BESSEMER TRUST

ACTEC 2017 Fall Meeting Musings

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The American College of Trust and Estate Counsel is a national organization of approximately 2,600 lawyers elected to membership. One of its central purposes is to study and improve trust, estate and tax laws, procedures and professional responsibility. Learn more about ACTEC and access the roster of ACTEC Fellows at **www.actec.org**.

This summary reflects the individual observations of Steve Akers from the seminars at the 2017 Fall Meeting and does not purport to represent the views of ACTEC as to any particular issues.

Steve R. Akers

Senior Fiduciary Counsel — Southwest Region, Bessemer Trust
300 Crescent Court, Suite 800
Dallas, TX 75201
214-981-9407
akers@bessemer.com
www.bessemer.com

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Important Information Regarding This Summary
This summary is for your general information. The discussion of any estate planning alternatives and other observations herein are not intended as legal or tax advice and do not take into account the particular estate planning objectives, financial situation or needs of individual clients. This summary is based upon information obtained from various sources that Bessemer believes to be reliable, but Bessemer makes no representation or warranty with respect to the accuracy or completeness of such information. Views expressed herein are current only as of the date indicated, and are subject to change without notice. Forecasts may not be realized due to a variety of factors, including changes in law, regulation, interest rates, and inflation.

Introduction

Some of my observations from the 2017 ACTEC Fall Meeting Seminars in Nashville, Tennessee on October 20-21, 2017 are summarized below. (At the request of ACTEC, the summary does not include any discussions at Committee meetings.) This summary does not contain all of the excellent information from the seminars, but merely selected issues. The summary is based on the presentations at the seminars, but the specific speakers making particular comments typically are not identified.

Items 1-24 are observations from seminars about a variety of ethics issues.

Items 1-12 summarize comments from a panel by Peter T. Mott, J. Lee Osborne, Linda J. Retz, and Adam F. Streisand discussing "New Edition of the Engagement Letters Guide for Practitioners Unveiled"

1. Engagement Letters Guide Available to Public; Sample Engagement Letters in Word

The new third edition of the ACTEC Engagement Letters Guide is available to the public on the websites of ACTEC and the ACTEC Foundation. Links are available at **www.actec.org/publications/engagement-letters/** and at **www.actecfoundation.org** (Resources/ACTEC Engagement Letters). The Guide contains sample engagement letters for a variety of client situations. At the beginning of each separate engagement letter in the Guide is a link to a Word document for that sample letter that can be customized by the attorney.

2. Organization of the Guide

a. **General Checklist**. The Guide begins with a general checklist of issues that the attorney should consider in structuring an engagement and of general topics that should be covered in engagement letters. Topics included in the general checklist are:

Issues a lawyer should consider before accepting the representation;

Define the scope of the representation;

Identify the client or clients;

Explain a lawyer's duty to avoid conflicts of interest and how potential or actual conflicts of interest will be resolved;

Explain the lawyer's duty of confidentiality and how confidential information will be handled;

Explain the fee or the basis for the determination of the fee and the billing arrangements;

Firm policies of which clients should be made aware;

Termination of the representation; and

Recommended procedures.

b. **Organization of Separate Chapters**. The Guide addresses engagement letters in various contexts in separate chapters.

Each chapter begins with references to the ACTEC Commentaries on the Model Rules of Professional Conduct (the "ACTEC Commentaries") that are relevant to that type of representation. (The ACTEC Commentaries are available to the public at **www.actec.org/publications/commentaries/**.)

Following the summary of relevant ACTEC Commentaries references is a supplemental checklist of issues that the attorney should consider in structuring the engagement in that particular type of representation and documenting that structure in the engagement letter.

Following that are various forms of engagement letters (with optional alternatives for some issues) for that type of representation.

c. **Chapter Headings (Types of Representations)**. The chapter headings (describing the various types of representations that are covered) are as follows:

1. Estate Planning Representation of One Person or Spouses;
2. Representation of Multiple Members of the Same Family Other Than or in Addition to Spouses;
3. Representation of Multiple Parties in a Business Context;
4. Estate Planning Lawyer Serving as a Fiduciary;
5. Representation of Executors and Trustees in Administration Matters;
6. Representation of Guardians/Conservators;
7. Probate Litigation;
8. Dealing with Diminished Capacity or Death of a Client Not Represented in a Fiduciary Capacity;
9. Termination of Representation.

