Assume that A has two living children, B and C, and one deceased child, D. B has one child, C has two children, and D left three children. A’s
will provides that upon her death, the residuary estate shall be distributed to her “issue, per stirpes.” A’s estate will be divided into three shares, one each for B and C, and one for the collective issue of D. B and C will each receive one-third of the estate, and the children of D will divide D’s one-third, each taking one-ninth of the estate.

Assume now, that both B and D predeceased A. By the definition of “per stirpes”, B’s child will receive one-third, while D’s children will receive only one-ninth, even though each devisee is of equal relation to the settlor as a grandchild.

To remedy this situation, the UPC has adopted an alternative mode of distribution referred to as “by representation” or “per capita at each generation”. HRS § 560:2-709. Thus, if A’s will devised his residuary estate to “my descendants, by representation”, A’s estate would be divided into as many shares as there are (1) surviving descendants in the generation nearest to A, and (2) deceased descendants in the same generation leaving living descendants. Each living descendant in the nearest generation would be allocated one share, and the remaining shares are combined and then divided in the same manner among the surviving descendants of the deceased descendants. Id. Thus, B would be allocated one-third of A’s estate. The two shares of A’s deceased children, B and D, would be combined and divided among the surviving descendants of B and D in the same manner. Since B left one child and D left three, the remaining two-thirds would be distributed in equal shares to the four grandchildren. Thus, each of A’s four grandchildren would receive the same amount - one-fourth of two-thirds, or one sixth each.
c. **Ademption.** The term “ademption” is commonly used to describe the failure of a specific bequest due to the sale or other disposition of the property bequeathed by the testator during his life. For example, if A’s will specifically devised A’s “Jaguar convertible” to son, B, but prior to A’s death, said Jaguar was sold and replaced with a BMW, the specific bequest to B fails - B does not receive the BMW as substitute property. If A intended to leave B said Jaguar or an equivalent sum of money, A’s will could have read: “I leave my Jaguar convertible to B, but if I do not own a Jaguar convertible at my death, then B shall receive the sum of $50,000.”

d. **Satisfaction.** Prior to the adoption of the UPC, it was often unclear whether a gift made by the testator during his lifetime was intended to satisfy any part of donee’s inheritance. Thus, if A bequeathed $100,000 to B in his will, and gave B the sum of $50,000 during life, it could be argued that A intended that the lifetime gift reduce A’s bequest. To avoid controversy, a testator might have disclaimed satisfaction by stating in his will: “No bequest that I make in this will shall be considered either partially or fully satisfied by any inter vivos gift that I may make.”

The UPC resolved this problem by providing that an inter vivos gift will be deemed in satisfaction of a bequest only if (1) the will provides for a deduction of the gift, (2) the testator declared in a contemporaneous writing that the gift is made in satisfaction of a devise, or (3) the donee acknowledged in writing that the gift is in satisfaction of a devise. HRS § 560:2-609.

If satisfaction is intended, the better practice involves amending the testator’s will by codicil.
To properly calculate the effect of a lifetime gift in satisfaction of a bequest, the personal representative must first add to residuary estate the value of the gift, and then divide the balance among the residuary beneficiaries. For example, assume that A’s will provides that upon A’s death, his estate shall be distributed to “my issue, per stirpes”, and A dies leaving three living children, B, C and D. During life, A made a gift of $100,000 to D in partial satisfaction of D’s inheritance. A’s net probate estate is comprised of $800,000. The personal representative should add the lifetime gift of $100,000 to the estate and divide by three, deducting $100,000 from D’s share. B and C will receive $300,000 each, and D will receive $200,000.

e. Abatement. Abatement occurs when the testator leaves insufficient assets to satisfy all of the bequests. This may occur for several reasons, including that the testator depleted his or assets, there is a substantial federal estate tax burden, or where a spouse exercises his or right to an elective share.

Except as otherwise provided in a will, property abates in the following order: (1) property not disposed of by will; (2) residuary devises; (3) general devises; and (4) specific devises. HRS § 560:3-902. Abatement within each classification is in proportion to each beneficiary’s share under the will. Id.

2. Tangible Personal Property Lists. Under the UPC, a will may refer to a written list to dispose of items of tangible personal property not otherwise specifically disposed of by the will, other than money. HRS § 560:2-513. The writing must be signed by the testator and must describe the items and devisee with “reasonable certainty.” Id. The writing need not be in existence at the time of will execution. Id.
Ex: I may leave a signed memorandum (which is not to be a part of this will) listing certain items of tangible personal property that I wish certain persons to have and direct that my wishes as set forth in the memorandum be observed.

3. **Survivorship.** Where a devisee dies shortly after the testator because of a common disaster, the testator’s intent may be frustrated. For example, assume that A’s will provides for the disposition of his estate to “child B, if living, but if B is not then living, to those living of B’s issue, per stirpes.” Unbeknownst to A, however, B’s will leaves B’s estate to charity. B dies 1 day after A. B will inherit A’s estate which will be distributed to charity instead of to A’s grandchildren (the children of B).

Under the UPC, a devisee must survive the decedent by 120 hours, or the devisee will be deemed to have predeceased the testator. HRS § 560:2-104. If 120 hours seems too short of a period of time to the testator, the will may be drafted to provide for a longer period of required survivorship. However, the period should not be so long as to interfere with probate administration. This provision avoids multiple probate administrations.

4. **Revocation, Revival, Divorce and Homicide.** A will may revoke a prior will. HRS § 560:2-507(a). Other methods of revocation include performing a revocatory act with the intent of revocation. Id. Revocatory acts include (1) burning, (2) tearing, (3) canceling, (4) obliterating, (5) or destroying the will. Id.

Revocation by act is not recommended because of the difficulty of proving the testator’s intent, which can lead to protracted litigation.
Divorce automatically invalidates will provisions relating to a spouse, including bequests and fiduciary appointments. HRS § 560:2-802. Homicide also serves to revoke any beneficial interests, including fiduciary appointments, of the killer. HRS § 560:2-803.

The revocation of a will by act does not revive a prior will. HRS § 560:2-510. For example, assume that a will executed in 1990 was revoked by a will executed in 1995. If in 2000, the testator burns the 1995 will, the 1990 will is not automatically revived. Id. In order to revive the first will, the testator must declare that he intended to revive the first will. Id. To avoid potential litigation regarding the testator’s intent, it is advisable to revive the first will in writing, or execute a new will.

II. ETHICAL CONSIDERATIONS

A. COMPETENCY - A WORD TO THE WISE

The competent representation of a client is not merely a method of avoiding malpractice claims, but constitutes an ethical duty on the part of the estate planning attorney. Rule 1.1 of the Hawaii Rules of Professional Conduct (“HRPC”) provide as follows:

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.

Thus, an attorney that fails to provide competent representation to an estate planning client faces not only civil claims for negligence but may also be subject to disciplinary action by the Hawaii Supreme Court. For example, Attorney Grievance Com. v. Myers, 490 A.2d 231 (1985), involved a disciplinary action brought against an attorney who negligently drafted a will. There, the attorney drafted a will that omitted signature lines for witnesses and an
attestation clause.  \textit{Id.} at 232. The attorney also sent the will to the client, with a note instructing her to sign the original will and return it to his office.  \textit{Id.}  Apparently, the note did not mention any witnessing requirement or the advisability of having the will self-proved by affidavit.

The Maryland Court of Appeals upheld the trial court’s determination that the attorney violated “Disciplinary Rule 6-101(A)(3) by neglecting to include an attestation clause and witness signature lines on the Will that he prepared . . . and that he negligently failed to properly instruct [the client] as to the requirements of attestation set forth” in Maryland law.\textsuperscript{2} \textit{Id.} at 234. The attorney was also found to have intentionally mislead the investigator of the Attorney Grievance Commission of Maryland in violation of yet another Disciplinary Rule (DR 1-102(A) (“Misconduct”) and suspended from the practice of law for a period of three years. \textit{Id.}

Additional cases regarding the disciplinary measures imposed upon attorneys that have violated their ethical duty to provide competent representation in probate matters are collected at Debra T. Landis, \textit{Negligence, Inattention, or Professional Incompetence of Attorney in Handling Client’s Affairs in Estate or Probate Matters as Ground for Disciplinary Action--Modern Cases}, 66 A.L.R.4th 342 (1988).

\textbf{B. CONFIDENTIALITY}

In the course of representing a client for estate planning, the attorney may receive private and confidential information regarding the client’s net worth, sources of income, family information, and health status. Under HRPC 1.6, a “lawyer shall not reveal information relating

\textsuperscript{2} Maryland Disciplinary Rule 6-101 (“Failing to Act Competently”) is similar to Hawaii Disciplinary Rule 6-101, the latter being the precursor to HRPC 1.1 (“Competency”).
to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation.

The attorney may need to disclose a client’s confidential information to third parties in connection with the designation of beneficiaries, the “funding” of revocable and irrevocable trusts, gifts to charity, and instructions to health care providers. In all cases, the attorney is well-advised to seek client approval before disclosure is made.

C. WHO IS THE CLIENT? CONFLICTS OF INTEREST AND JOINT REPRESENTATION

An attorney has a duty of loyalty to his or her client, and therefore, may not undertake a representation, if in doing so, an impermissible conflict of interest with another client would be created. Under HRPC 1.7:

(a) A lawyer shall not represent a client if the representation of that client will be directly adverse to another client; unless

1. the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and
2. each client consents after consultation.

(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer’s responsibilities to another client or to a third person, or by the lawyer’s own interests, unless:

1. the lawyer reasonably believes the representation will not adversely affected; and
2. the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.
As further noted in the Commentary to HRPC 1.7:

Conflict questions may also arise in estate planning and estate administration. A lawyer may be called upon to prepare wills for several family members, such husband and wife, and, depending upon the circumstances, a conflict of interest may arise.

HRPC 1.7, Comment 13 (emphasis added).

Estate planners should advise their married clients of the nature and conditions of the attorney’s joint representation of the both clients. Husband and wife should be informed that the attorney will not keep any “secrets” from the other spouse, and is duty-bound to convey any such information received from one spouse to the other that might significantly impact the other spouse’s estate plan. Both clients should be informed that in the event of a dispute between them, the attorney may be prevented from continuing to represent either of them, at which point they may be required to seek separate counsel. These conditions may disclosed in the “representation” or “engagement” letter or in a separate agreement. Form language for consideration follows:

It is important that you understand that in asking us to represent you both, we must and will treat all communications and actions by either of you and us as common knowledge to be shared by both (while, of course, maintaining strict confidentiality as to anyone else). We cannot take action for one of you that is not known and agreed to by the other. Either of you can terminate this joint representation at any time, but the other would have to know of that development. And, if in the course of our representation, you are unable to resolve a disagreement, we will cease representing both of you in connection with the preparation of your estate plan.

In the estate planning context, potential and actual conflicts of interest may arise in the following (non-exhaustive list of) situations:
1. Where there are children by prior marriages;

2. Where property is held in a trust that restricts lifetime use by the surviving spouse (such as a Qualified Terminable Interest in Property trust);

3. choosing executors, trustees, guardians;

4. disinheriting a spouse;

5. designating non-spouse beneficiaries for retirement plans;

6. gifts to others;

7. transfers of life insurance;

8. establishing irrevocable trusts to extend beyond the age of twenty-one upon the termination of a Hawaii Uniform Transfers to Minors Act account; and

9. establishing an estate plan for a parent that favors a particular child, where that child may have had an opportunity to exert undue influence upon the parent.

Hypothetical: You are contacted by the adult daughter of Mr. Sun Cho Lee regarding estate planning for him. You are advised that Lee has three adult children by a prior marriage, including daughter. Daughter, however, informs you that “dad” wants everything to go to her upon his death in exchange for the emotional and physical support that she has provided for him and Mrs. Lee during the past three years. She wants to bring her father in without Mrs. Lee for estate planning advice.

Questions: 1. What do you tell daughter? 2. Do you speak to Mr. Lee, and if so, what do you say? 3. Who will you include/exclude at the first meeting?

Follow-up: Assume that Mr. Lee informs you that after his death, he would like
to ensure that Mrs. Lee has partial use of his assets, but would like any remaining assets to go to his daughter, but not to his two sons on the Mainland. Assume also, that Mrs. Lee, who has no children of her own, requests that you represent her as well, and that she would like to leave some of her assets to Mr. Lee upon her death, but upon his death, bequeath her estate to charity.

Questions: (1) Do you undertake the representation? (2) Under what conditions, if any? (3) What estate planning options do you discuss with them?

D. WHO IS THE CLIENT? - CLIENT UNDER A DISABILITY

The only rule that specifically addresses attorney conduct in connection with a disabled client is HRPC 1.14, which provides as follows:

(a) When a client’s ability to make adequately considered decisions in connection with the representation is impaired, whether because of minority, mental disability, or for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.

(b) A lawyer may seek the appointment of a guardian or take other protective action with respect to a client, only when the lawyer reasonably believes that the client cannot adequately act in the client’s own interest.

HRPC 1.14 (emphasis added). The Official Comment to HRPC 1.14 attempts to give additional guidance to the rule itself:

[1] . . . When the client . . . suffers from a mental disorder or disability, however, maintaining the ordinary client-lawyer relationship may not be possible in all respects. In particular, an incapacitated person may have no power to make legally binding decisions. Nevertheless, a client lacking legal competence often
has the ability to understand, deliberate upon, and reach conclusions about matters affecting the client’s own well-being. Furthermore, to an increasing extent the law recognizes intermediate degrees of competence.

[2] . . . If the person has no guardian or legal representative, the lawyer must often act as de facto guardian. . . .

[3] . . . If a legal representative has not been appointed, the lawyer should see to such an appointment where it would serve the client’s best interests. . . . In many circumstances, however, appointment of a legal representative may be expensive or traumatic for the client. Evaluation of these considerations is a matter of professional judgment on the lawyer’s part.

[4] If the lawyer represents the guardian as distinct from the ward, and is aware that the guardian is acting adversely to the ward’s interest, the lawyer may have an obligation to prevent or rectify the guardian’s misconduct. See Rule 1.2(d).

HRPC Rule 1.14, Comment (emphasis added). With respect to the attorney’s obligation to prevent or rectify a guardian’s misconduct, HRPC 1.2(d) is instructive:

[7] . . . The lawyer is not permitted to reveal the client’s wrongdoing, except where permitted or required by Rule 1.6 [crime/fraud exceptions] or Rule 4.1 [disclosure to avoid assisting crime/fraud]. However, the lawyer is required to avoid furthering the purpose, for example, by suggesting how it might be concealed. A lawyer may not continue assisting a client in conduct that the lawyer originally supposes is legally proper but then discovers is criminal or fraudulent. Withdrawal from the representation, therefore, may be required.

HRPC 1.2, Comment (emphasis added).

E. ATTORNEYS’ FEES

Generally speaking, the attorneys’ fees and costs charged in basic estate planning are based on a fixed fee in Hawaii. The fees for preparing simple wills are generally lower than
for trusts for several reasons, including that simple wills are generally less complex, less time-consuming, and are relatively easier to establish (because they do not need to be “funded”). Complicated wills such as testamentary trusts can be more expensive because of their relative complexity.

When setting the fee or devising a method for determining how the fee will be charged, the attorney should keep in the mind HRPC 1.5, which provides, in relevant part:

(a) A lawyer's fee shall be reasonable. The factors to be considered in determining the reasonableness of a fee include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

(6) the nature and length of the professional relationship with the client;

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services;

(8) whether the fee is fixed contingent, and in contingency fee cases the risk of no recovery and the conscionability of the fee in light of the net recovery to the client;
(9) the relative sophistication of the lawyer and the client; and

(10) the informed consent of the client to the fee agreement.

HRPC 1.5(a).
Estate and Wealth Preservation

Florida 2014

By Holland & Knight LLP
»Introduction

»Basic Estate Planning Considerations

»Wealth Preservation Considerations
Estate Planning Pyramid

Foundational Estate Planning:
Will; Revocable Trust; Durable Powers of Attorney & Related Disability Documents; Asset Ownership Planning; Enhanced Insurance Protection (Life, Disability, Casualty, Malpractice)

Family Investment Companies

Split Interest Charitable Planning

Other Sophisticated Transactions
Federal Estate Tax

» Lifetime/estate tax applicable exclusion amount for 2014: $5,340,000 (now adjusted for inflation).

» Maximum Federal estate tax rate: 40%.

» Portability of applicable exclusion between spouses ($10,680,000/couple for 2014). This is a very favorable development for physicians’ estate planning.

» Due 9 months after death & paid in CASH!!

Holland & Knight
» Included in your taxable estate:

» All assets titled in your name (including business interests)

» All assets owned jointly with another (to the extent of your interest)

» Assets in Revocable (or “Living”) Trusts

» 401(k)/IRAs/Annuities/Investment Accounts

» Death benefits of life insurance owned or controlled by you

» Generally, anything over which you have control
Why a Revocable Trust as the Centerpiece of Your Estate Plan?

» Your family’s privacy is better protected at your death.
» Assets are not subject to probate.
» Assists in event of incapacity.
» Fully changeable/revocable by you.

Caveat – A Revocable Trust is an asset-ownership tool.

*It alone does not provide asset protection for you.*
»For your spouse and descendants as part of your estate plan.

»For your benefit if created by your parents or grandparents as part of their estate plan.
Best time to address wealth preservation planning?

“The best time to plant a tree was 20 years ago. The second best time is now.”

--Chinese Proverb

*Assuming that you are not being sued presently, and are not acting under the threat of a claim.*
Categorizing Your Assets Under Florida Law

Exempt from 3rd Party Creditors of Either Spouse or Joint Creditor
- Florida Homestead (with limitations)
- Wages (with limitations)
- Cash Value of Life Insurance Policies
- Cash Value of Annuities
- Disability Income
- Qualified Retirement Plans/IRAs
- Section 529 Plans
- Medical Savings Accounts
- $4,000 of Personal Property
- $1,000 Automobile
- Prescribed Health Aids
- IRS Refund

Immune from 3rd Party Creditors of One Spouse
- Tenancy by the Entireties

Vulnerable
- Non-Homestead Individually Owned Real Estate
- Individually Owned Investment Accounts
- Tangible Property (Above $4,000)
- Automobile (Above $1,000)
- Tenancy by the Entireties Property After Death of Non-Physician Spouse or Post-Divorce
- Other Assets

A “super creditor” (e.g. IRS) may still be able to reach all of these assets!!

Holland & Knight
»In Florida, a judgment creditor of a member of a multiple-member LLC cannot foreclose on the debtor’s LLC membership interest (or a limited partner’s LP interest) in satisfaction of a debt.

»The creditor can obtain a “charging order” that allows the creditor to receive distributions from the entity otherwise payable to the debtor (if and when made).

»So….LLC (or LP) interests are not exempt from creditors’ claims, but they are much less tempting for creditors, given the restrictions under Florida law.
Dunn v. Patterson (2009) 395 Ill.App.3d 914
(ESTATE PLANNING / ETHICAL ISSUES)
Dunn v. Patterson, 395 Ill.App.3d 914 (2009)
919 N.E.2d 464, 335 Ill.Dec. 685

395 Ill.App.3d 914
Appellate Court of Illinois,
Third District.

Charles W. DUNN and Charlotte E. Dunn,
Plaintiffs–Appellees,
v.
Lawrence F. PATTERSON, Defendant–Appellant.


Synopsis
Background: Clients brought action against attorney seeking declaratory judgment that revocation and amendment provisions in estate plan that were drafted by attorney were void as contrary to public policy. The 12th Judicial Circuit Court, Will County, Barbara Petruangaro, J., granted clients’ motion for judgment on the pleadings and imposed sanctions on attorney for making improper filings. Attorney appealed.

Holdings: The Appellate Court, Schmidt, J., held that:

1. attorney had standing to appeal judgment and imposition of sanctions;

2. provisions in estate plan were not void as contrary to public policy or violative of rule of professional conduct; and

3. sanctions against attorney were not warranted.

Reversed and remanded.

West Headnotes (9)

II

1

Appeal and Error

Persons other than parties or privies

Attorney had standing to appeal judgment of trial court finding that provisions in estate planning documents drafted by attorney were void as against public policy and imposing sanctions on attorney for making improper filings, as clients obtained judgment against attorney, and attorney was identified as clients’ fiduciary in documents at issue. Sup.Ct.Rules, Rule 137.

Cases that cite this headnote

II

Action

Persons entitled to sue

For a party to have standing, the party must suffer some injury in fact to a legally cognizable interest and must have sustained, or be in danger of immediately sustaining, a direct injury.

Cases that cite this headnote

III

Appeal and Error

Parties or Persons Injured or Aggrieved

The entry of a judgment itself against a party constitutes legally cognizable damages, such that the party has standing to appeal the judgment.

Cases that cite this headnote

IV

Attorney and Client

Miscellaneous particular acts or omissions

Provisions in estate planning documents, which limited elderly clients’ power to amend or revoke documents by requiring consent of attorney, or alternatively, consent of court, were not void as against public policy or violative of rule of professional conduct requiring attorney to follow clients’ instructions, notwithstanding that attorney drafted documents, where attorney did not mislead clients, clients were informed of provisions, attorney did not have financial stake in estate plan, and attorney, following his discharge by clients, sought to meet with them before agreeing to grant or refuse consent. Rules
of Prof. Conduct, Rule 1.2.

Cases that cite this headnote

Appeal and Error
Liability and Costs and Allowances

A ruling on sanctions against an attorney or a party for making improper filings should not be overturned unless the trial court has abused its discretion. Sup.Ct.Rules, Rule 137.

Cases that cite this headnote

Attorney and Client
Liability for costs; sanctions
Costs
Nature and Grounds of Right

The purpose of the rule providing for sanctions against an attorney or a party who makes improper filings is to prevent parties from abusing the judicial process with actions unsupported by fact or law, not to punish litigants and their attorneys merely because they were unsuccessful in the litigation. Sup.Ct.Rules, Rule 137.

Cases that cite this headnote

Attorney and Client
Liability for costs; sanctions
Costs
Nature and Grounds of Right

Sanctions against attorney for making improper filings were not warranted, based on his inclusion in elderly clients' estate planning documents requirement that clients get his consent or consent of court before amending or revoking documents, and his subsequent refusal to give such consent after clients hired new attorneys and new attorneys thwarted his attempts to meet with clients, as reasonable and prudent fiduciary would not consent to amendment to documents without first determining what was in clients' best interests. Sup.Ct.Rules, Rule 137.

Cases that cite this headnote

Attorney and Client
Liability for costs; sanctions
Costs
Nature and Grounds of Right

In a trial court's consideration of whether to impose sanctions against an attorney or a party who makes improper filings, it is not sufficient that the party honestly believed his or her case was well grounded in fact or law. Sup.Ct.Rules, Rule 137.

Cases that cite this headnote

Attorneys and Law Firms

**405** Pamela Davis Gornowski (argued), Kavanagh, Grumley & Gorbold, LLC, Joliet, IL, for Appellant.

Sarah M. Valen, Frank P. Andreano (argued), Brumund, Jacobs, Hammel, Andreano & Davidson, LLC, Joliet, IL, for Appellee.

Opinion
**406** Justice SCHMIDT delivered the opinion of the court:

**687** 

Plaintiffs, Charles and Charlotte Dunn, brought a declaratory judgment action against defendant, Lawrence Patterson, the attorney who prepared an estate plan for them. The circuit court of Will County entered judgment on the pleadings, finding, as a matter of law, that provisions in certain estate planning documents prepared by defendant were contrary to public policy and void. The trial court thereafter awarded attorney fees constituting a Supreme Court Rule 137 (155 Ill.2d R. 137) sanction against defendant in the amount of $5,393.75.

Patterson appeals, arguing: (1) the trial court erred in finding the provisions requiring his consent, or alternatively, an order of the court to amend or revoke the estate planning documents to be contrary to public policy; and (2) the trial court abused its discretion by awarding Rule 137 sanctions. We reverse and remand.

**BACKGROUND**

Charles and Charlotte Dunn hired defendant, attorney, Lawrence Patterson, to, *inter alia*, prepare certain estate planning documents for them. Patterson prepared the following documents, all dated June 12, 2006:(1) Charles W. Dunn and Charlotte E. Dunn joint declaration of trust; (2) living will declaration of Charles W. Dunn; (3) living will declaration of Charlotte E. Dunn; (4) limited durable power of attorney of Charles W. Dunn; and (5) limited durable power of attorney of Charlotte E. Dunn.

Each of these documents contained a qualified amendment and revocation provision, which provided that any amendment or revocation of the documents may only be executed with the written consent of Patterson or by order of the court. The twelfth paragraph of the "916 "Joint Declaration of Trust (Conditionally Amendable and Revocable)" provides:

"QUALIFIED RIGHT TO AMEND AND/OR REVOKE. Charles W. Dunn and Charlotte D. Dunn acting jointly or the survivor of them, may, at any time or times, amend or revoke this Joint Declaration of Trust, in whole or in part, by instrument in writing (other than a Will) delivered to the acting Trustee; subject however to the receipt of the written consent of Attorney LAWRENCE F. PATTERSON, whose signature on said written consent form is Medallion Certified (whether Attorney Lawrence F. Patterson is then acting as the Attorney at Law for either one or both of us, or has been discharged as said Attorney for either one or both of us, orally or in writing) or, in the alternative, receipt of the written consent of a Court having jurisdiction, upon Petition filed by said Attorney or by any other interested person."

(Emphasis in original.)

Both Charles and Charlotte Dunn’s limited durable power of attorney (health care) and living wills contain the following provision:

"Qualified Amendment and Revocation. SECTION 1. Any provisions in the Law of the State of Illinois or in this instrument to the contrary notwithstanding, I hereby reserve the power to amend or revoke this Power of Attorney at any time and in any manner while I have the legal capacity to do so, subject however, to my receipt of the written consent to said amendment or revocation of Attorney LAWRENCE F. PATTERSON, whose signature on said written consent form is Medallion Certified (whether Attorney LAWRENCE F. PATTERSON is then acting as the Attorney at Law for either one or both of us, or has been discharged as ***688 ***407 said Attorney for either one or both of us, orally or in writing) or, in the alternative, without [sic] the consent of a Court having jurisdiction, upon Petition filed by said attorney or by any other interested person."

(Emphasis in original.)

Each power of attorney and living will is signed by Charles or Charlotte Dunn, and each page containing the aforementioned provision is initialed by Charles or Charlotte Dunn. According to Patterson, the "qualified amendment and revocation provision" is something that he routinely inserts in his clients’ estate planning documents to prevent elder abuse.

On November 14, 2006, Patterson received a letter from attorney Timothy J. Mcilroynt, informing Patterson that he had been retained by the Dunns to modify the estate plan that Patterson had previously drafted. Mcilroynt explained that the Dunns no longer wanted their ability to revoke or amend their estate planning documents to be contingent on Patterson’s approval and, therefore, wished to remove his name from the documents and make other minor amendments.

**917** Patterson responded by letter, stating it was necessary for the Dunns to personally meet with him to discuss this matter. Patterson’s letter, in pertinent part, provided as follows:

"For my clients to make any..."
changes in their plan it is necessary for both of them to discuss those changes with me and for me to then determine whether the changes are consistent with the interests and protections embodied in the original plan."

He continued by stating that if his clients are unwilling to meet with him, their only other alternative was to petition the court for leave to amend.

On April 27, 2007, the Dunns brought suit seeking a declaratory judgment against Patterson. The Dunns requested the court to declare, among other things, that they had an absolute right to revoke and amend the estate planning documents and that Rule 1.2(a) of the Rules of Professional Conduct (134 Ill.2d R. 1.2(a)) required Patterson to abide by their directions. Patterson was named as a defendant.

In Patterson’s answer to the action, he admitted some basic factual allegations, but responded that he had no knowledge sufficient to form a belief as to the truth or falsity of a number of allegations in the plaintiffs’ complaint, including that plaintiffs desired to revoke various estate planning documents and powers of attorney. In addition to his answer, Patterson filed an affirmative defense, alleging that the estate planning documents contained a clause prohibiting the plaintiffs from amending or revoking the documents without the written consent of Patterson, whether or not he has been discharged as the plaintiffs’ attorney, or, alternatively, upon order of the court.

The answer also stated that Patterson met personally with the Dunns to review the final draft of all the documents in issue, including the amendment and revocation provisions. Exhibit No. 7 to the answer is a letter dated July 14, 2006, from Patterson to the plaintiffs enclosing the original executed estate planning documents. The letter states, in part, that the joint declaration of trust, powers of attorney for healthcare, and living will are only “conditionally amendable or revocable in order to ensure that your express intentions will not be unwittingly changed if you enter into a deteriorating mental state which compromises your ability to fully understand the consequences of your decisions at that time.”

**408 ***689 Defendant alleges that he asked plaintiffs to personally confirm that he was terminated with respect to estate planning and trust funding. Exhibit No. 11 is the letter dated February 6, 2007, to the Dunns from Patterson requesting that they execute a formal notice of termination. No response was received from plaintiffs.

"918 In another attempt to gauge whether he should consent to the change in the documents, Patterson served a notice of discovery deposition for Charles and Charlotte Dunn upon McJoyn and a notice to produce on the Dunns. When Patterson received no response to his discovery requests, he filed a motion for discovery sanctions pursuant to Supreme Court Rule 219 (210 Ill.2d R. 219).

The plaintiffs filed a motion for judgment on the pleadings, alleging that no genuine issue of material fact existed in the cause. In their motion, the plaintiffs argued that the cause presented a straightforward issue of law: “is an attorney obligated to follow the direction of his or her client, even if the attorney deems the clients’ actions unwise, ill-conceived, or improper?” Plaintiffs argued that pursuant to Rule 1.2(a) of the Rules of Professional Conduct, an attorney is obligated to abide by his client’s decision so long as the direction given by the client is not contrary to law, unethical, or otherwise in violation of an ethical or legal obligation. Because plaintiffs did not request that Patterson act in a way that was unethical, contrary to law, or otherwise improper, plaintiffs argued that judgment on the pleadings was proper.

In his response to the motion for judgment on the pleadings, Patterson argued that issues of fact existed as to whether the Dunns were and/or are the clients of attorney Timothy J. McJoyn. Patterson denied that “an attorney does not have the right to disregard a client’s express wishes and instead substitute his or her own judgment and wisdom as to the client’s personal affairs.”

Patterson continued, citing text of Rules 1.14(a) and (b) of the Rules of Professional Conduct (134 Ill.2d R. 1.14(a), (b)) to be in support of his position, due to his alleged belief that Charlotte Dunn may have been impaired in her ability to make adequately considered decisions. Thus, Patterson claimed to invoke his responsibility under Rule 1.14 to maintain a normal lawyer-client relationship and take protective action because he reasonably believed that Charlotte could not adequately act in her own interest.

When the parties appeared for oral argument, Patterson again expressed that he had no evidence that McJoyn or attorney Frank Andracco represented plaintiffs. He stated that he needed further verification because the pleadings were unverified. McJoyn provided no verification other than the letter he sent, and the plaintiffs failed to respond to his letter requesting further verification or his request for discovery depositions.
The discovery sanctions motion was struck without prejudice because a Supreme Court Rule 201(k) (210 Ill.2d R. 201(k)) conference had not been held. The court granted the plaintiffs’ motion for judgment on the pleadings and held that the qualified revocation or *919 amendment provision requiring Patterson’s approval was contrary to public policy because it ignored the provisions of Supreme Court Rule of Professional Conduct 1.2.

The plaintiffs petitioned the court for assessment of fees under Illinois Supreme Court Rule 137. Plaintiffs argued that a reasonable attorney would not have adopted and forwarded the arguments presented by defendant in the instant case. **690 **490 Said motion was granted, and plaintiffs were awarded attorney fees and costs in the amount of $5,393.75. Patterson appeals.

**920 Patterson first argues that the consent provisions in the estate planning documents were merely third-party consent provisions, which are completely legal in Illinois. The Restatement (Third) of Trusts recognizes that consent by a third party to amendment or revocation is a proper and valid measure. Section 63(1) provides, “the settler of an inter vivos trust has power to revoke or modify the trust to the extent that the terms of the trust * * * so provide.” Restatement (Third) of Trusts § 63(1) at 442 (2003), Comment j on section 63(3), entitled, “Power to Revoke or Modify With Another’s Consent” states, “If the settler reserves a power to revoke or modify the trust with the consent of [another], such as the trustee, [a beneficiary], or a third party, the power normally cannot be exercised without that consent.” Restatement (Third) of Trusts § 63(3), Comment j, at 448 (2003). The comment explains that a court may intervene if the person whose concurrence is required improperly withholds or grants the consent, such as where the person acts in bad faith or from an improper motive. Restatement (Third) of Trusts § 63 (2003).

**410 **691 Plaintiffs stipulate that such limitations are permissible and appropriate. However, plaintiffs contend that such limitations are not permissible when the consent required is that of the drafting attorney, whether or not said attorney is still representing the parties. This is so, say the plaintiffs, because that attorney’s behavior is held to different standards than those that apply to a lay third party, that is, the Rules of Professional Conduct.