3. General Structure of Engagement Letters

The engagement letters are customized for each of the separate contexts that are covered. However, the general structure of the letters covers the following major topics:

- Scope of the Engagement
- Fees for Legal Services and Costs
- Confidential Information and Waiver of Potential Conflicts of Interest
- Our Policies Concerning Client Files and Original Documents
- Attorney-Client Communications
- No Guarantee of Favorable Outcomes
- Conclusion of Representation

Additional topics are covered in some of the letters in particular contexts. (For example, the samples of engagement letters for representation of multiple clients will address joint or separate representation issues, conflicts with other clients, and a consent to the terms of the engagement.)

4. General Comments for All Representations

a. **Vetting Prospective Clients.** The General Checklist (on page 4 of the Guide) addresses client intake and vetting issues. FATF has guidelines that it recommends for vetting prospective clients. The lawyer's staff can assist, but should not be responsible for doing all of the vetting of prospective clients. For example, one panelist likes to speak with prospective clients before the first meeting to help ascertain who are the clients and the capacity in which they will be represented and that may allow the attorney to prepare and send the engagement letter before the first meeting. In addition, the attorney can warn the prospect about who should or should not attend the first meeting. (Another panelist generally does not send out the engagement letter before the initial meeting.)

b. **Scope of Representation**. The attorney must clearly identify the scope of the representation, and clients must understand certain things that the firm will not do (such as court appearances in another state). Attorneys are encouraged to define the scope of the representation narrowly. For example, a list of documents that the firm will draft may be included. Certain things that are left to the client's responsibility (such as transferring assets to a revocable trust or changing beneficiary designations) should be made clear.

c. **Fees**. The sample engagement letters generally do not include any specific fee language, but leaves that for each attorney to prepare. The engagement letter does cover fees that will apply if an attorney is called to testify or respond to discovery regarding any aspect of the representation.

d. **Conflicts of Interest, Particularly for Dual Representation Situations**. The attorney will not take any action or refrain from taking action that affects one multiple client without the knowledge and consent of the others. If a difference of opinion arises, the attorney can point out the pros and cons of respective positions, but cannot advocate one client's position over another. The multiple clients are waving potential conflicts that might arise as a result of a dual representation. (In California, the letter must also disclose relevant potential conflict circumstances and the reasonable and foreseeable adverse consequences in those situations.)

   If an actual conflict arises, two alternatives are offered for the engagement letter: (1) the lawyer will withdraw from representation of either client, or (2) the lawyer will seek to continue representing one of the clients but not the other.

e. **Attorney-Client Communications**. The engagement letter warns that electronic communication is not as safe from inadvertent disclosure, but if the client provides an email address, the client gives permission to communicate in that mode. If someone who is not represented is included in a meeting or phone call or correspondence, the engagement letter warns that the attorney-client privilege may be lost as to subjects disclosed. In addition, the letter warns that if the client authorizes using email or a fax machine to which others might have access, the attorney-client privilege may also be lost.

f. **Client Files and Original Documents**. The engagement letters generally provide two optional alternatives regarding original documents: (1) the firm will not retain original documents, or (2) the firm will retain originals other than documents associated with the client's health care. The engagement letter informs the client that if a question arises about a client's capacity or death, the original documents will be released only to the person legally entitled to them in the firm's discretion, and the firm can petition a court to determine who is legally entitled to the documents.

g. **Conclusion of Representation**. The greatest debate of the Professional Responsibility Committee regarding the preparation of the Guide was whether representation should be terminated once documents are signed. The attorney does not want to alienate the client by "firing" the client, but various advantages arise from formally terminating the representation after matters in the specific representation have been completed. The approach of the Guide is to terminate the representation after documents are signed, but the termination is softened by stating that "We will be happy to provide additional or continuing legal services. But unless arrangements for such services are made and agreed upon in writing, we will have no further responsibility to either of you with respect to future or ongoing legal issues, nor will we have any duty to notify you of changes in the law or upcoming filing or other deadlines."

5. Representation of One Person or Spouses

The prior edition of the ACTEC Engagement Letters Guide provided alternatives for either (1) concurrent representation of spouses generally, or (2) concurrent but separate representation of spouses. The College has now concluded that it does not encourage concurrent but separate representations, so the second letter is omitted. In its place is a letter regarding the representation of one person (whether married or single). If both spouses are represented, the paragraphs dealing with dual representation of clients obviously are relevant.

6. Representation of Multiple Members of the Same Family Other Than or in Addition to Spouses

Two sample engagement letters are provided. The first deals with representing a married couple in connection with the separate representation of other members of the same family in estate planning matters. The second addresses the joint representation of multiple members of the same family (other than spouses) in non-litigated matters of common interest.

If a married couple and other members of the same family are represented, the engagement letter makes clear that the attorney represents the couple jointly, but with respect to other members of the family, the representations are separate. The attorney will not disclose anything about the couple with other family members, even if the attorney thinks it might be important to the other family members. The attorney gives each family member (or couple) individual advice and will not be influenced by work for the other members. (As described above regarding conflicts of interest, in California the attorney must go further and disclose the foreseeable adverse consequences of relevant conflict situations.)

The second alternative of the engagement letter regarding the joint representation of multiple members of the same family other than spouses makes clear that the clients will be jointly and severally responsible for payments of attorney's fees, and the attorney may seek payment from any of them.

7. Representation of Multiple Parties in a Business Context

The Guide contains three sample engagement letters in the business representation context: (1) representation of the entity; (2) representation of the organizers only; and (3) representation of the entity and organizers.

A key in this type of representation is clearly identifying the clients and defining the scope of the representation.

8. Lawyers Serving as a Fiduciary

Key to this type of representation is documenting that the client is making an independent decision to appoint the lawyer in a fiduciary capacity. The supplemental checklist contains helpful suggestions before accepting this type of representation (such as whether the firm has trained staff for serving as a fiduciary, whether any restrictions are imposed on the attorney's ability to serve as a fiduciary under state law, etc.).

The checklist at the beginning of chapter 4 includes suggested clauses that could be added. These clause address (1) dual compensation as a fiduciary and for services as an attorney, (2) broad exculpation, and (3) shortening the period of time a beneficiary may object to an accounting. (Some of these may present ethical issues in some states.)

9. Representation of Executors and Trustees in Administration Matters

Separate letters are provided regarding the administration of an estate and the administration of a trust. The supplemental checklist at the beginning of chapter 5 has a good checklist of services to be performed for a probate administration and for communications with beneficiaries (pages 68-70) and services to be performed for a trust administration and communications with trust beneficiaries (pages 78-79).

The engagement letters address an exception to the rule of confidentiality. The attorney may have a duty to notify a beneficiary in the event of inappropriate actions or inactions of fiduciaries.

10. Representation of Guardians/Conservators

Chapter 6, dealing with the representation of guardians/conservators, is new in the third edition of the Engagement Letters Guide. Significant customization of this letter may be required based upon particular state guardianship/conservatorship laws.

11. Probate Litigation

Chapter 7, addressing probate litigation, includes two sample engagement letters: (1) representation of beneficiaries in litigation matters; and (2) representation of fiduciaries in litigation matters.

If the attorney is engaged as local counsel but not lead trial counsel, the engagement letter should clearly describe the role of services as local counsel.

If the fiduciary is also a beneficiary, the engagement letter must make clear whether the client is being represented as a beneficiary or fiduciary. That may impact how fees are paid (from the trust or from the beneficiary individually). If the attorney is representing the client in both capacities, fees will have to be segregated and separate bills must be sent for services provided in those separate capacities. In addition, if a client is represented in a dual capacity as fiduciary and beneficiary, the engagement letter should define the potential consequences of the joint representation, including circumstances in which the attorney may not be able to be as zealous in the representation.

In addition, if the attorney is representing a fiduciary, the engagement letter should clarify whether the trust or the fiduciary is paying for legal services. California and some other states provide that if the trust is paying for services, the attorney-client privilege between the trustee and the attorney belongs to the office of the trustee, so any successor trustee will be entitled to all communications with the attorney. That does not apply if the trustee is individually paying for legal services.