Plaintiffs argue that public policy requires lawyers, under Rule 1.2, to follow the direction of their clients, so long as the client is not asking the attorney to do anything unethical or illegal. This is due to the fact that clients should be able to have confidence their lawyer will handle their important, and often very personal, legal matters pursuant to the clients’ direction. Thus, plaintiffs contend that Patterson’s position, as the plaintiff’s attorney, required him to provide independent professional judgment. Plaintiffs contend that an attorney’s duty is to
identify the person(s) who will act on behalf of elderly clients if they become disabled, and it is patently improper for an attorney to draft estate planning documents that places himself or herself in such a role. See Sherman v. Klopfer, 32 Ill.App.3d 519, 336 N.E.2d 219 (1975) (attorney who drafted various documents for aunt breached attorney-client relationship by failing to give aunt sufficient control of the business so as to permit her to sell its assets and refusing to consent to sale of the business).

Sherman, however, can be distinguished from the case at bar in two important ways. In Sherman, the court found that the attorney failed to adequately inform his client of information necessary for her 921 to understand her ownership interest in the business. Moreover, the attorney in Sherman was a partner with the client in the business and, therefore, stood to benefit from the dealing. Sherman, 32 Ill.App.3d at 534-35, 336 N.E.2d 219. In the instant case, there is no evidence that Patterson misled the plaintiffs in any way. He testified that he informed them of the amendment and revocation clause and that they both signed and initialed next to the provision in the documents. Additionally, there is no evidence that Patterson stood to primarily benefit from refusing to consent to the amendment of the plaintiffs’ estate planning documents.

Given that third-party consent is a recognized method of protecting setlors and principals from making changes based on mental incompetency or undue influence, Patterson argues that an attorney may appropriately serve as the third party who is to give such consent. Patterson contends that such a designation is actually consistent with the broad fiduciary duties an attorney owes his or her client, and with the attorney-client relationship, which is based on duties of loyalty and trust. We agree.

Out here in the cornfields of Illinois and, we suspect, sometimes in the large metropolitan areas of Illinois, one’s lawyer is often his or her most trusted friend and advisor with respect to major life decisions. Where, as here, the lawyer is given no financial stake in an estate by virtue of his capacity as a fiduciary, we see no reason why the family lawyer cannot act in such capacity simply because he is drafting a trust document. Plaintiffs argue that a lawyer should not be able to limit how his clients spend their money or distribute their assets as long as it is not illegal. First of all, these documents do not give the fiduciary such broad powers. Secondy, every time a lawyer drafts an irrevocable trust for a client, he is limiting his client’s future decisions regarding the distribution of his or her estate. However, this is done with the client’s permission.

Patterson directs us to the single focus of the Rules of Professional Conduct: the client’s best interests. Patterson argues that the amendment and revocation provisions are not inconsistent with the right of a client to discharge his or her attorney. He states that even assuming he was discharged as plaintiffs’ attorney, his only role at that point was to then consider whether the trust documents and powers of attorney should be amended and to give or deny such consent on a good-faith basis. Thus, the ability of the plaintiffs to discharge Patterson as their attorney was not limited. Again, we agree.

The revocation provisions executed by the plaintiffs are not inconsistent with the duty of an attorney to follow his clients’ instructions under Rule 1.2 of the Rules of Professional Conduct. Patterson 922 followed the explicit instructions of his clients as expressed by them in the estate planning documents. There is no allegation that the plaintiffs did not execute or comprehend the estate plan documents. Alternatively, if we assume Patterson was terminated as their attorney, he was not acting as their attorney when he declined to consent to the revocation of the trust and, therefore, did not violate his duty to follow his clients’ wishes when he declined to consent.

Moreover, Patterson contends that he sought to meet with the plaintiffs before agreeing to grant or deny consent, but that through their new attorney, they refused to meet with him. Attorney McJoynt represented in his letter to Patterson that the plaintiffs were competent. However, a statement by a third party alone is not enough for Patterson, whether or not he was the plaintiffs’ attorney, to fulfill his duties to act in their best interest before offering his consent. Thus, a meeting with the plaintiffs, at a minimum, was necessary so that Patterson could assess competency and any possible undue influence, in order to make a good-faith determination as to whether the amendment was in the best interest of the plaintiffs.

Furthermore, there is no evidence or even suggestion that Patterson personally benefitted from or had any financial interest in the estate plan. Patterson testified that he did not have any relationship with possible beneficiaries of the trust and, therefore, unlike a family member, had no reason to favor or disfavor certain changes based on who, other than the plaintiffs, may benefit from them.

143 In conclusion, we do not believe that the trust documents authored by Patterson violate public policy or the Rules of Professional Conduct. The duty of a fiduciary is consistent with the role of attorney and counselor and
represents its highest ideals. Plaintiffs point out that Rule 1.2 requires lawyers to follow the directions of their clients, so long as the client is not asking the attorney to do anything unethical or illegal. The trust documents required Patterson to use the utmost good faith in either granting or withholding consent to a change in the documents. If he refused to consent, plaintiffs could seek authority for a change from a court. In fact, plaintiffs could have gone directly to a court without ever seeking Patterson's consent. If Patterson unreasonably withheld his consent to a change, there is an obvious remedy for that breach of fiduciary duty. We know of no cases that would hold that the Rules of Professional Conduct require an attorney to follow self-destructive directions of an incompetent client. Patterson agreed to act as fiduciary for the plaintiffs and to try to ensure that as they aged, they did not unwittingly make detrimental changes to their trust documents. At least at this stage, there is no reason to believe that he has done anything but keep that promise. *923 Through **693 *412 their new attorneys, plaintiffs have refused to even meet with Patterson.

We note that Patterson has put himself in a tough and expensive position here. If he had agreed to the requested change without first reasonably ascertaining that the plaintiffs were competent to make the change and that they were not subject to undue influence, and had the plaintiffs then been duped out of their assets, Patterson might very well have been called to answer as to why he consented to the change without having ascertained the plaintiffs' competency and the absence of undue influence. We routinely see cases in the court where people take advantage of the elderly, take them to see a lawyer of their choice with the end result being that the elderly person's assets are stolen by the one asserting undue influence. The sad fact is that the elderly are particularly susceptible to being taken advantage of and, clearly, the provision in question was tailored to try to reduce that risk for the plaintiffs. The documents provided that if the plaintiffs did not want to seek the consent of Patterson, they could have asked the court to authorize the change. However, the court did not take any evidence as to whether the change ought to be granted *via-a-vis the plaintiffs’ welfare. Rather, it simply held that the provision requiring Patterson's consent was against public policy, a violation of the Rules of Professional Conduct and therefore void. For the reasons set forth above, we find that it is not void. This ruling by the trial court is reversed and the matter is remanded for further proceedings.

II. Sanctions

Patterson next argues that the Supreme Court Rule 137 sanctions award should be reversed. A ruling on Rule 137 sanctions should not be overturned unless the trial court has abused its discretion. Dismuke v. Rand Cook Auto Sales, Inc., 378 Ill. App. 3d 214, 217, 317 Ill.Dec. 727, 882 N.E. 2d 607, 610 (2007).

Supreme Court Rule 137 provides in part:

"The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good-faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation." 155 Ill. 2d R. 137.

The purpose of this rule is to prevent parties from abusing the judicial process with actions unsupported by fact or law, not to punish litigants and their attorneys merely because they were unsuccessful in the litigation. Dismuke v. Rand Cook Auto Sales, Inc., 378 Ill. App. 3d at 217, 317 Ill. Dec. 727, 882 N.E. 2d 607. In a determination of whether to impose sanctions, it is not sufficient that the party honestly believed his or her case was well grounded in fact or law. Whiteman v. Munson, 335 Ill. App. 3d 501, 514, 269 Ill. Dec. 821, 781 N.E. 2d 618, 628 (2002). Rather, an objective standard is to be employed in evaluating what was reasonable under the circumstances. Baker v. Daniel S. Berger, Ltd., 323 Ill. App. 3d 956, 963, 257 Ill. Dec. 268, 753 N.E. 2d 463, 469 (2001).

In the case at bar, Patterson argues that he declined to consent to the amendment in good faith, given that he had no information regarding whether the proposed amendments were in the plaintiffs' best interest. Further, Patterson states that he had no personal interest or ability to benefit from the estate.

Plaintiffs contend that Patterson's conduct simply did not comport with the actions 694 413 of a reasonable and prudent attorney. At the outset, plaintiffs argue that it is oppressive and unreasonable to suggest that clients need to verify anything with their former attorney. To suggest that an attorney needs to prove he or she "really" represents a client is ludicrous, and if every attorney took such a position the court system would grind to a halt. Finally, plaintiffs argue that a reasonable and prudent attorney would not have opposed a request to consent to
an amendment or sought this in the courtroom. We disagree.

There was nothing unreasonable about Patterson's conduct in this case. As explained above, we find that the qualified amendment and revocation clause at issue did not violate public policy. Further, Patterson attempted to visit with the plaintiffs in order to determine whether there were any competence/undue influence issues involved. A reasonable and prudent fiduciary, whether a lay person or attorney, would not consent to an amendment to these trust documents without first determining what was in the plaintiffs' best interest. A letter from an attorney alone is not sufficient evidence for a fiduciary to make a good-faith decision regarding competency and undue influence. To so hold would render meaningless any attempts to protect oneself from the possibility of future harm resulting from diminished mental faculties.

In plain English, it is undisputed that Patterson consulted with the plaintiffs regarding several estate planning documents. After consulting with Patterson, the plaintiffs recognized that with their advancing age, there was a probability of diminished mental faculties and therefore susceptibility to undue influence or unsound decisions. They were apparently happy with the documents when they were written and on advice of counsel agreed to provisions which indicated that before they changed the documents, they had to seek the consent of either: (a) their fiduciary (Patterson); or (b) a court of competent jurisdiction. Patterson agreed to act as the fiduciary and, in so doing, he promised to use the utmost good faith with respect to granting or withholding such consent. This is clearly implicit in the documents. We see nothing in Patterson's conduct other than an attempt by a lawyer, at no small expense to himself, to keep a promise he made to either his clients or former clients. We in no way mean or intend to impugn the integrity of plaintiffs' new attorneys. However, that being said, it was not unreasonable for Patterson to withhold his consent when the only thing he had was a lawyer's letter stating the plaintiffs want to make this change. Every attempt Patterson made to consult with the plaintiffs personally was thwarted. We do not find Patterson's conduct sanctionable. Rather, we find it admirable and consistent with the highest ideals of the bar. In light of the obvious expense to Patterson, we will leave it to other estate planners whether they wish to use this particular method of estate planning.

For the reasons set forth above, we find that the trial court abused its discretion in awarding sanctions against Patterson. That award of sanctions is reversed.

CONCLUSION

For the foregoing reasons the judgment of the circuit court of Will County is reversed and this matter is remanded for further proceedings consistent with this opinion.

Reversed and remanded.

O'BRIEN, P.J., and CARTER, J., concur.

Parallel Citations

395 Ill.App.3d 914, 919 N.E.2d 404

(ESTATE PLANNING / JOINT REPRESENTATION HUSBAND & WIFE)
158 N.J. 51
Supreme Court of New Jersey.

A., individually and on behalf of minor child, C.,
Plaintiff,
v.
B., Defendant and Third-Party
Plaintiff--Respondent,
v.
Hill Wallack, Attorneys at Law, Third-Party
Defendant--Appellant.


Law firm that jointly represented husband and wife in planning their estates sought to disclose existence of husband's illegitimate child to wife. Husband joined law firm as third-party defendant in paternity action to prevent firm from making the disclosure. The Superior Court, Family Part, denied husband's requested restraints, but the Superior Court, Appellate Division, reversed and remanded for imposition of preliminary restraints. Law firm appealed. The Supreme Court, Pollock, J., held that law firm was entitled to disclose existence, but not name, of husband's illegitimate child.

Reversed and remanded.

West Headnotes (5)

[1] Attorney and Client
  "Nature and term of office"

The principle of attorney-client confidentiality imposes a sacred trust on the attorney not to disclose the client's confidential communication.

Cases that cite this headnote

  "Acts and omissions of attorney in general"

Possible inheritance of wife's estate by

husband's illegitimate child did not constitute a "substantial injury to the financial interest or property of another," so as to require law firm that was jointly representing husband and wife in planning their estates to disclose existence of illegitimate child to wife. RPC 1.6(b).

Cases that cite this headnote

  "Client's confidences, in general"

Attorney and Client
  "Acts and omissions of attorney in general"

Law firm that was jointly representing husband and wife in planning their estates was entitled to disclose to wife the existence of husband's illegitimate child; husband's deliberate omission of the existence of an illegitimate child when discussing his estate with law firm constituted a fraud on wife, which law firm was allowed to rectify under the rules of professional conduct, law firm learned about child from mother and not in confidential communication from husband, and husband and wife had signed agreement suggesting their intent to share all information with each other. RPC 1.6(c).

Cases that cite this headnote

  "Particular Cases and Problems"

Attorney and Client
  "Nature of attorney's duty"

An attorney, on commencing joint representation of co-clients, should agree explicitly with the clients on the sharing of confidential information.

Cases that cite this headnote
Records

--Regulations limiting access; offenses

Estate planning law firm’s disclosure of the existence, but not the identity, of husband’s illegitimate child would not violate statute governing confidentiality of paternity proceedings. N.J.S.A. 9:17–42.

Cases that cite this headnote

Attorneys and Law Firms

**924** *52 John J. Gibbons, Newark, submitted a brief on behalf of third-party defendant-appellant (Gibbons, Del Deo, Dolan, Griffinger & Vecchione, attorneys).

Mark Z. Segal and Neil M. Day, Lawrenceville, submitted a brief on behalf of defendant and third-party plaintiff-respondent (Fox, Rothschild, O’Brien & Frankel, attorneys; Kenneth H. Mack, of counsel).

Opinion

The opinion of the Court was delivered by

POLLOCK, J.

This appeal presents the issue whether a law firm may disclose confidential information of one co-client to another co-client. Specifically, in this paternity action, the mother’s former law firm, which contemporaneously represented the father and his wife in planning their estates, seeks to disclose to the wife the existence of the father’s illegitimate child.

**53** A law firm, Hill Wallack (described variously as “the law firm” or “the firm”), jointly represented the husband and wife in drafting wills in which they devised their respective **925** estates to each other. The devises created the possibility that the other spouse’s issue, whether legitimate or illegitimate, ultimately would acquire the decedent’s property.

Unbeknown to Hill Wallack and the wife, the husband recently had fathered an illegitimate child. Before the execution of the wills, the child’s mother retained Hill Wallack to institute this paternity action against the husband. Because of a clerical error, the firm’s computer check did not reveal the conflict of interest inherent in its representation of the mother against the husband. On learning of the conflict, the firm withdrew from representation of the mother in the paternity action. Now, the firm wishes to disclose to the wife the fact that the husband has an illegitimate child. To prevent Hill Wallack from making that disclosure, the husband joined the firm as a third-party defendant in the paternity action.

In the Family Part, the husband, represented by new counsel, Fox, Rothschild, O’Brien & Frankel (“Fox Rothschild”), requested restraints against Hill Wallack to prevent the firm from disclosing to his wife the existence of the child. The Family Part denied the requested restraints. The Appellate Division reversed and remanded “for the entry of an order imposing preliminary restraints and for further consideration.”

Hill Wallack then filed motions in this Court seeking leave to appeal, to present oral argument, and to accelerate the appeal. Pursuant to Rule 2:8–3(a), we grant the motion for leave to *54 appeal; accelerate the appeal; reverse the judgment of the Appellate Division and remand the matter to the Family Part. Hill Wallack’s motion for oral argument is denied.

**Rule 2:8–3** provides:

Motion for Summary Disposition

(a) Supreme Court. On an appeal taken to the Supreme Court as of right from a judgment of the Appellate Division, any party may move at any time following the service of the notice of appeal for a summary disposition of the appeal. Such motion shall be determined on the motion papers and on the briefs and record filed with the Appellate Division and may result in an affirmance, reversal or modification. The pendency of such motion shall toll the time for the filing of briefs and appendices on the appeal. The Supreme Court may summarily dispose of any appeal on its own motion at any time, and on such prior notice, if any, to the parties as the Supreme Court directs.

I.

Although the record is both informal and attenuated, the parties agree substantially on the relevant facts. Because the Family Part has sealed the record, we refer to the parties without identifying them by their proper names. So viewed, the record supports the following factual statement.
In October 1997, the husband and wife retained Hill Wallack, a firm of approximately sixty lawyers, to assist them with planning their estates. On the commencement of the joint representation, the husband and wife each signed a letter captioned “Waiver of Conflict of Interest.” In explaining the possible conflicts of interest, the letter recited that the effect of a testamentary transfer by one spouse to the other would permit the transfer to dispose of the property as he or she desired. The firm’s letter also explained that information provided by one spouse could become available to the other. Although the letter did not contain an express waiver of the confidentiality of any such information, each spouse consented to and waived any conflicts arising from the firm’s joint representation.