12. Dealing with the Diminished Capacity or Death of a Client Not Represented in a Fiduciary Capacity

The engagement letter should advise clients of attorney responsibilities after the client's incapacity or death and request authorization to do certain things including discussing the appointment of someone to manage financial affairs if an incapacity occurs. If the attorney has concerns about a client's capacity, the engagement letter may provide that the attorney can continue to represent the client in the firm's discretion, and will take only those actions the attorney believes to be in the client's best interest and consistent with the client's expressed wishes. In the event of incapacity, the attorney is authorized to communicate with family physicians or professional advisers and to disclose pertinent confidential information that the attorney may determine to be reasonably appropriate to act in the client's best interest. In addition, the attorney may request a court to appoint someone to represent the client's interest.

Items 13-17 address Attorney-Client Privilege and Work Product Issues Regarding Lawyers and Other Advisors Working Together. Speakers were Kim Kamin, Jon Scuderi, Michael D. Simon, and Jessica Uzcategui.

13. Attorney-Client Privilege

a. **Rationale of Privilege Doctrine**. The underlying rationale of the attorney-client privilege doctrine is that lawyers can effectively represent clients only if a free flow of information exists between the client and lawyer.

b. **Distinction from Confidential Information**. The lawyer's duty to maintain confidences is an ethical duty. The attorney-client privilege is an evidentiary doctrine, typically defined by statute. Communications subject to the confidentiality restriction are not necessarily privileged in a litigation context.

c. **Essential Elements**. Three essential elements of the attorney-client privilege are (1) information was transmitted between a lawyer and her client; (2) in the course of the attorney-client relationship; and (3) in confidence.

d. **Fiduciary Exception**. The fiduciary exception to the attorney-client privilege recognizes that a communication is not privileged in a proceeding alleging a breach of trust by a fiduciary "if the communication (a) is relevant to the claimed breach; and (b) was between the trustee and a lawyer … who was retained to advise the trustee concerning the administration of the trust." RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS §84 (2000). The beneficiary may argue that the attorney is being paid by the trust for the beneficiary's benefit, so the beneficiary should be able to access any communications between the lawyer and the fiduciary. The counterargument is that the purpose of the privilege is to facilitate communications between a lawyer and fiduciary, and that the beneficiary is not necessarily entitled to access those communications. A distinction made in some jurisdictions is whether the communication was intended to protect the fiduciary against a breach of duty claim by beneficiaries (in which case the exception would not apply and the communication would remain privileged). The scope of the fiduciary exception to the attorney-client privilege doctrine varies from jurisdiction to jurisdiction. Having the fiduciary pay individually for legal services for advice for the protection of the fiduciary enhances the likelihood that the exception will not apply.

14. Work Product Doctrine

The work product doctrine applies only to certain matters prepared for litigation in progress or in reasonable anticipation of future litigation. It includes tangible or intangible items. Two types of work product include (1) fact work product [such as witness statements, investigative reports, interoffice memoranda, photographs, etc.] and (2) opinion work product [such as mental impressions, conclusions, opinions or legal theories of a party's attorney or other representative concerning litigation].

Opinion work product is always protected, but fact work product may have to be disclosed if the opposing party shows "it has substantial need for materials to prepare its own case and cannot, without undue hardship, obtain their substantial equivalent by other means." FEDERAL RULES OF CIVIL PROCEDURE §26(b)(3)(A)(ii).

The purpose of the work product doctrine is that litigators should be able to prepare their cases without interference from the other side, and lazy lawyers should not merely be able to piggyback on the work of the opposing attorneys. An exception is that if work product is going to be used in a trial, disclosure may be required prior to the trial.

The work product doctrine is broader than the attorney-client privilege in that it can include materials in addition to communications between a lawyer and client.

The most often litigated issue regarding the attorney work product doctrine is whether the product was produced in anticipation of litigation. Phrases used in various cases include "substantial probability that litigation will occur and that commencement of such litigation is imminent," "real and imminent," "identifiable," and "reasonably have been anticipated or apprehended." In the tax context, merely receiving an audit letter from the IRS may not be sufficient to satisfy the anticipation-of-litigation requirement. Not all audit letters result in litigation.

Work product protection can be waived, just like the attorney-client privilege. Voluntary disclosure of information can result in a waiver.

Examples of situations in which attorney work product can arise in the estate planning context with third party wealth strategists or fiduciary counsel include (1) client disputes (for example, arising in strategy meetings or in providing analysis for counsel), (2) tax controversies, (3) the wealth strategist/fiduciary counsel serving as expert witness/consultant, and (4) participation in internal investigations where concerns exist that the financial institution may be sued.