Unfortunately, the clerk who opened the firm’s estate planning file misspelled the clients’ surname. The misspelled name was entered in the computer program that the firm uses to discover possible conflicts of interest. The firm then prepared reciprocal wills and related documents with the names of the husband and wife correctly spelled.

*55 In January 1998, before the husband and wife executed the estate planning documents, the mother coincidentally retained Hill Wallack to pursue a paternity claim against the husband. This time, when making its computer search for conflicts of interest, Hill Wallack spelled the husband’s name correctly. Accordingly, the computer search did not reveal the existence of the firm’s joint representation of the husband and wife. As a result, the estate planning department did not know that the family law department had instituted a paternity action for the mother. Similarly, the family law department did not know that the estate planning department was preparing estate plans for the husband and wife.

A lawyer from the firm’s family law department wrote to the husband about the mother’s paternity claim. The husband neither objected to the firm’s representation of the mother nor alerted the firm to the conflict of interest. Instead, he retained Fox Rothschild to represent him in the paternity action. After initially denying paternity, he agreed to voluntary DNA testing, which revealed that he is the father. Negotiations over child support failed, and the mother instituted the present action.

After the mother filed the paternity action, the husband and wife executed their wills at the Hill Wallack office. The parties agree that in their wills, the husband and wife leave their respective residuary estates to each other. If the other spouse does not survive, the contingent beneficiaries are the testator’s issue. The wife’s will leaves her residuary estate to her husband, creating the possibility that her property ultimately may pass to his issue. Under N.J.S.A. 3B:1-2;3-48, the term “issue” includes both legitimate and illegitimate children. When the wife executed her will, therefore, she did not know that the husband’s illegitimate child ultimately may inherit her property.

The conflict of interest surfaced when Fox Rothschild, in response to Hill Wallack’s request for disclosure of the husband’s assets, informed the firm that it already possessed the requested information. Hill Wallack promptly informed the mother that it unknowingly was representing both the husband and the wife in an unrelated matter.

Hill Wallack immediately withdrew from representing the mother in the paternity action. It also instructed the estate planning department not to disclose any information about the husband’s assets to the member of the firm who had been representing the mother. The firm then wrote to the husband stating that it believed it had an ethical obligation to disclose to the wife the existence, but not the identity, of his illegitimate child. Additionally, the firm stated that it was obligated to inform the wife “that her current estate plan may devise a portion of her assets through her spouse to that child.” The firm suggested that the husband so inform his wife and stated that if he did not do so, it would. Because of the restraints imposed by the Appellate Division, however, the firm has not disclosed the information to the wife.

II.

This appeal concerns the conflict between two fundamental obligations of lawyers: the duty of confidentiality, Rules of Professional Conduct (RPC) 1.6(a), and the duty to inform clients of material facts, RPC 1.4(b). The conflict arises from a law firm’s joint representation of two clients whose interests initially were, but no longer are, compatible.

*11 Crucial to the attorney-client relationship is the attorney’s obligation not to reveal confidential information learned in the course of representation. Thus, RPC 1.6(a) states that “[a] lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation.” Generally, “the principle of attorney-client confidentiality imposes a sacred trust on the attorney not to disclose the client’s confidential communication.” State v. Land, 73 N.J. 24, 30, 372 A.2d

A lawyer's obligation to communicate to one client all information needed to make an informed decision qualifies the firm's duty to maintain the confidentiality of a co-client's information. RPC 1.4(b), which reflects a lawyer's duty to keep clients informed, requires that "[a] lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." See also Giannam v. De Luca, 215 N.J.Super. 388, 397, 521 A.2d 1343 (App.Div.1987) (stating that attorney has continuing duty "to inform his client promptly of any information important to him"); Passanante v. Yormark, 138 N.J.Super. 233, 238, 350 A.2d 407 (App.Div.1975) ([An attorney's] duty includes the obligation **927 of informing his client promptly of any known information important to him."). In limited situations, moreover, an attorney is permitted or required to disclose confidential information. Hill Wallack argues that RPC 1.6 mandates, or at least permits, the firm to disclose to the wife the existence of the husband's illegitimate child. RPC 1.6(b) requires that a lawyer disclose "information relating to representation of a client" to the proper authorities if the lawyer "reasonably believes" that such disclosure is necessary to prevent the client "from committing a criminal, illegal or fraudulent act that the lawyer reasonably believes is likely to result in death or substantial bodily harm or substantial injury to the financial interest or property of another." RPC 1.6(b)(1). Despite Hill Wallack's claim that RPC 1.6(b) applies, the facts do not justify mandatory disclosure. The possible inheritance of the wife's estate by the husband's illegitimate child is too remote to constitute "substantial injury to the financial interest or property of another" within the meaning of RPC 1.6(b).

By comparison, in limited circumstances RPC 1.6(c) permits a lawyer to disclose a confidential communication. RPC 1.6(c) permits, but does not require, a lawyer to reveal confidential information to the extent the lawyer reasonably believes necessary to rectify the consequences of a client's criminal, illegal or fraudulent act in furtherance of which the lawyer's services had **58 been used." RPC 1.6(c)(1). Although RPC 1.6(c) does not define a "fraudulent act," the term takes on meaning from our construction of the word "fraud," found in the analogous "crime or fraud" exception to the attorney-client privilege. See N.J.R.E. 504(c)(4) (excepting from attorney-client privilege "a communication in the course of legal service sought or obtained in the aid of the commission of a crime or fraud"); Kevin H. Mihels, New Jersey Attorney Ethics § 15:3-3 at 280 (1998) ("While the RPCs no longer incorporate the attorney-client privilege into the definition of confidential information, prior constructions of the fraud exception may be relevant in interpreting the exceptions to confidentiality contained in RPC 1.6(b) and (c) ") (internal citation omitted). When construing the "crime or fraud" exception to the attorney-client privilege, "our courts have generally given the term "fraud" an expansive reading." Fellerman v. Bradley, 99 N.J. 493, 503-04, 493 A.2d 1239 (1985).

We likewise construe broadly the term "fraudulent act" within the meaning of RPC 1.6(c). So construed, the husband's deliberate omission of the existence of his illegitimate child constitutes a fraud on his wife. When discussing their respective estates with the firm, the husband and wife reasonably could expect that each would disclose information material to the distribution of their estates, including the existence of children who are contingent residuary beneficiaries. The husband breached that duty. Under the reciprocal wills, the existence of the husband's illegitimate child could affect the distribution of the wife's estate, if she predeceased him. Additionally, the husband's child support payments and other financial responsibilities owed to the illegitimate child could deplete that part of his estate that otherwise would pass to his wife.

From another perspective, it would be "fundamentally unfair" for the husband to reap the "joint planning advantages of access to information and certainty of outcome," while denying those same advantages to his wife. Teresa S. Collett, Disclosure, Discretion, or Deception: The Estate Planner's Ethical Dilemma from a *59 Unilateral Confidence, 28 Real Prop. Prob. Tr. J. 683, 743 (1994). In effect, the husband has used the law firm's services to defraud his wife in the preparation of her estate.

The New Jersey RPCs are based substantially on the American Bar Association Model Rules of Professional Conduct ("the Model Rules "). RPC 1.6, however, exceeds the Model Rules in authorizing the disclosure of confidential information. A brief review of the history of the Model Rules and of RPC 1.6 confirms New Jersey's more expansive commitment to the disclosure of confidential client information.

In 1977, the American Bar Association appointed a Commission on Evaluation of Professional Standards, chaired by the late Robert J. Kutak. The Commission, generally known as the "Kutak Commission," originally **928 proposed a rule that permitted a lawyer to disclose confidential information in circumstances comparable to those permitted by RPC 1.6. The House of Delegates of
the American Bar Association, however, rejected the Kutak Commission's recommendation. As adopted by the American Bar Association, Model Rule 1.6(b) permits a lawyer to reveal confidential information only "to the extent the lawyer reasonably believes necessary to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm." Unlike RPC 1.6, Model Rule 1.6 does not except information relating to the commission of a fraudulent act or to relating to a client's act that is likely to result in substantial financial injury. In no situation, moreover, does Model Rule 1.6 require disclosure. Thus, the Model Rules provide for narrower disclosure than that authorized by RPC 1.6.

In 1982, this Court appointed a committee to consider the Model Rules. The committee, chaired by the Honorable Dickinson R. Debevoise, became known as the "Debevoise Committee." It determined that the original provisions proposed by the Kutak Commission more closely reflected the existing ethics rules in New Jersey. Thus, the Committee concluded that Model Rule 1.6 would "narrow radically the circumstances in which New Jersey attorneys either may or must disclose the information of their clients' criminal or fraudulent behavior." Report of the New Jersey Supreme Court Committee on the Model Rules of Professional Conduct (1983), reprinted in Michel, supra, Appendix D at 1103. When adopting the RPC's, this Court substantially followed the recommendation of the Debevoise Committee. Described as an "openly-radical experiment," Geoffrey C. Hazard, Jr. & W. William Hodes, 2 The Law of Lawyering § AP4:104 (1998), RPC 1.6 "contained the most far-reaching disclosure requirements of any attorney code of conduct in the country," Leslie C. Levin, Testing the Radical Experiment: A Study of Lawyer Response to Clients Who Intend to Harm Others, 47 Rutgers L. Rev. 81, 92 (1994).

Under RPC 1.6, the facts support disclosure to the wife. The law firm did not learn of the husband's illegitimate child in a confidential communication from him. Indeed, he concealed that information from both his wife and the firm. The law firm learned about the husband's child through its representation of the mother in her paternity action against the husband. Accordingly, the husband's expectation of nondisclosure of the information may be less than if he had communicated the information to the firm in confidence.

In addition, the husband and wife signed letters captioned "Waiver of Conflict of Interest." These letters acknowledge that information provided by one client could become available to the other. The letters, however, stop short of explicitly authorizing the firm to disclose one spouse's confidential information to the other. Even in the absence of any such explicit authorization, the spirit of the letters supports the firm's decision to disclose to the wife the existence of the husband's illegitimate child.

Neither our research nor that of counsel has revealed a dispositive judicial decision from this or any other jurisdiction on the issue of disclosure of confidential information about one client to a co-client. Persuasive secondary authority, however, supports the *61 conclusion that the firm may disclose to the wife the existence of the husband's child.

The forthcoming Restatement (Third) of The Law Governing Lawyers § 112 comment l (Proposed Final Draft No. 1, 1996) ("the Restatement") suggests, for example, that if the attorney and the co-clients have reached a prior, explicit agreement concerning the sharing of confidential information, that agreement controls whether the attorney should disclose the confidential information of one co-client to another. Ibid ("Co-clients ... may explicitly agree to share information" and "can also explicitly agree that the lawyer is not to share certain information ... with one or more other co-clients. A lawyer must honor such agreements."). See also Report of the ABA Special Study Committee on Professional Responsibility: Comments and Recommendations on the Lawyer's Duties in Representing Husband and Wife, 28 Real "**929 Prop. Prob. Tr. J. 765, 787 (1994) ("Although legally and ethically there is no need for a prior discussion and agreement with the couple about the mode of representation, discussion and agreement are the better practice. The agreement may cover ... the duty to keep or disclose concerns."); American College of Trust and Estate Counsel, ACTEC Commentaries on the Model Rules of Professional Conduct 65-66 (2d ed. 1995) ("When the lawyer is first consulted by the multiple potential clients the lawyer should review with them the terms upon which the lawyer will undertake the representation, including the extent to which information will be shared among them.").

[As the preceding authorities suggest, an attorney, on commencing joint representation of co-clients, should agree explicitly with the clients on the sharing of confidential information. In such a "disclosure agreement," the co-clients can agree that any confidential information concerning one co-client, whether obtained from a co-client himself or herself or from another source, will be shared with the other co-client. Similarly, the co-clients can agree that unilateral confidences or other confidential information will be kept confidential by the attorney. Each prior *62 agreement will clarify the
expectations of the clients and the lawyer and diminish the need for future litigation.

In the absence of an agreement to share confidential information with co-clients, the Restatement reposes the resolution of the lawyer's competing duties within the lawyer's discretion:

[The lawyer, after consideration of all relevant circumstances, has the discretion to inform the affected co-client of the specific communication if, in the lawyer's reasonable judgment, the immediacy and magnitude of the risk to the affected co-client outweigh the interest of the communicating client in continued secrecy.

[Restatement (Third) of The Law Governing Lawyers, supra, § 112 comment f.]

Additionally, the Restatement advises that the lawyer, when withdrawing from representation of the co-clients, may inform the affected co-client that the attorney has learned of information adversely affecting that client's interests that the communicating co-client refuses to permit the lawyer to disclose. ibid.

In the context of estate planning, the Restatement also suggests that a lawyer's disclosure of confidential information communicated by one spouse is appropriate only if the other spouse's failure to learn of the information would be materially detrimental to that other spouse or frustrate the spouse's intended testamentary arrangements. Id. § 112 comment f, illustrations 2, 3. The Restatement provides two analogous illustrations in which a lawyer has been jointly retained by a husband and wife to prepare reciprocal wills. The first illustration states:

Lawyer has been retained by Husband and Wife to prepare wills pursuant to an arrangement under which each spouse agrees to leave most of their property to the other. Shortly after the wills are executed, Husband (unknown to Wife) asks Lawyer to prepare an inter vivos trust for an illegitimate child whose existence Husband has kept secret from Wife for many years and about whom Husband had not previously informed Lawyer. Husband states that Wife would be distraught at learning of Husband's infidelity and of Husband's years of silence and that disclosure of the information could destroy their marriage. Husband directs Lawyer not to inform Wife. The inter vivos trust that Husband proposes to create would not materially affect Wife's own estate plan or her expected receipt of property under Husband's will, because Husband proposes to use property designated in Husband's will for a personally favored charity. In view of the lack of

material effect on Wife, Lawyer may assist Husband to establish and fund the inter vivos trust and refrain from disclosing Husband's information to Wife.

*63 [Id § 112 comment f, illustration 2.]

In authorizing non-disclosure, the Restatement explains that an attorney should refrain from disclosing the existence of the illegitimate child to the wife because the trust "would not materially affect Wife's own estate plan or her expected receipt of property under Husband's will." ibid.

The other illustration states:

Same facts as [the prior Illustration], except that Husband's proposed inter vivos trust would significantly deplete Husband's estate, to Wife's material detriment and in frustration of the Spouses' intended testamentary arrangements. If Husband will neither inform Wife nor permit Lawyer to do so, Lawyer must withdraw from representing both Husband and Wife. In the light of all relevant circumstances, Lawyer may exercise discretion whether to inform Wife either that circumstances, which Lawyer has been asked not to reveal, indicate that she should revoke her recent will or to inform Wife of some or all the details of the information that Husband has recently provided so that Wife may protect her interests. Alternatively, Lawyer may inform Wife only that Lawyer is withdrawing because Husband will not permit disclosure of information that Lawyer has learned from Husband.

[Id § 112 comment f, illustration 3.]

Because the money placed in the trust would be deducted from the portion of the husband's estate left to his wife, the Restatement concludes that the lawyer may exercise discretion to inform the wife of the husband's plans. ibid.

An earlier draft of the Restatement described the attorney's obligation to disclose the confidential information to the co-client as mandatory. Id. (Council Draft No. 11, 1995), cf. Collett, supra, at 743 (arguing that nature of joint representation of husband and wife supports mandatory disclosure rule). When reviewing the draft, however, the governing body of the American Law Institute, the Council, modified the obligation to leave disclosure within the attorney's discretion.

Similarly, the American College of Trust and Estate Counsel (ACTEC) also favors a discretionary rule. It recommends that the "lawyer should have a reasonable degree of discretion in determining how to respond to any
particular case.” American College of Trust and Estate Counsel, supra, at 68. The ACTEC suggests that the lawyer first attempt to convince the client to *64 inform the co-client, ibid. When urging the client to disclose the information, the lawyer should remind the client of the implicit understanding that all information will be shared by both clients. The lawyer also should explain to the client the potential legal consequences of non-disclosure, including invalidation of the wills. Ibid. Furthermore, the lawyer may mention that failure to communicate the information could subject the lawyer to a malpractice claim or disciplinary action. Ibid.

The ACTEC reasons that if unsuccessful in persuading the client to disclose the information, the lawyer should consider several factors in deciding whether to reveal the confidential information to the co-client, including: (1) duties of impartiality and loyalty to the clients; (2) any express or implied agreement among the lawyer and the joint clients that information communicated by either client to the lawyer regarding the subject of the representation would be shared with the other client; (3) the reasonable expectations of the clients; and (4) the nature of the confidence and the harm that may result if the confidence is, or is not, disclosed. Id. at 68–69.

The Section of Real Property, Probate and Trust Law of the American Bar Association, in a report prepared by its Special Study Committee on Professional Responsibility, reached a similar conclusion:

Faced with any adverse confidence, the lawyer must act as a fiduciary toward joint clients. The lawyer must balance the potential for material harm to the confiding spouse caused by disclosure against the potential for material harm to the other spouse caused by a failure to disclose.

[Report of the Special Study Committee on Professional Responsibility: Comments and Recommendations on the Lawyer’s Duties in Representing Husband and Wife, supra, 28 Real Prop. Prob. Tr. J. at 787.]

The report stresses that the resolution of the balancing test should center on the expectations of the clients. Id. at 784. In general, “the available ruling authority ... \*931 points toward the conclusion that a lawyer is not required to disclose an adverse confidence to the other spouse.” Id. at 788. At the same time, the report acknowledges, as did the Restatement, that the available *65 ruling authority is “scant and offers little analytical guidance.” Id. at 788 n. 27.

Florida, however, have concluded that disclosure to a co-client is prohibited. New York State Bar Ass’n Comm. on Professional Ethics, Op. 555 (1984); Florida State Bar Ass’n Comm. on Professional Ethics, Op. 95–4 (1997).

The New York opinion addressed the following situation:

A and B formed a partnership and employed Lawyer L to represent them in connection with the partnership affairs. Subsequently, B, in a conversation with Lawyer L, advised Lawyer L that he was actively breaching the partnership agreement. B preceded this statement to Lawyer L with the statement that he proposed to tell Lawyer L something “in confidence.” Lawyer L did not respond to that statement and did not understand that B intended to make a statement that would be of importance to A but that was to be kept confidential from A. Lawyer L had not, prior thereto, advised A or B that he could not receive from one communications regarding the subject of the joint representation that would be confidential from the other. B has subsequently declined to tell A what he has told Lawyer L.

[New York State Bar Ass’n Comm. on Professional Ethics, Op. 555, supra.]

In that situation, the New York Ethics Committee concluded that the lawyer may not disclose to the co-client the communicating client’s statement. The Committee based its conclusion on the absence of prior consent by the clients to the sharing of all confidential communications and the fact that the client “specifically in advance designated his communication as confidential, and the lawyer did not demur.” Ibid.

The Florida Ethics Committee addressed a similar situation:

Lawyer has represented Husband and Wife for many years in a range of personal matters, including estate planning. Husband and Wife have substantial individual assets, and they also own substantial jointly-held property. Recently, Lawyer prepared new updated wills that Husband and Wife signed. Like their previous wills, their new wills primarily benefit the survivor of them for his or her life, with beneficial disposition at the death of the survivor being made equally to their children.

***
Several months after the execution of the new wills, Husband confers separately with Lawyer. Husband reveals to Lawyer that he has just executed a codicil *66 prepared by another law firm) that makes substantial beneficial disposition to a woman with whom Husband has been having an extra-marital relationship.

[Florida State Bar Ass'n Comm. on Professional Ethics, Op. 95-4, supra.]

Reasoning that the lawyer’s duty of confidentiality takes precedence over the duty to communicate all relevant information to a client, the Florida Ethics Committee concluded that the lawyer did not have discretion to reveal the information. In support of that conclusion, the Florida committee reasoned that joint clients do not necessarily expect that everything relating to the joint representation communicated by one co-client will be shared with the other co-client.

In several material respects, however, the present appeal differs from the hypothetical cases considered by the New York and Florida committees. Most significantly, the New York and Florida disciplinary rules, unlike RPC 1.6, do not except disclosure needed “to rectify the consequences of a client’s ... fraudulent act in the furtherance of which the lawyer’s services had been used.” RPC 1.6(c). But see New York Code of Professional Responsibility DR 4-101; Florida Rules of Professional Conduct 4-1.6. Second, Hill Wallack learned of the husband’s paternity from a third party, not from the husband himself. Thus, the husband did not communicate anything to the law firm with the expectation that the communication would be **932 kept confidential. Finally, the husband and wife, unlike the co-clients considered by the New York and Florida Committees, signed an agreement suggesting their intent to share all information with each other.

Because Hill Wallack wishes to make the disclosure, we need not reach the issue whether the lawyer’s obligation to disclose is discretionary or mandatory. In conclusion, Hill Wallack may inform the wife of the existence of the husband’s illegitimate child.

9:17-42, which provides:

All papers and records and any information pertaining to an action or proceeding held under [the New Jersey Parentage Act] which may reveal the identity of any *67 party in an action, other than the final judgment or the birth certificate, whether part of the permanent record of the court or of a file with the State registrar of vital statistics or elsewhere, are confidential and are subject to inspection only upon consent of the court and all parties to the action who are still living, or in exceptional cases only upon an order of the court for compelling reason clearly and convincingly shown.

The law firm learned of the husband’s paternity of the child through the mother’s disclosure before the institution of the paternity suit. It does not seek to disclose the identity of the mother or the child. Given the wife’s need for the information and the law firm’s right to disclose it, the disclosure of the child’s existence to the wife constitutes an exceptional case with “compelling reason clearly and convincingly shown.”

The judgment of the Appellate Division is reversed and the matter is remanded to the Family Part.

For reversal and remandment—Chief Justice PORITZ and Justices HANDLER, POLLOCK, GARIBALDI, STEIN, and COLEMAN—6.

Opposed—none.

Parallel Citations
726 A.2d 924

(FIDUCIARY RESPONSIBILITIES)
The decision of the Court is referenced in a table in the New York Supplement.)

Surrogate's Court, Monroe County, New York.

In the Matter of the Judicial Settlement of the Second Intermediate Account of Chase Manhattan Bank, as trustee of the Testamentary Trust Established Under WILL OF Charles G. DUMONT, Deceased.

No. 1956TT443.

Harris Beach LLP, Paul J. Yesawich, III Esq. and Gregory J. McDonald, Esq., for Chase Manhattan Bank, petitioner-trustee.

Williams & Williams, Mitchell T. Williams, Esq.; Prof. Kenneth Joyce, Esq., of counsel, for Margaret S. Hunter, Esq., of counsel, for Margaret S. Hunter, University of Rochester, Rochester Institute of Technology and American Red Cross, objectants-beneficiaries.

New York State Attorney General, Audrey Cooper, Esq., Assistant Attorney General, Statutory Representative of Ultimate Charitable Beneficiaries.

EDMUND A. CALVARUSO, J.

Charles Dumont (“Dumont”, “testator”), a widower, executed his last will and testament on June 1, 1951. After providing for a few small trusts for favored employees, a small demonstrative bequest and a small general bequest, he left the remainder of his estate to a trust set up under Article Fifth of his will. This residuary trust was to pay income primarily to his daughter Blanche Hunter during her lifetime, but the trustee had “sprinkle powers”: the discretion to distribute the income among Blanche's descendants if it wished to do so. After Blanche's death, income was to go to her daughter Margaret. After Margaret's death, the trust was to cease and pay over the principal to Margaret's issue; or, if she died without issue, to the following charities: University of Rochester, Rochester Institute of Technology and American National Red Cross. In June of 1951, Margaret was twenty-seven years old. Margaret's daughter Alice was born in May of 1955. Margaret's daughter Pamela was born in May of 1957. The record shows that Margaret also had a daughter, Angela, but does not reveal when Angela was born, only that she was deceased by the time the accounting period began (Affidavit of John F. Teegardin, March 3, 2000, par. 6). Charles Dumont passed away on February 21, 1956, after Margaret had started her family. Dumont had made no changes to his testamentary plan.

After the dispositional provisions, the testator added an extensive paragraph “LASTLY”, wherein he set forth the powers of the nominated fiduciaries, notably the power to “administer ... sell, transfer and dispose” of the stock. Additionally, buried within this paragraph is an interesting notation that the testator's estate would be primarily comprised of a single security: the stock of Eastman Kodak Company (“Kodak”). Further along in this final paragraph, Charles Dumont included the following language:

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

Finally, and most importantly, he concluded his retention language with the following language (the “exception phrase”), which remains the crux of this litigation:

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

Petitioner's predecessor, Lincoln First Bank, (the "bank", "petitioner") was appointed by this court as testamentary trustee under Dumont's will on February 27, 1956. The trust was funded on June 17, 1958 with 4746 shares of Eastman Kodak Company and 375 shares of Socony Mobil Oil Corporation. For fourteen years, the composition of the trust corpus changed little. On December 29, 1972, Blanche Hunter died. Petitioner thereafter filed its first intermediate accounting, showing a continued retention of the Kodak stock. No objections were filed to this accounting and petitioner received a decree of judicial settlement, settling its account. Petitioner continued to retain a near exclusive concentration of the Kodak stock in the trust's portfolio for over twenty years, despite a precipitous drop in value during the 1970's.

*2 At the beginning of the accounting period, the bank employees responsible for the Dumont trust were R.A. Lewis and Thomas Brown. Lewis served as the trust administrative officer, Brown was the portfolio manager/investment officer. (The term "trust officer" will be used generically to refer to either of these positions). As explained at trial, the trust administrators held primary responsibility for communicating with beneficiaries, forwarding income to recipients, and making judgment calls where trusts allowed discretionary authority such as the "sprinkle" provision in the Dumont trust. Portfolio managers were responsible for knowing the needs of the beneficiaries, the time horizon of the trust, and choosing investments accordingly.

In 1973, Margaret Hunter was the income beneficiary of the trust. Lewis was the primary contact at the bank for her. This remained true even after his formal responsibilities with the trust ended, sometime around 1978 (the record is unclear as to the exact date). When Lewis ceased to have trust administrator responsibility for the Dumont trust, John F. Teegardin assumed those duties. Teegardin had been serving as the portfolio manager for the Dumont trust since 1976, having succeeded Thomas Brown. After taking over Lewis's administrative duties for the Dumont trust, Teegardin was singularly responsible for the management of the trust and remained so for almost twenty years. After Teegardin's resignation in 1997, the trust was again handled by dual officers: John Fitzpatrick as portfolio manager and Russell Mandrino as trust administrator.

Shortly after Fitzpatrick and Mandrino assumed responsibility for the trust, they were approached by Richard Holderman, counsel to Margaret Hunter, regarding potential sale of Kodak stock. An agreement amongst all parties to sell the stock was briefly pursued but never executed. In December of 1997, in response to a letter from Mr. Holderman urging them to do so (Exhibit P189), Fitzpatrick and Mandrino requested an in-house legal opinion regarding the terms of the trust, specifically seeking a more thorough definition of "compelling reason" contained within the exception phrase. However, despite their prompt receipt of a legal analysis of the trust's terms, the trust officers took no action regarding the sale of stock and the matter was dropped. A few months thereafter, a compulsory accounting proceeding was commenced by Margaret Hunter and her remaining daughter Pamela (Alice had died in March of 1980). In response to this, the bank filed a petition for the judicial settlement of its second intermediate account on August 31, 1998. Margaret Hunter and Pamela Creighton promptly filed objections to this account. They sought damages in excess of $39 million due to losses sustained because of bank's alleged improper retention of a near 100% concentration in Kodak stock and overall mismanagement of the trust estate.

Throughout the early litigation, the bank continued to hold the stock. In December of 2001, the bank determined that compelling reason to sell the Kodak stock did indeed exist, based purportedly upon Eastman Kodak's lack of presence in the new
digital market. Sale of 95% of the stock was recommended. It was encouraged to occur over the course of thirteen months, so as to spread out over three tax years the substantial capital gains tax which would be incurred. The actual sale of Kodak stock was expedited, and took place over the course of nine months. The bank filed a supplemental accounting after the sale. The official accounting period before the court is December 30, 1972 to September 15, 2003.

*3 The court issued summary judgment decisions in the summer of 2002, denying the motion of the objectants as well as the cross-motion of the bank. In December of 2002, Pamela Creighton passed away, extinguishing her interest in the trust. The interests of the charitable beneficiaries suddenly became substantial and relatively assured. Margaret's daughters had always been the presumptive remainderholders of this trust, even though their status to inherit the corpus was contingent upon their survival of Margaret. All three pre-deceased her. Because none of Margaret's daughters ever had children, Margaret was left with no descendants. Upon Pamela's death, the charities became the presumptive remainderholders. These three charitable remainderholders, as well as the New York Attorney General, joined Margaret Hunter in her suit. Trial was held in late January, 2004.

OPINION

Legal Requirement to Diversify

The accounting period before the Court spans two different legal standards for trust administration. From the beginning of the accounting period until December 31, 1994, the trustee's actions are governed by the Prudent [Person] Rule ("PPR"), as originally set forth in New York State in King v. Talbot, 40 N.Y. 76 (1869), and was later codified in EPTL 11–2.2:

A fiduciary holding funds for investment may invest the same in such securities as would be acquired by prudent men of discretion and intelligence in such matters, who are seeking a reasonable income and preservation of their capital.

*4 The PPR itself did not require a trustee to diversify an estate, but diversification was a factor in the determination of prudence. See, Matter of Newhoff, 107 A.D.2d 417, 486 N.Y.S.2d 956 (1985); Durant v. Crowley, 197 A.D. 540, 189 N.Y.S. 385 (1921). Liability for lack of diversification is based upon a breach of a fiduciary's duty to
prudently manage the estate. *In Re Estate of Janes, 165 Misc.2d 743, 630 N.Y.S.2d 472 (1995).* To determine whether such a breach of duty occurred, the Court must evaluate the fiduciary's actions along with relevant factors which affected or ought to have affected the fiduciary's decisions; for instance, the performance of the market, the corpus of the estate (both in size and composition), the situation and needs of the beneficiaries, potential tax consequences, the time (investment) horizon of the estate, the terms of the governing instrument (EPTL 11–2.2) and the intent of the settlor:

The court's job in overseeing the administration of a testator's estate is to implement the testamentary plan the testator intended, determining intent from the words used in the will and construing them according to their everyday and ordinary meaning”. *In re Estate of Walker, 64 N.Y.2d 354, 357, 486 N.Y.S.2d 899, 476 N.E.2d 298 (1985)* (citations omitted).

In this extensive and non exclusive list, the terms of the governing instrument are highly important because the terms of the instrument itself can set the stage for the weight to be applied to the other factors, and can completely reframe the fiduciary's perspective in monitoring the interplay between them.

The Prudent Investor Act (“PIA”), which took effect on January 1, 1995, was the first time that New York statutorily required diversification. Even this requirement was not absolute, however. Under the PIA, a trustee is required to “diversify assets unless ... it is in the interests of the beneficiaries not to diversify, taking into account the purposes and terms and provisions of the governing instrument” (EPTL 11–2.3(b)(c), emphasis added). The PIA therefore puts diversification at the forefront of the fiduciary's obligations but allows leeway for the fiduciary to “opt out” if the beneficiaries require otherwise, or if the testator himself/herself directed a different course of action.

For purposes of this case, the primary difference between the Prudent Person Rule and the PIA is whether diversification is the default requirement or not. They are similar in that both standards encourage diversification while allowing for the fact that the terms of the governing instrument have an important role to play in the fiduciary's decision whether or not to diversify. Because both of the standards give such deference to a testator, and because Mr. Dumont did in fact exercise his ability to direct his fiduciary on diversification decisions, the existence of two different standards over the course of the accounting period will have little practical effect. Mr. Dumont's specific instructions will carry the most weight in this litigation, not to supersede a prudence determination under the statute, but to guide and develop the concept of prudence to which the trustee will be held.

*5 In post-trial papers, objectants have argued that a trust clause which mandates an investment strategy that would normally be deemed imprudent (such as the retention of a 100% concentration of a stock) effectively eliminates the standard of prudence and thus violates EPTL 11–2.7. The Court disagreed with this argument at summary judgment and continues to do so now. Prudence is a conclusion; a determination reached after an evaluation of relevant factors, one of which is the terms of the governing instrument. Objectants are putting the cart before the horse, presuming an action's imprudence and then arguing against the authorizing clause's validity.

It is clear that a fiduciary must use good faith and prudence to carry out its duties (EPTL 11–2.7), and that a retention clause cannot trump the application of prudence in the management of an estate. *In Re Hubbell, 302 N.Y. 246, 97 N.E.2d 888 (1951)*. The Hubbell case holds that where a retention clause conflicts with the legal duty of prudence imposed upon a fiduciary, the clause must lose. The Hubbell case clarifies the fact that a retention clause cannot eliminate the requirement of prudence, and in so doing also supports the idea that a balancing between the terms of a retention clause and prudent financial management is pos-
sible, because it removed the possibility of stalemate between the two. There are three voices to which the fiduciary must listen: the settlor (his/her intent and strength of wording); the beneficiaries (regarding their economic situation and expressed desires); and the market (the realities of the financial world and composition of the trust corpus). Proper fiduciary diligence and attention paid to this triad should be sufficient to keep the proverbial floodgates of liability from swinging open.