15. Other Privileges

In addition to the attorney-client privilege and work product doctrine, other privileges include the client-accountant privilege (more specifically, the "federally authorized tax practitioner's privilege" under I.R.C. §7525), privileges arising under HIPAA, and the psychotherapist-patient privilege.

16. Impact of Third Party Involvement on Attorney-Client Privilege and Work Product Doctrine

How do the activities of third parties having relationships with the client impact the attorney-client privilege and work product doctrine? Examples of such third parties include wealth strategists/fiduciary counsel with financial institutions, accountants, appraisers, physicians, and law firm staff.

a. **Approach to Analyzing Impact on Attorney-Client Privilege**. Two issues are (1) whether the communication was privileged in the first place, and (2) whether the privilege was waived. For example, if third parties attend a meeting between the lawyer and client and begin the meeting with chitchat about various unrelated items, those communications are not information transmitted between an attorney and client in the course of the relationship in confidence, and therefore are not privileged at all. With respect to waiver, communications for the purpose of rendering legal advice and within the scope of employment are privileged UNLESS they were not communicated in confidence; if third parties are present, there is no expectation of confidentiality and privilege does not exist unless the status of the third-party facilitates the legal representation.

b. **Third Party Exceptions to Facilitate Legal Representation**.

- **Agent of Client or Lawyer**. The most common exception is if the third party is an agent of the client or lawyer, either formally (for example under a power of attorney) or informally. The communication to the agent must be for the purpose of rendering legal advice and in the scope of the representation. An agent of the lawyer could include the lawyer's secretary, legal assistants, or in-house accountants. An important caveat of using the agency theory is that an agency terminates at the death of the principal. Therefore, after the client's death, the client's wealth advisor is no longer an agent of the client, and the attorney must determine if communications with the wealth advisor would still be privileged for other reasons.

- **Translator**. The third party may be necessary for the attorney to understand relevant issues. Examples could include foreign languages, accounting or financial concepts. Another example is that an attorney dealing with an older client may need the assistance of a third-party to help calm and communicate with the client.
- **Facilitator**. The third party may be necessary for the rendition of legal advice, such as providing clerical tasks or emotional support. In some cases, obtaining explanations from a third party who keeps the client's financial records and knows about financial activities, etc. may be necessary. (A person who is merely present for moral support is more likely to fail to satisfy the "facilitator" exception.)

17. Practical Tips When Dealing with Third Parties to Maintain Privilege and Work Product Protection

a. **Most Third Party Contacts Will be Uneventful, BUT ….** Most third-party collaborations will be completely uneventful. But for the very small percentage of situations that may later result in litigation, thoughtfully structuring and documenting relationships can be imperative to preserving attorney-client privilege and work product protection.

b **"Building a Shield."** When communications occur with third parties, arguments may later be made that the communication was not privileged or that privilege was waived. Lots of little steps can be taken to assist in defending against a disclosure motion. The goal is to build as many helpful barriers as possible to shield against a potential challenge.

c. **Emphasize Privilege Significance to Client and Third Parties**. At the outset, the attorney should emphasize to the client how the privilege concept is protected and the importance of not disclosing attorney-client communications with third parties. "It is not because I don't like your friend/son/spouse/accountant. We must be careful throughout about preserving the privilege."

In addition, the attorney should emphasize to advisors the importance of maintaining the attorney-client privilege and why the parties must work together for the client's best interest. The third parties must understand that necessarily there will be tension between the concepts of collaboration and privilege and that facilitating the free flow of information is not always consistent with maintaining privilege.

Everyone "in the room" with attorney-client communications should understand the potential for waiver if information is disclosed to anyone who is not part of the privileged group.

d. **Anticipate Upfront in Meetings**. This issue must be anticipated upfront in meetings – once communications have occurred in the presence of third parties who do not satisfy one of the exceptions, protection may be lost forever. Problem situations can sneak up unexpectedly. The attorney and third parties should consider this issue in every day phone calls and meetings. The potential of blowing privilege or work product protection will not come with "flashing red lights" (but the parties will later wish there had been flashing red lights).

e. **Ask About and Document Status**. If a third party is present, the attorney should immediately ask about the status of the third-party. "Who are you? Why are you here?" The attorney must explain this is not a personal matter, but important to maintain the privilege, and the client and third parties will be happier in the long run if parties that would jeopardize the privilege are not present in the meeting. The attorney must get comfortable having these conversations in a nice way.

f. **Documentation of Status of Third Party**. If the third party's status is not documented in writing, parties later will view purported justifications as made-up excuses. Consider having the third party and client sign an agency letter clarifying the third party's status. At a minimum, include the status of any third parties present in meetings in the attorney's notes or meeting logs.