Ultimately, the question is not a blind, “Did the trustee’s actions constitute prudent management?” but rather, “Did the trustee’s actions constitute prudent management in light of the terms of the governing instrument?” In order to properly answer this question, the Court must first review the Dumont will to determine a uniform interpretation of Mr. Dumont’s language.

Judicial Construction of “Compelling Reason”


Paragraph “LASTLY” encompassed directives quite infrequently found, and used language that was rarer still. Richard Crawford, Objectants’ expert, testified at trial that in his years of experience he had not encountered language such as that which Charles Dumont used. (Crawford, T–104). The bank has admitted the will’s uniqueness (Teegardin, T–876 and T–912). Dumont’s use alone of the disputed provisions sets his will apart. The fact that he elected to incorporate language regarding the composition of his estate and the retention of stock indicates that a distinct vision existed in his own mind. Furthermore, the extent to which he discussed this also reveals the depth of importance he placed upon it. Trust management was important enough to Mr. Dumont that he directed an entire page out of a seven page will to discussing the composition of his estate and his preferred management scheme.

Mr. Dumont dedicated much verbiage in his paragraph “LASTLY” to discuss the fact that his estate would be comprised of a single security and that he preferred that it remain so. It was to be transferred in-kind to his trustee after his estate was settled, and hopefully eventually to the ultimate beneficiaries under his residuary trust. Mr. Dumont also requested his fiduciaries to purchase more Kodak stock if more should become available to them. This section of the will provides the reader with a clear understanding that the testator had a strong affinity for Eastman Kodak, and that he ultimately wished to create a legacy of that affinity for his distant progeny once he passed away.

FN1. It was established that Charles Dumont had a family history with the Kodak company, and it was Kodak which had created the family’s wealth to begin with. Directions to retain are looked upon more favorably by courts when the stock was held by the testator (see Margaret Valentine Turano and C. Raymond Radigan, New York Estate Administration, § 14.05, 504 n. 6 (2004) for caselaw and discussion) and
as such would be even more so here with a long-standing intimate family connection to the company.

However, despite this proclivity, Mr. Dumont was also extraordinarily clear that his fiduciaries would have full authority to sell Eastman Kodak stock and manage the corpus of the trust itself:

My [fiduciaries] are hereby given full power to administer and control my estate and the several trust estates with full power to sell, transfer and dispose of the same ... it being intended hereby to give to my said [fiduciaries] full and complete authority to hold, administer, sell and invest the whole and every part of my estate and said trust estates ... (Dumont will, par. “LASTLY”)

There is no disputing the fact that the language which authorizes the sale of stock is worded much more strongly than the language which urges retention. In fact, the empowerment language is written using mandatory terms whereas the retention language which relies upon the phrase “it is my desire and hope” is clearly precatory. Precatory phrases are not binding on a fiduciary (see discussion in Warren's Heaton on Surrogate's Courts, § 187.02[8][a] ), and Dumont's words “desire and hope”, have even less proverbial teeth than precatory phrases at issue in prior cases. See, In re Flanagan, 184 Misc. 938, 55 N.Y.S.2d 200 (1945).

The placement of language itself within the will is further illuminating as to Mr. Dumont's testamentary intent. All discussion of fiduciary powers comes at the tail end of the trust description, the tail end of the will itself. It is also interesting that within this final paragraph, the powers of sale granted to the fiduciary are discussed first, the precatory retention language is discussed afterward. Foremost in his will, Charles Dumont discussed beneficiaries, specifically his family. In fact he, in his second sentence, referenced the reason for the execution of his June 1,1951 will as being because of a change in his family circumstances: the death of his granddaughter Patricia. Charles Dumont first busied himself with setting forth whom the will is designed to benefit: when, how much, and how; and then discussed the administrative how-to. This reveals that the first focus of Charles Dumont was not to create a trust to retain Kodak stock, but rather to create a trust to benefit the Dumont family and preserve their standard of living. Therefore, it is fair to glean that Mr. Dumont's residuary trust was set up first to benefit his family members, specifically his daughter and granddaughter, and secondarily to provide his descendants with a piece of their economic “heritage”, an in-kind distribution of the very stock for which he had expressed such an affinity.

With this intention of the testator at the forefront, the next step is to construe the most critical sentence of the entire will:

The foregoing provisions shall not prevent my said executors or my said trustee from disposing of all or part of the stock of the Eastman Kodak Company in case there shall be some compelling reason other than diversification of investment for doing so.” (court's emphasis).

Mr. Dumont never defined compelling reason, nor gave any examples of what it might constitute. What Dumont did do was provide his fiduciaries with an example of what “compelling reason” is not:

Mr. Dumont required his fiduciary to have a “compelling reason other than diversification” in order to sell Kodak stock. This wording reveals that Dumont himself would have normally deemed diversification a “compelling reason” to sell off part or all of a stock concentration, but in this instance, directed his fiduciary to do otherwise. This suggests to the court two things (1) Mr. Dumont was well aware of the basics of prudent financial management and, (2) he sought to give his fiduciary more leeway than the investment guidelines for fiduciaries would normally have afforded at that time. Fitting this phrase in with the testamentary intent of the will, it seems quite likely that Charles Dumont included the compelling reason phrase to encourage

his fiduciary to manage his estate with the air of sentimentality toward Kodak that he himself possessed. The language urging retention of Kodak stock plus the language authorizing sale for compelling reason, taken in light of the language of the entire will, suggests that the fiduciary was to hold Kodak stock as long as was feasible, ideally until the end of the trust's term, as long as the trust's primary purpose, the benefit of Dumont's family, was being accomplished. Prudent management of the trust would dictate that the trustee was not to blindly manage the corpus but rather hold the Kodak stock, keeping an eye on the Kodak company, the market, and the needs of the beneficiaries, to continually ensure that the trust was accomplishing its purpose. Sale was not prohibited, just not to be pre-emptively or lightly undertaken.

FN2. An element of context can be helpful here. In 1951 when this will was written, fiduciaries were bound to hold only those assets on a “legal list”. See, Warren's Heaton on Surrogate's Courts, § 70.01[1]. The legal list was an administration standard which preceded the PPR. If an asset received by the fiduciary was not on the legal list, the fiduciary was obligated to immediately liquidate this asset and re-invest the proceeds in a “legal” investment in order to avoid liability. Under the law at the time, if Kodak stock was not included within “legal” investments, testamentary authorization such as Dumont's retention language would have been the only way for a fiduciary legally to retain any of it.

*8 Petitioner's position is that sale of the Kodak stock based solely upon the preservation of the trust corpus would have been a sale for diversification, something which it was prohibited from doing by the terms of the instrument. The court does not adopt this characterization of diversification, and does not believe that petitioner's position mirrors the intent of Charles Dumont. Black's Law Dictionary defines diversification as a removal of risk presented by a concentration:

Diversification: The act of investing in a wide range of companies to reduce the risk if one sector of the market suffers losses (Black's Law Dictionary, 7th edition, 1999).

Diversification, therefore is pre-emptive. Diversification is the receipt of a concentrated portfolio, and selling off the majority of the concentration before any hint of problems with the company or stock is received. Diversification is a sale which is done even when the subject company's value is climbing. Conversely, a sale to preserve the value of a trust corpus and ideally to remedy a suffered loss is not the same. Although such a sale could result in a diversified portfolio, diversification would not be the reason for sale, and therefore such an action would be within the ability of the fiduciary under Dumont's directives.

Petitioner argues that its employees properly interpreted the document, thus maintaining that its own definition(s) of compelling reason should be adopted here. The court declines to do so. The bank never developed a uniform definition of this phrase at any time throughout the accounting period. Until 1997, no legal advice as to its meaning was even sought. As such, each employee who picked up the Dumont will was free to make his or her own evaluation of the instrument's terms. Most did so. These opinions of the language ran the gamut from “very subjective” (Deposition of Mandrino, T–453) to “black and white” (Teegardin, T–646), suggesting even more strongly that a legal opinion was needed because there was room for disagreement in interpretation. R.A. Lewis's testimony revealed that he basically treated the Kodak stock as untouchable. John Fitzpatrick testified that “compelling reason” meant changes in Kodak's business fundamentals. Later he added in the income generated for Margaret Hunter as a consideration (Fitzpatrick, T–1098). John Teegardin's definition was similar to Fitzpatrick's, although he did give lip service to the names of the remainderholders (Teegardin, T–687).
Teegardin’s actions, supported across the record, show no true concern that the remainderholders’ interests were preserved.

The Court does not adopt the bank’s definition(s) of “compelling reason”. Not only were the definitions ad hoc, informal and not uniform, but they were troubling because they focused upon the Eastman Kodak company and not the beneficiaries of the trust. The bank’s definition’s emphasis on the Kodak company itself is problematic because the trust was set up to benefit the testator’s family, and compelling reason for sale should likely be linked to some compromise of the trust’s ability to provide such benefit, not the status of Kodak itself. The bank’s focus upon Kodak suggests to the court that the bank adhered to the proposition that the Kodak retention itself was the purpose of the trust.

Furthermore, in regard to the beneficiaries themselves, the bank’s compelling reason definition(s) were clearly legally insufficient. A definition of compelling reason which includes the needs of a life income beneficiary but not those of the remainderholders is on its face a breach of fiduciary duty. A trustee has a duty of impartiality among classes of beneficiaries (Restatement of Trusts, 2nd, § 232; In Re Woodin’s Estate, 118 N.Y.S.2d 465, 469 (1952); In Re Kilmer’s Will, 18 Misc.2d 60, 69, 186 N.Y.S.2d 120 (1959)), and therefore any favoritism between them is not only highly improper, but a significant breach of that fiduciary duty. The bank’s primary witness was aware of this duty (Teegardin, T–922–923). The bank’s own legal counsel acknowledges that the compelling reason phrase cannot be construed to alleviate the duty of care (deposition of Smith, T–979), and Mandrino acknowledged this, too (deposition of Mandrino, T–1005), yet this is exactly what the bank did by developing a very one-sided concept of the exception phrase. Proper upholding of fiduciary duty demands equal consideration among beneficiaries as well as consideration of the instructions of the testator.

Deductively, then, “compelling reason” can better be defined as: any factor which should indicate to the fiduciary that the interest of any beneficiary is not being reasonably maintained or protected by the trust, or that the interest of any beneficiary would not continue to be reasonably maintained or protected by the trust, if the trustee were to continue to retain the stock. This definition advances the purposes of the testator as expressed throughout the will and incorporates a balance between his desires and his mandates. It also is equally concerned with income beneficiaries as well as remainderholders. The bank’s conduct over the accounting period will now be evaluated with the above standards in mind.

Conduct of the Bank

It is well settled that a fiduciary’s prudence is a test of conduct, not performance. Matter of Bank of New York, 35 N.Y.2d 512, 364 N.Y.S.2d 164, 323 N.E.2d 700 (1974); Matter of Banker’s Trust Co., 219 A.D.2d 266, 636 N.Y.S.2d 741 (1995); EPTL § 11–2.3(b)(1)). Prescience is not required of fiduciaries; good faith, diligence and loyalty are. In Re Hubbell, 302 N.Y. 246, 97 N.E.2d 888 (1951). A fiduciary cannot alter the actions of the beneficiaries, the terms of the governing instrument or the realities of the market. A fiduciary must work with what s/he is given. However, it is most certainly clear that a fiduciaries’s duty is not absent just because one of the three sides of the trust triangle poses a difficult challenge. High needs beneficiaries, restrictive trust terms, or a depressed market do not offer excuses for a fiduciary to shirk at his tasks, but rather present a heavier challenge attributed to the mantle of fiduciary which s/he has agreed to assume. Here, the two primary areas in which the court has concern are: (1) the bank’s definition of “compelling reason” and its manner of interpreting unique trust terms, and (2) the administration of the trust, specifically its actions in regard to communications with the beneficiaries and the management of the Kodak stock.

Interpretation of the Terms of the Trust

Petitioner received letters of trusteeship on
February 27, 1956. It was thereafter bound to follow the terms of the document. Petitioner itself asserts this fact (Teegardin, T–908), using it as an argument for why it should not have sold the 95% of the stock on January 31, 1973 (petitioner's post-trial memorandum, pg 6). The problem with the bank's argument, however, is that it allows no room for disagreement as to what the terms of the document meant. Testimony on the record shows a lack of uniformity amongst the trust officers' perceptions of the clarity of the phrase, a red flag that a legal opinion was needed. Instead, the bank's employees downplayed or even ignored the exception phrase. Most seemed unclear as to whose job it would have been to even raise the issue.

From 1973 to 1976, the trust was managed by R.A. Lewis and Thomas Brown. Lewis testified that he did not recall forming a definition of compelling reason, and did not forward the trust for an external evaluation. Thomas Brown was never even presented for testimony, despite his critical nature to this proceeding and the strong suggestion in the record that the bank was well aware of his whereabouts (Lewis, T–520). This suggests that he would have nothing to offer in the bank's defense. Lewis testified that during the early years of the accounting period, trusts went through an annual, formal review process but that he had no recollection of whether this was documented. There is no evidence in the record that either Lewis or Brown attempted to glean a legal opinion of the language in the will, and no testimony that Lewis ever even noted the exception phrase and/or formed his own definition of when it might need to be invoked. From Lewis's testimony, he seemed content with Margaret Hunter's "preference" for retention of Kodak stock (Lewis, T–520), and his adopted default interpretation that the will unequivocally directed retention (Lewis, T–506). Most tellingly, throughout this three year period, there are no copies of correspondence, no copies of review forms, no internal memos regarding the trust's terms, no documentation whatsoever as to the investment strategy of the trust or the performance of Eastman Kodak.

The complete lack of documentation alone is itself a breach of trust. Matter of John D. Rockefeller, Jr. NYLJ, March 1, 2004, at 31. See also, In Re Reckendorfer's Estate, 307 N.Y. 165, 120 N.E.2d 696 (1954). Objectants' expert Loren Ross testified to the extreme importance of keeping records as a part of prudent monitoring of a portfolio (Ross, T–180–181). Taken in conjunction with the testimony from Lewis, it shows a lack of due consideration paid to this trust by the bank. Coupled with the lack of any testimony from Brown, it suggests that portfolio management of the Dumont trust during Brown's tenure was negligible at best and certainly below the standard of care required of a fiduciary.

John F. Teegardin, the primary witness for the bank, testified that he first read the Dumont will when he assumed responsibility for the trust in 1976. Teegardin was one of only two trust officers who testified to seeking, of his own accord, additional opinions on the meaning of “compelling reason”. Russell Mandrino had informally asked Don Easterly, a colleague who had a legal education, for his opinion. (deposition of Mandrino, T–450). Teegardin said that he sought out opinions on the matter from “superiors” (Teegardin, T–689), some of whom were legally trained. Teegardin’s testimony, however, is contradictory. He testified that “compelling reason” was not normal language in a trust instrument, and that the language was carefully scrutinized (Teegardin, T–638–639). However, he testified even more strongly that he believed the document to be without ambiguity: “the language was right there, in black and white” (Teegardin, T–646), and that the will clearly laid out an investment plan (Teegardin, T–656), suggesting that he truly felt that the will required no detailed scrutiny at all. From the testimony of Teegardin, it is apparent that he believed strongly in his own ability to unilaterally interpret the trust and was moved only to seek supervisory validation of his own opinion, not a true external evaluation (Teegardin, T–916). After discussing the matter with his supervisors, Teegardin was no more moved.
to explore the compelling reason language further (Teegardin, T–694), and thus the exception phrase became again a non-issue in the day-to-day administration of the trust. Whether the banks’ lack of concern over the exception language was encouraged by Teegardin’s superiors or whether it was a result of an under-emphasized scenario from Teegardin himself (his own actions revealed his personal belief that the Kodak stock was effectively not ever to be sold, T–908), or possibly an issue of wording as he asked for advice (Teegardin, T–914–916), the record does not reveal. However, it is clear that neither Teegardin himself, nor the bank as an institution saw any need to obtain a different interpretation of compelling reason, than the very narrow and legally insufficient one which Teegardin had adopted.

FN3. Interpretations which could in any way reflect negatively on Eastman Kodak could very well have been discouraged at the bank. Both were local companies, and there was overlap between the board of Eastman Kodak and the board of the bank, as well as familial connections between the two. (Teegardin, T–823). Also quite significant is the fact that the bank served as the transfer agent for Eastman Kodak during the accounting period. (Teegardin, T–827).

*11 The arrival of John Fitzpatrick as the Dumont trust’s portfolio manager provided little change to the prior lack of concern which the bank exhibited toward the uniqueness of the trust’s language. Fitzpatrick testified that the language was a “straightforward matter” (Fitzpatrick, T–1094), yet he admits that he did not give the will a thorough attentive read, in fact quite possibly upon assuming the helm, did not even read the entire trust (Fitzpatrick, T–1089). He had no discussions with Teegardin regarding prior administration or management (Fitzpatrick, T–1085), and did not of his own accord seek legal opinion of its terms. Fitzpatrick’s testimony does show that he diligently monitored Eastman Kodak, but because he was operating from the presumption that retention of Kodak stock was unequivocal (Fitzpatrick, T–1094), this translated into no major portfolio changes for the trust. Russell Mandrino, trust administrator during Fitzpatrick’s tenure, also did not earmark the trust for external review. Mandrino was not presented for testimony at trial, but from his transcripts alone, Mandrino offered no unique approach to this trust and was vocal about the fact that he believed trust interpretation on this issue was not his responsibility (deposition of Mandrino, T–1006).

For the first three years of this accounting period, there is a complete dearth of evidence that the bank’s employees truly even noticed this trust. Then, for over nineteen years, the bank gave complete and utter responsibility for this trust to one, non-legally trained and rather fresh-on-the field man. Teegardin was only five years out of college when he assumed responsibility for the Dumont trust. This trust was the most “significant” account of his tenure with the bank. (Teegardin, T–691). Throughout most of the accounting period, Teegardin had exclusive authority for forming a legal opinion as to the trust’s terms, complete discretion over the execution of these terms, and complete and unilateral control over communicating any and/or all of this information to the beneficiaries or to his superiors. The final few years of the accounting period returned this trust to a regime where it was managed by two separate officers, but unfortunately even this return to a review by two pairs of eyes did the trust no better than prior treatment.

The bank’s answer to the exclusive or near-exclusive authority of its trust officer(s) is the existence of the Investment Review Committee (“IRC”). This committee existed to give annual reviews to every trust over which it had fiduciary responsibility. All of the trust officers in testimony cited to this “formal” annual review, and it was presented by the bank as being an in-depth evaluation of all circumstances involving the trust, by a various mix of professionals within the bank, at least once per
In truth, the IRC was a rubber-stamp process and was ill-equipped to handle unique accounts, or even to identify them. After 1976, the record includes copies of the forms submitted to the IRC. These forms were usually prepared by the trust administrator and signed by the portfolio manager and provided to the IRC at the time of the annual presentations. In the name of disclosure, each form in the record had the appropriate box checked to indicate the existence of a concentration within the Dumont trust, with the simple explanation "Instrument Directs Retention", or something nearly identical. At no place on any of the IRC forms over the entire accounting period, was there any hint that Charles Dumont's language was not absolute. None of the trust officers even hinted to the committee that there was any type of discretionary or interpretive issue involved. Before he became portfolio manager of the Dumont trust, John Fitzpatrick sat on the Investment Review Committee. He testified that he recalled no conversation at any IRC meeting regarding the compelling reason phrase of the Dumont trust. (Fitzpatrick, T–436).

The committee never questioned this black and white interpretation, even when provided with an excerpt of the will for reference. This could partially be because the presentation to the committee was revealed to be less a presentation than a submission of forms for quick authorization. Teegardin testified that his annual presentations to the committee lasted about twenty minutes, and that on average, he presented eight to fifteen accounts each time (Teegardin, T–834–835). No meaningful discussion could be had on the nuances of Dumont's language or the existence of external circumstances possibly warranting sale, in the mere two minutes of average attention the Dumont trust received from the IRC once per year. The IRC was not equipped to review interpretation of the trust, the needs of the beneficiaries, the business dealings of Eastman Kodak or the realities of the market. This is not so much due to problems with the forum itself or its professional composition as it was due to the manner and the lack of frequency in which the trusts were presented. The IRC was little more than a reason for the trust officers to pick up the file, and possibly to communicate to each other in order to generate paperwork for an amalgamation of superiors to almost blindly sign their approval. As such, the actions of the IRC were far from the adequate attention which the bank asserts that it paid, either to the exception phrase of the trust or the external factors which could trigger it.

The bank’s overall approach to the terms of this trust was problematic for several reasons. First and foremost was the fact that the employees responsible for its management were given near exclusive control on document interpretation with no true check on their actions. This allowed for the development of a default management plan whereby no active involvement on the bank’s behalf was required. The precedent which precipitated, a “maintain Kodak stock at all costs” mindset, allowed the bank to avoid performing any portfolio management while still collecting its standard fiduciary commissions. Although there was no evidence of bad faith or willful malfeasance on the part of the bank's employees, each's interpretation that the trust required no portfolio intervention created an on-going, self-perpetuating atmosphere of neglect.

Richard Crawford, one of objectants' experts, testified that the proper way to address unique terms of a trust would be first to utilize a “team resolve” approach wherein a group of the bank's own

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FN4. Adding insult to injury, the bank's interpretation of compelling reason was tightly reigned only when applied to the beneficiaries. The bank had no qualms about defining the payment of its own commissions as a “compelling reason” for sale (Teegardin, T–422) and regularly and routinely sold shares of Kodak stock to pay its commissions throughout the entire accounting period.
employees would meet to determine a uniform resolution to a trust's phraseology (Crawford, T–107). If no consensus was reached, the matter should then be forwarded to counsel for preparation of a legal opinion. Finally, if necessary, a request for a judicial construction would be in order. The record shows that the IRC was no “team approach” and the bank had no other adequate version of this methodology. Despite the fact that counsel was available to the trust officers throughout the entire accounting period (deposition of Richard Smith, T–962), no opinion on the exception phrase was requested until demanded by the beneficiary. Despite the fact that the bank could have sought a judicial determination of the phrase, and that a construction could have greatly aided the bank and also significantly reduced potential liability in this matter, a court proceeding was never suggested by any employee.

*13 The second problem with the bank's approach is that within its own internal structure, it did not clearly specify whose job it was to handle questions of document interpretation on management directives. Trust Administrators primarily had responsibility of document interpretations and making discretionary calls when it came to payments, but in no way touched the actual investment decisions of the trust. Portfolio Managers, accustomed to freedom in investment decisions based solely on the needs/ages of the beneficiaries, were not typically called upon to perform constructions. The result of this was that where two separate officers were responsible for the trust, they each assumed the task of interpreting an investment provision belonged to the other. Communication between the two was apparently infrequent, and rather than working as a unit to address the trust, they each went their separate ways. Their hindsight response was to point fingers (Deposition of Mandrino, T–1006, T–1010; Fitzpatrick, T–996). Since after the passage of an entire generation and much litigation, it is still not clear whose job it was to interpret Dumont's exception phrase, apparently the bank had holes in its personnel coverage of duties as well as an imperfect review procedure.

Thirdly, the bank never attempted to prospectively define any triggering criteria which would raise a red flag for the trust officer in charge to raise the necessity of an immediate and more in-depth review. Good practice would dictate that upon the occurrence of a pre-determined significant event (such as a precipitous decline in stock value) the trust would undergo some form of intensive review to make sure that fiduciary duty is being properly upheld. Good practice would dictate a before-the-fall type of analysis to attempt to identify proper triggers which would call for such a review. Good practice would dictate complete documentation of all of these processes (Fitzpatrick, T–1124). It took legal advice (memorandum of law, Smith to Mandrino, December 1, 1997, Exhibit 18), begrudgingly requested, nearly forty years after the funding of this trust and twenty-four years after the accounting period began, for the bank to appreciate this.

Communications with the Beneficiaries

*14 The death of Blanche Hunter on December 29, 1972 represented a change in the life income beneficiary of the Dumont trust and became a convenient end date for the first accounting period. The bank was unavoidably aware of Blanche Hunter's death, since the bank had fiduciary responsibility in administering her estate and subsequent testamentary trusts. There was overlap
between the officers who managed the Dumont trust as well as those who administered the Blanche Hunter estate. (Lewis, T–481). The bank argues that the death of Blanche Hunter specifically triggered little for the Dumont trust because Margaret Hunter was receiving all of the trust income, pursuant to the sprinkle authority, prior to Blanche Hunter's death. According to the bank, Margaret Hunter's receipt of the trust income in 1973 was no different than her receipt of its income in 1972: “the income from the Dumont trust was being distributed to Margaret Hunter even during Blanche Hunter's lifetime. So, nothing changed”. (Teegardin, T–658–659). Such an argument does not aid the bank's defense that it was indeed prudently monitoring this trust.

FN5. This is standard practice in the trust and estates field, since it timely obtains a release of liability from the estate of the deceased beneficiary (SCPA § 2210(11)), something more difficult to accomplish as time goes on.

The death of Blanche Hunter was a triggering event for the trust, in that afterward Margaret Hunter became the sole measuring life by which the investment horizon would be determined. Upon Blanche Hunter's death, the powers of the trustee became much more limited with regard to the distribution of income-the sprinkle authorization in place during Blanche Hunter's lifetime ceased at her death, and the trustee was thereafter obligated to distribute all income to Margaret Hunter. There can be no argument over the fact that the trust would need to be managed in a different manner after Blanche Hunter's death than before, since the needs of an entirely new beneficiary had been introduced. Although Margaret Hunter received income prior to Blanche Hunter's death, this was pursuant to a discretionary provision and she had no right to expect, rely upon or affect the amount of this income stream, even if she had been destitute otherwise.

The death of Blanche Hunter should have turned the bank's attention to Margaret Hunter as income beneficiary of the trust, and should have immediately initiated discussions between the trust officers and Margaret Hunter as to the trust's terms, the performance of Eastman Kodak and the general market, and the needs and desires of Margaret Hunter for her own income stream. Objectants' expert testified that this was the appropriate strategy to take. (Crawford, T–106). The change in discretionary authority upon Blanche Hunter's death should have prompted a discussion with Margaret Hunter, to notify her of the change in her status from future interest holder to present interest holder, and the corresponding changes in management this would precipitate. No such communication was had (Deposition of Hunter, T–606). The bank's view that Blanche Hunter's death created no real change in the trust could only exist if the trust was receiving no meaningful and thorough review, as if the decision to forward the trust's income to Margaret Hunter had not been re-evaluated or even re-addressed since 1958, when it was first made. It also reveals that the bank was not actively comparing the income yield to the needs of the beneficiary entitled to receive it. The bank's argument that Blanche Hunter's death changed the trust little completely ignores the fact that Margaret Hunter's status changed immensely upon the death of her mother. After December 29, 1972, Margaret Hunter had a right to receive income, and with it, a right to demand a reasonable yield from the trust.

*15 The precedent of inadequate communication which was set upon the change of generations was continued throughout the accounting period. When Teegardin assumed the role of portfolio manager he gradually began to take over as Margaret Hunter's primary contact at the bank. While the record shows an increase in the overall amount of communication between Margaret Hunter and the bank during Teegardin's tenure, this communication was not frequent. Furthermore, when communications did occur, the record shows that time and time again the Dumont trust had little or no bearing on the topic of discussion. Most of the communica-
tions between the bank and Margaret Hunter instead dealt with the other accounts held by the Dumont/Hunter family, or the performance of Kodak in general. It is unsurprising that for many years Margaret Hunter was not looking at the individual performance of her distinct sources of income, since the bank tended to lump it all together when discussing it with her. The bank's lack of specificity is underscored by Margaret Hunter's deposition testimony, where when she was repeatedly questioned regarding the conversations between her and the trust officers, each time she responded that the topic was simply, “money”. (Deposition of Hunter, T–606–607).

Even if the bank had offered evidence of copious communications with Margaret Hunter over the accounting period, the fact that most did not touch upon the trust entity subject to this lawsuit deems them only marginally relevant. Discussions regarding Margaret Hunter's personal holdings, her daughters' accounts, or the latest local puffing of Kodak do not stand as evidence that the trustee and the beneficiary were in communion on the trustee's interpretation of the trust or the needs of Margaret Hunter.

Furthermore, many of the communications in the early years seemed to take the form of the trust officer “informing” Margaret Hunter of the bank's inability to sell Kodak stock: “I told her that her grandfather specifically requested, directed in his will, that the Eastman Kodak be retained.” (Teegardin, T–650). The fact that the trust officers put forth their own informally-made understanding of “compelling reason” as an institutional mandate by the bank was deceiving and improper. Margaret Hunter testified that she had been under the belief that the Kodak stock in the Dumont trust could not be sold (Deposition of Hunter, T–614). The bank accepted Margaret Hunter's initial lack of argument as a consent to retain Eastman Kodak and pursued the matter with her no further. Not surprisingly, her later retention of counsel and eventual litigation seemed to have caught the bank off guard.

The bank's communications, when they occurred, with the remainderholders followed a similar vein. On one occasion, Pamela telephoned Teegardin, concerned by a drop in Kodak stock. Teegardin informed her that she had nothing to worry about. (Deposition of Creighton, T–444). Teegardin did not discuss long-term needs with Alice Creighton (Teegardin, T–410), even though he was portfolio manager for nearly four years before she died and she had reached the age of majority. Although his communications with Pamela had been relatively regular after she reached the age of majority (deposition of Creighton, T–442–443) these discussions were notably initiated by Pamela herself; rarely, if ever addressed the Dumont trust (Deposition of Creighton, T–445); and never addressed the trust's exception language (Deposition of Teegardin, T–419). John Fitzpatrick spoke with Pamela, but never about the Dumont trust (Fitzpatrick, T–1089).

Ironically, although Margaret Hunter did not receive much attention from the bank in her role as Dumont trust beneficiary, she received a great deal of attention in her individual capacity. The weight of evidence in the record shows that the bank was not so focused upon the Dumont trust as it was upon Margaret Hunter herself. Margaret Hunter represented a great source of potential revenue for the bank and the bank therefore courted her as an individual client. At the beginning of the accounting period, Margaret Hunter had had a simple custodial account with the bank into which the income from the Dumont trust was deposited. This account earned the bank $500 in fees per year (Teegardin, T–848). Despite the bank's own concession that Margaret Hunter had not wanted her personal holdings of Kodak to be “managed” (Teegardin, T–668), Teegardin convinced Margaret Hunter to switch her custodial account to an investment management account, whereby the bank continued to retain Kodak stock per Margaret Hunter's directives, but now received over $5000 annually in fees.
FN6. The court recognizes that corporate fiduciaries are often simultaneously managing multiple trusts and multiple individual accounts within the same family or even for the same individual. Any one client can be a grantor, an income beneficiary, a remainderholder and an owner of an individual custodial account. There is certainly nothing wrong with such multi-layer relationships, provided that the fiduciary does not allow an individual business relationship with a beneficiary to cloud its vision of fiduciary duty.

Possibly to Teegardin's credit (vis-a-vis Margaret Hunter), he was attempting through the establishment of the Investment Management Account, to convince Margaret Hunter to diversify some of her own Eastman Kodak holdings. His intent was that if the Dumont trust itself could not be divested of Kodak stock, Margaret Hunter could (Teegardin, T–848). This is one of the bank's primary defenses in this lawsuit, the idea being that it did what it could to diversify the “situation” and thus acted prudently. The problem with this argument and the thought process behind it is that Margaret Hunter is not the only Dumont trust beneficiary to whom the bank held a duty of care. In the quest to manage Margaret Hunter's holdings, the concept that the Kodak stock in the Dumont trust was untouchable became more deeply entrenched into the bank's approach, and eventually any type of management of the funds in the Dumont trust seemed to be forgotten altogether.

Breach of Fiduciary Duty

The bank was charged with upholding the terms of the trust: “In making investments of trust funds the trustee is under a duty to the beneficiary to conform to the terms of the trust” In Re Goebel's Estate, 177 Misc.2d 553, 554, 677 N.Y.S.2d 668 (1941). As such, the bank ought to have diligently explored the meaning and the intent behind the words Charles Dumont used. This is especially true given the uniqueness of the terms of the trust, and the fact that the document directed a course of fund management which goes against the grain. Retention clauses are valid even though they advocate a holding strategy which has been deemed imprudent in the absence of such a clause ( In re Estate of Janes, 165 Misc.2d 743, 630 N.Y.S.2d 472 (1995)), and which has not been encouraged by current statutory directives (Prudent Investor Act, EPTL 11–2.3). However, it is also clear that their validity does not authorize a “do nothing” strategy ( In Re Hubbell, 302 N.Y. 246, 97 N.E.2d 888 (1951)), and does not insulate the fiduciary from liability where the fiduciary's actions were imprudent.

*17 Where a fiduciary is administering an estate under directives of a retention clause, it is incumbent upon that fiduciary to develop a uniform understanding of the testator’s words, basing such a definition on the input of an experienced team of industry professionals, preferably under the guidance of in-house legal advice. It is also critical that the fiduciary's actions reflect an understanding that a retention clause does not exculpate itself from poor judgment and laziness, but instead that a retention clause almost requires a greater level of diligence and work, as prudent management of the estate will demand a delicate balancing act.