Third parties can also assist in being diligent to document their status. When third-party planners communicate with attorneys, the third parties should document that the communication is on behalf of the client as a directed agent to facilitate the rendering of legal advice.

g. **Meeting Agendas**. If third parties will be present for some portions of attorney-client meetings, consider using an agenda to list the times and issues that will be discussed only with the client. The agenda would make clear when third parties will leave the room.

h. **Protecting Work Product**.

- **Personal Notes**. A third party's personal notes reflecting counsel's strategies or opinions may be entitled to protection.
- **Write "Work Product "or "Confidential Work Product" at the Top of Notes or Other Documents**. Consider writing "work product" or "confidential" at the top of notes or other documents to evidence the intention that material is work product in anticipation of litigation. If a third party is asked by the attorney to prepare reports, label them as confidential work product. That is not determinative, but it lets the court know what the third party was thinking when the documents were created. This is also very helpful to counsel when later responding to discovery. In the course of reviewing 10,000 pages, having documents specifically labeled as work product is very helpful.
- **Document Why Anticipation of Litigation**. The third party or attorney may document why the report is being prepared in anticipation of litigation. This is a fact-specific determination by courts.
- **Be Careful in Gray Areas**. "Anticipation of litigation" means more than just a mere possibility of litigation.
- **Letter from Counsel**. If a third party is acting as an expert for financial analysis or some other purpose, the attorney should prepare a letter defining the scope and purpose of the analysis.
- **Protect from Disclosure**. Work product can be waived by voluntary disclosure so be careful with the circulation of documents or other information.

g. **No Bcc's.** Do not include bcc's on emails. Any "Reply All" to the message will also go to any bcc's.

Items 18-24 summarize comments from a panel by Thomas L. Overbey, James C. Worthington, Sr., and Michael D. Simon discussing "Tech Do's and Don'ts"

18. Cybersecurity Concerns: Broader Issue of Preserving Client Confidences

Cybersecurity concerns, from an attorney's standpoint, is part of the larger aspect of preserving client confidences. Specific cybersecurity technology issues include protecting metadata, email, information stored on the cloud, passwords and password managers, protecting devices from theft or loss, deleting data from lost or stolen devices, mobile data storage devices (thumb drives and external hard drives), using public Wi-Fi and VPNs (virtual private networks), and disposing of old phones.

19. Ethics Rules

a. **Model Rule 1.1-Competence.** "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." Comment [8] to Rule 1.1 was modified in 2012 to require that a lawyer keep abreast of changes in the law and its practice, "including the benefits and risks associated with relevant technology."

Ethics opinions make clear that competence requires remaining current "not only to developments in the law, but also developments in technology that affect the practice of law." Florida Ethics Opinion 12-3 (revised 4-26-16). If a lawyer uses storage devices (such as a hard drive or smartphone), the lawyer has a duty to keep abreast of technology changes. *See* Florida Ethics Opinion 10-2 (revised 9-24-14).

b. **Model Rule 1.6-Confidentiality**. Model Rule 1.6 (c) was revised in 2012 to provide: "A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client." Comment [18] to that revised rule provides that unauthorized access to, or inadvertent or unauthorized disclosure of, information relating to the representation of a client does not violate this rule "if the lawyer has made reasonable efforts to prevent the access or disclosure."

Ethics opinions require that attorneys protect confidential information leaving the lawyer's office, including electronic documents and communications (*see* Florida Ethics Opinion 06-2 (revised 8-24-11)), that lawyers warn clients about the risk of sending or receiving electronic communications (*see* ABA Formal Opinion 11-459), and take reasonable steps to assure that confidences are not disclosed through theft or inadvertence (*see* Arizona Ethics Opinion 05-04). An attorney using cloud computing must perform due diligence in researching the outside service provider to ensure that adequate safeguards exist to protect information stored with the service provider (*see* Florida Ethics Opinion 12-3 (revised 4-26-16)).