The Dumont trust was awkwardly worded. Admittedly, the paragraph “LASTLY” presents a large challenge to a fiduciary desirous of direction on a prudent course of action. Nevertheless, such impediments to ease of management ought not to be considered impediments to prudent management. The failure of the bank to properly interpret the trust, to even properly try to address it, and the bank's complacent adoption of a default meaning that was the least work intensive and yet the most profitable is not excused by the trust’s terms. The activities of the bank in this regard represent a breach of fiduciary duty.

Furthermore, because the Dumont trust contained an exception clause that authorized sale of the Kodak stock if necessary to protect the interests of the beneficiaries, it was imperative that the bank
engage in regular discussions with those beneficiaries to ensure that the trust was fulfilling its purpose and to verify that compelling reason did not exist. The bank could not prudently manage this trust without acquiring such information, since input from the beneficiaries was necessary to determine that the trust's terms were carried out. Because the bank did not perform the frequent content-relevant communications it would have needed to do in order to ascertain that the trust was being properly administered, the failure to do so also represents a breach of fiduciary duty.

Thirdly, the bank also had the duty to treat beneficiaries impartially. Its adoption of a one-sided definition of compelling reason, addressing only the needs of the life income beneficiary, is a clear breach of this duty. Likewise, so was the incorporation of a financial strategy to diversify Margaret Hunter's holdings rather than to address the difficult retention language in the trust.

**Existence of Compelling Reason and Causation of Loss**

This case provides an interesting bifurcation on the issue of liability. Even though the court has found that the bank breached its fiduciary duty to the beneficiaries, this breach will not necessarily indicate personal liability without a finding that compelling reason for sale existed. Objectants claim the existence of two compelling reasons which should have prompted the bank to sell most of the Kodak stock by January 31, 1973. The first is the low yield of Kodak stock during this time frame. The second is the risk presented to the remainderholders by the concentration itself. The latter will be addressed first.

**Risk of the Concentration, Preservation of the Corpus**

*18 Objectants propound that the risk created by the concentration was itself a compelling reason to justify sale of the stock on or before January 31, 1973. Although objectants have based a great deal of trial testimony on supporting this argument, the court does not adopt it. Charles Dumont knew when he was creating his will that he was creating a concentration in stock. The family's wealth was and had been deeply entwined with the Eastman Kodak company. Faith on the performance of one singular company was not a new concept to Charles Dumont. Furthermore, if the Kodak concentration alone was a compelling reason to sell the stock in 1973, it would have been also a compelling reason to sell the stock in 1958, when the trust was funded. Under this logic, Charles Dumont's retention directives would have been meaningless, as “compelling reason” to sell the Kodak stock would have existed the second the trust was funded. As Loren Ross testified, volatility (risk) can be positive as well as negative, as there is always a “risk” of the stock appreciating in value (Ross, T–177).

Objectants' argument also fails to address the remainder of Dumont's language: “compelling reason other than diversification”. According to the testator, diversification would normally be a compelling reason to sell the Kodak stock, but in this instance Dumont directed that the stock not be sold for diversification. Objectants' assertion that the risk presented by the concentration was, by itself, a compelling reason to sell the stock, advocates a plan which, although termed differently by objectants, is nothing more than (pre-emptive) diversification, which was not authorized by the document. Objectants' expert, Loren Ross, testified that removing the concentration would only be had by diversifying the portfolio (Ross, T–248). Ross attempted to testify that diversification was not the flipside of concentration, but when asked to more fully explain himself, the options which he listed to remove a concentration all entailed some form of sale to broaden the number or type of investment issues in the portfolio (Ross, T–241). Objectants therefore have not proved, to the court's satisfaction, that there is a way to eliminate the risk presented by a stock concentration without diversifying the portfolio. The court believes that a pre-emptive sale of Kodak (which a sale within a month of the start of the accounting period would have been: two days after the death of Blanche Hunter Kodak stock...
was at an all-time month end high), based upon the risk of concentration in Kodak alone, was exactly a sale which Charles Dumont directed his fiduciary to avoid.

However, despite the court's rejection of objectants' position that the mere risk of the concentration was compelling reason, the court does not believe that Mr. Dumont wished his trustee to retain the stock despite ongoing, significant losses which jeopardized the value of the corpus. There is a line to be drawn between risk of possible future loss, and the mitigation of substantial, present and continuing loss. The latter should have been recognized and dealt with as a part of protecting the needs of the remainderholders and preserving the testator's intent to benefit his granddaughters, whereas the first is an exercise in speculation which was outright prohibited by the instrument.

*19 The bank argues that it was essentially prohibited from selling the Kodak stock on the basis of the preservation of the corpus, because to do so would have been diversification and was prohibited. This does not convince the court. Taken to its logical extreme, petitioner's argument would claim that petitioner's hands were tied, no matter how far the stock fell in value. The court does not believe that this was the intent of Charles Dumont. Nor does the bank's interpretation pass the test articulated in Hubbell, where a strongly worded retention clause must still be subject to the element of prudence. A trustee has a duty to preserve the corpus of a trust. Restatement of Trusts, 2nd § 176. See also, Restatement of Trusts 2nd, § 181. A significant drop in stock value such that this duty to preserve is compromised, would dictate that a prudent action by the trustee would be to sell the falling stock and attempt to regain the losses sustained to the corpus. Where prudence dictates sale, a retention clause is superseded. In re Hubbell, 302 N.Y. 246, 97 N.E.2d 888 (1951). There is no colorable argument that the bank's continued retention of Kodak stock despite an ongoing, significant and continual loss in value was at all prudent when it had an exception phrase so clearly placed in the document, presumably to address such a possible circumstance. The risk presented by the concentration itself may not have been compelling reason for sale, but the actual, substantial loss and lack of visible hope of long term gain was. The court finds that if the bank had been prudently monitoring this trust, it would not have continued to retain the near-exclusive concentration of Kodak stock as it did until 2002. Therefore, the failure of the bank to adequately carry out its fiduciary duties directly resulted in objectants' loss.

As a defense, the bank argues that there is no way it could have known, in January 1973, that Eastman Kodak was about to take the loss which it did. It is essentially making an argument that the investment of Kodak stock at that time was a prudent one.

Objectants have sought to bar the bank from making this argument, asking the court to disregard any of the bank's proffered evidence that Eastman Kodak was a good and sound investment. Objectants rely on the doctrine of collateral estoppel and on the premise that this was an issue already decided against the bank in the Janes case. 165 Misc.2d 743, 630 N.Y.S.2d 472 (1995). While the objectants are correct that this case deals with the same bank, the same stock, and the same time frame, the court disagrees that this case involves the same “issue”, a requirement for the application of the doctrine. In Janes, the issue was the prudent management of an executor acting under no testamentary direction for fund management. Here, the issue is the prudent management of a trustee acting under a retention clause. There are vastly different standards for prudence between the two, even given the uncanny factual similarities FN7.

FN7. It is, however, interesting to note that the Janes court, reviewing a period between 1973 and 1978, held that the sale of the Kodak concentration in the Janes estate ought to have occurred on or before August 1, 1973.
The court agrees with the bank that on January 31, 1973, the bank did not act imprudently in retaining the Kodak stock, given the existence of the retention clause. January 31, 1973 was a mere month after the beginning of the second accounting period, and Kodak was enjoying a great high. After the beginning of 1973, however, the tide quickly turns. For every positive statement toward Eastman Kodak which the petitioner introduced at trial, the objectants introduced a negative. Financial management is an art as well as a science, and eventually there became a point where steeply declining values of stock ($140.88 in January 1973, $136 in August of 1973, and $116 in December of 1973) should have raised a red flag to the trust officers. The losses sustained by the trust early in the year ought to have indicated an on-going problem, and the major drop that November ought to have revealed that compelling reason existed to sell off part of the stock in order to re-generate and hopefully preserve the corpus.

The last independent report on Kodak which was received at trial was a Valueline report dated January 11, 1974 (Exhibit P264). Compared with the 1973 reports, which show an almost boundless enthusiasm for Kodak, the January 1974 report is so subdued that the absence of copious praise for Kodak suggests a major change in field's perception of the company. Very notably, after January of 1974, the record contains no independent evaluations. The reports submitted were instead generated by the bank's own in-house committee, reports which have little probative value given the fact that the bank was Kodak's transfer agent at the time. It is therefore the court's holding that compelling reason existed to sell off the concentration of Eastman Kodak stock by January of 1974, and that such sale ought to have occurred on or before January 31, 1974.

Low Income Yield

Objectants also argue that the extremely low yield of Kodak stock in January 1973 was a compelling reason for sale. Objectants' expert testified that in January 1973, Eastman Kodak was yielding a 1.06% return in income. Comparatively, the S & P was yielding 2.75%, long term government bonds: 6.75%, and treasury bills “a couple of percent” (Ross, T–200–201). The bank has not argued that under everyday circumstances the extremely low yield of Eastman Kodak was an appropriate yield for a trust. Instead it argues that under the totality of the circumstances, the yield was reasonable and therefore not compelling reason for sale. The bank justifies this by stating that Margaret Hunter had extensive external assets in her own name and therefore was not in need of additional return from the Dumont trust.

It is clear that a fiduciary has a duty to produce a reasonable income for a trust. It is also clear that the bank was operating under a retention clause that forbid sale of the Kodak stock without a compelling reason. However, the extremely low yield of Eastman Kodak in early 1973 should have prompted the bank to engage in a more thorough and frequent review of the trust. The trustee had a duty to produce reasonable income for the trust. This duty is to the trust itself, not the beneficiary, which the petitioner has conceded. As of Blanche Hunter's death, Margaret Hunter had the right to expect a reasonable income percentage from the Dumont trust. Margaret Hunter's right to a reasonable income from the trust was not being adequately met by the trust, since the yield of Kodak was so poor. The yield of Eastman Kodak during this time was so low that it was less than half of the average yield of the S & P. Objectants' expert Richard Crawford testified that a 2% yield was not reasonable for 1973. (Crawford, T–131). Objectants' expert Loren Ross testified that the 1973 Kodak yield was “extremely low” (Ross, T–200). Petitioner's own witness, John F. Teegardin, also admitted that it was a low return (Teegardin, T–463). With no statistical evidence showing otherwise, the court believes that a yield less than half of a “normal” yield is not a reasonable yield. The low yield of Kodak during this “snapshot in time” may not in and of itself have warranted immediate sale of the stock, but it should
have prompted the bank to scrutinize the trust and its principal stock to ensure that the trust was meeting the needs of Dumont's beneficiaries. Closer attention paid to this trust should have resulted in the recognition that by January of 1974, the low yield of Eastman Kodak, coupled with a steep decline in Kodak's stock value, represented a compelling reason for the bank to sell part of the stock concentration.

*21 As a defense, the bank argues that Margaret Hunter's external income was so extensively large that under the totality of the circumstances the low Kodak yield was reasonable. In truth, the bank's actions revealed an overconfidence in the fact that Margaret Hunter's individually-owned wealth meant that she was somehow not entitled to a more typical yield. John Fitzpatrick put it bluntly:

“[Because of Margaret Hunter's extensive external assets] I didn't even think more than five seconds about the level of income from the Dumont trust” (Fitzpatrick, T–1099).

The court does not accept this argument. The law protects the wealthy no less than the poor. The duty to produce reasonable income is a duty to the trust itself, not the income beneficiary. The extremely low yield of Kodak stock taken over the course of time, ought to have triggered deeper evaluation by the bank. Only at this point should Margaret Hunter's income become a factor in the evaluation, used possibly to justify a lower than normally-acceptable yield as being yet “reasonable” under the circumstances. Critical, though, this is the second step in the process, not the first, and it is to be taken with input from Margaret Hunter. The bank's suggestion that Margaret Hunter somehow approved of the income generated does not withstand scrutiny. Like in the Janes case, 165 Misc.2d 743, 630 N.Y.S.2d 472 (1995), Margaret Hunter was not truly consulted on the matter and did not give any written direction or waiver to the bank. The bank cannot expect that a handful of statements given by Margaret Hunter to the trust officers could be construed as consent to retain. True consent is informed and freely given. This was neither, nor was it reduced to writing or documented in any way.

The initiation of these discussions was the bank's responsibility because of its status as a corporate fiduciary and skill in the field, and because it was collecting commissions for its services. It was also the bank's responsibility because it was the bank's duty to properly interpret the document, including the phrase “compelling reason”. To do so adequately it needed input from the beneficiaries, which it did not do.

The bank's own definition of compelling reason included the needs of Margaret Hunter. However, its procedure for monitoring this trust contained no mechanism whereby it could elicit input as to what her needs were. The court previously discussed and held that this management style was a breach of bank's fiduciary duty. The lack of proper analysis of the trust's terms and lack of communications with Margaret Hunter directly caused it to avoid selling the stock, despite a compelling reason for sale, and therefore caused a loss to the objectants.

The bank argues that objectants' date of January 31, 1973 figures Kodak income yield over the course of only one month. The bank contends that the usage of this date is only a “snapshot in time”, is not truly determinative of yield, and therefore should not be used as the date by which to measure damages. The court agrees. Rash actions on the part of fiduciaries are not desired. Income yield is best evaluated over the course of several months to determine an appropriate average. Although discussing the term of time in the context of preservation of principal, Loren Ross testified that his evaluation of the stock would have encompassed a six to nine month period. (Ross, T–224).

*22 Income yield of Kodak, figured over the course of nine months, ought to have elicited the bank to hold more thorough reviews and persuaded the bank to begin engaging in discussions with beneficiaries. Therefore, despite the external assets of
Margaret Hunter, the low income yield of Kodak was compelling reason for sale by January 1974 and the bank ought to have divested itself of the Kodak concentration on or before January 31, 1974.

**Damages**

The court held above that the bank ought to have divested itself of the Eastman Kodak concentration on or before January 31, 1974. Of course, concentration has a different meanings to different people. The bank's policy at the time held that any stock comprising more than 20% of a portfolio was a concentration (Teegardin, T–887), objectants’ experts testified that this number could be appropriate at 10–15% (Crawford, T–113) but that anything over five percent would traditionally be deemed problematic (Crawford, T–114). Loren Ross testified that he would have sold up to 95% of the Eastman Kodak stock (Ross, T–224). When the bank finally did sell the Kodak stock, it sold 100% of the stock (Exhibit. P1–Second Intermediate Accounting, schedule F). The court finds that at the point where the bank ought to have divested itself of the Kodak concentration, it ought to have sold 95% of the Eastman Kodak stock.

With regard to the factoring of capital gains taxes in the calculation of damages, the Court agrees with the bank that *Matter of Saxton*, 274 A.D.2d 110, 712 N.Y.S.2d 225 (2000), controls. The proper calculation of damages in this matter must take into account capital gains taxes which would have been incurred in 1974 had the Kodak stock actually been sold. A hypothetical sale of 95% of the Kodak stock on January 31, 1974 would have yielded $4,130,243.10. The capital gains tax which would have been incurred from such a sale would have been $1,402,314.46 FN8, leaving a net amount of $2,727,928.64.

FN8. Comprised of federal capital gains tax in the amount of $1,112,509.46 and state capital gains tax in the amount of $289,805.

The award of interest is within the discretion of the trial court. *In re Janes*, 90 N.Y.2d 41, 55, 659 N.Y.S.2d 165, 681 N.E.2d 332 (1997). Where interest is awarded however it should be offset by the amount of income attributable to the retained assets. *Id.* The court agrees with objectants regarding the imposition of statutory interest, compounded. This was done in *Janes*, 223 A.D.2d 20, 643 N.Y.S.2d 972 (1996), and the court feels that it is appropriate here, especially since this case deals with a trust, covering a significant period of time. The court therefore awards objectants statutory interest, compounded annually. The interest computed from February 1, 1974 until September 15, 2003 totals $25,759,431.67. As was stated in *Janes*, the surcharge amount is to be offset by the dividends received by Margaret Hunter during the accounting period ($3,840,671) and the actual sales proceeds of the Kodak stock ($3,688,386).

Finally, the court believes it is appropriate to grant objectants’ request to deny commissions in this matter. Although the court found that compelling reason did not exist to sell the Kodak stock until January 31, 1974, it is clear that the bank’s imprudent actions and policies existed by the time the accounting period even began. As such, the court orders that commissions paid to the trustee over the course of the accounting period shall be returned to the corpus of the trust, with statutory interest compounded annually on the same. All requests for legal fees are denied.

*23 Accordingly, the trustee is hereby surcharged $20,958,303.31. Submit order accordingly.*