Comment [18] to Model Rule 1.6(c) provides several nonexclusive factors to guide lawyers in making a "reasonable efforts" determination as to technology security measures:

- the sensitivity of the information;
- the likelihood of disclosure if additional safeguards are not employed;
- the cost of employee additional safeguards;
- the difficulty of implementing the safeguards; and
- the extent to which safeguards adversely affect the lawyer's ability to represent clients (e.g., by making a device or important piece of software excessively difficult to use).

The ethics rules themselves provide little guidance regarding technology issues, but ABA and State Bar ethics opinions clearly have addressed technology matters. The overwhelming if not unanimous trend is to apply a reasonableness standard and not to provide specific technology recommendations (because any such specific recommendations would likely be quickly outdated). *See* ABA COMMISSION REPORT ON ETHICS 20/20 REPORT 105A (Aug. 2012), quoted in Form Opinion 477R at n.13.

c. **Articles.** Recent articles have addressed ethical issues raised by cybersecurity matters. *See* Madelyn Tarr, *Law Firm Cybersecurity: The State of Preventative and Remedial Regulation Governing Data Breaches in the Legal Profession*, 15 DUKE LAW & TECH. REVIEW 234 (2016) (calling for standard of care and private cause of action for data breaches); Shea Boyd, *The Attorney's Ethical Obligations with Regard to Technologies Employed in the Practice of Law*, 29 GEO. J. LEG. ETHICS 849 (2016) (overview of state ethics opinions, primarily California and New York)

20. ABA Formal Opinion 477R

ABA Formal Opinion 477R was issued May 11, 2017, and revised May 22, 2017. It updates ABA Formal Opinion 99-413 which concluded that "unencrypted email posed no greater risk of interception or disclosure than other non-electronic forms of communication." ABA Formal Opinion 477R is a long ethics opinion, quoting various other state ethics opinions, addressing cybersecurity concerns. The opinion emphasizes the *process* that attorneys should follow to comply with the "core duty of confidentiality in an ever-changing technological world" in which hacking and data losses are a "when, not if" proposition. The opinion gives guidance on what reasonableness requires regarding cybersecurity.

Under Formal Opinion 477R, attorneys must discuss the level of security with the client at the beginning of the relationship, the attorney must establish appropriate policies, procedures, and training, and the opinion provides general guidance (not specific recommendations) with respect to the reasonableness of such actions.

While Formal Opinion 477R makes no attempt to specify the reasonable steps the lawyer should take under any set of circumstances, it offers seven considerations as guidance.

1. Understand the nature of the threat.

2. Understand how client confidential information is transmitted and where it is stored.

3. Understand and use reasonable electronic security measures. The opinion offers suggestions regarding specific considerations in the reasonableness of security measures that attorneys should take.

> A lawyer should understand and use electronic security measures to safeguard client communications and information. A lawyer has a variety of options to safeguard communications including, for example, using secure internet access methods to communicate, access and store client information (such as through secure Wi-Fi, the use of a Virtual Private Network, or another secure internet portal), using unique complex passwords, changed periodically, implementing firewalls and anti-Malware/Anti-Spyware/Antivirus software on all devices upon which client confidential information is transmitted or stored, and applying all necessary security patches and updates to operational and communications software. Each of these measures is routinely accessible and reasonably affordable or free. Lawyers may consider refusing access to firm systems to devices failing to comply with these basic methods. It also may be reasonable to use commonly available methods to remotely disable lost or stolen devices, and to destroy the data contained on those devices, especially if encryption is not also being used.
>
> Other available tools include encryption of data that is physically stored on a device and multi-factor authentication to access firm systems.
>
> In the electronic world, "delete" usually does not mean information is permanently deleted, and "deleted" data may be subject to recovery. Therefore, a lawyer should consider whether certain data should *ever* be stored in an unencrypted environment, or electronically transmitted at all.

4. Determine how electronic communications about client matters should be protected.

5. Label client confidential information. The opinion suggests appending a "disclaimer" to client emails stating that the emails and any files transmitted with them are confidential and intended solely for the use of the individual or entity to whom they are sent. Model Rule 4.4(b) obligates a lawyer who "knows or reasonably should know" that he has received an inadvertently sent "document or electronically stored information relating to the representation of the lawyer's client" to promptly notify the sending lawyer.

6. Train lawyers and nonlawyer assistants in technology and information security.

7. Conduct due diligence on vendors providing communication technology.

The discussion under the third guidance makes clear that attorneys cannot ignore technology, and that they have technical duties to use a certain amount of technology.

Formal Opinion 477R does not address how to satisfy the duty of competency regarding technology issues or what to do if there is a cybersecurity breach of confidences.

21. Cloud

Before selecting a Cloud vendor, carefully read its privacy policy. For example, the Dropbox policy says that Dropbox can use posted information for any purpose it wants. (Query whether that is an automatic waiver of privilege for anything posted on Dropbox, because arguably no expectation of confidentiality exists.)

22. Metadata

Examples of metadata include the filename, the file's location in the system, the type of file, edit date, the editor, the date it was accessed, how long the file was worked on, and the file's size. An attorney should generally scrub documents of metadata before sending electronic documents outside the office. However, when an attorney in litigation is under a duty to preserve documents, the data is not limited to the "surface layer" of the document, but includes metadata.

A crude, but effective, way of ensuring that metadata is not transmitted is to send a scanned copy of a print of the document. Various software programs also provide convenient ways to scrub metadata. Examples include Word and Acrobat. In Word, (1) go to File/Info/Check for Issues/Inspect Document, (2) check all boxes, (3) click "Inspect," and (4) click "Remove All" for any sections that return results. For prior versions of Acrobat, (1) go to Document/Examine Document from the pull-down menu, (2) select "Expand All" to preview the hidden information, (3) click "Remove" then confirm removal, and (4) "Save" the document to apply the changes. For Acrobat XI, use Tools/Protection/Remove Hidden Information. For Acrobat DC (the current version) use Tools/Protect/Remove Hidden Information.

23. Password Managers

Using strong passwords is one of the most important steps that can be taken to protect confidential information, but remembering (or being able to find) strong passwords is cumbersome. Some alternatives for Password Managers (to store all passwords with a single much more complex initial password) are Dashlane, LastPass, and RoboForm.

24. Protecting Device From Theft of Loss

Mobile phones can now hold the equivalent of well over 100 million pages of documents. To protect against possible theft or loss of a remote device, the ability to delete remotely (or "wipe") confidential client information is invaluable.

The "Find My iPhone" feature in iPhones and "Find My Device" or "Find My Mobile" for Android phones provide a way to locate lost devices or to wipe all of the data from a lost device that cannot be retrieved.

Items 25-34 address Domestic Asset Protection Trusts.   Speakers were W. Donald Sparks II, Duncan E. Osborne, and Amy K. Kanyuk

25. Historical Background

The 1980s were difficult economic times, and clients sought advice about protecting their assets.

In 1989, the Cook Islands amended its International Trust Act to facilitate the creation of a trust of which the settlor could be a beneficiary yet still in enjoy the advantages of a spendthrift clause. This development was initially greeted by critics in the United States, but thousands of U.S. trusts were settled in the Cook Islands within several years. Other offshore jurisdictions noticed, and by 1992, 24 jurisdictions had asset protection legislation.

The initial response in the United States was not until 1997 when Alaska was the first state to pass a statute protecting discretionary self-settled trusts. (2017 is the 20th anniversary of that initial domestic asset protection trust (DAPT) legislation.) Various states have followed suit in the intervening years, and 17 states now have some form of DAPT legislation.

Passed in 2005, perhaps partially in response to criticism of the DAPT statutes by academics, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 limited asset protection in bankruptcy proceedings for homesteads and IRAs and also contained what amounted to a 10-year statute of limitations for attacking "self-settled trusts and similar devices." (*Battley v. Mortensen* was an Alaska bankruptcy court case concluding that a transfer to the Alaska DAPT made within 10 years prior to bankruptcy filing was a fraudulent transfer under §548(e) of the Bankruptcy Code.)

The Foreign Account Tax Compliance Act (FATCA) passed in 2010 added onerous burdens for dealing with offshore assets, which had the interesting effect of promoting the use of domestic trusts.

Flagrant abuses of asset protection trust planning in cases such as *Anderson* and *Lawrence* have emboldened academic criticisms of asset protection trusts.

In 2014, the Uniform Law Commission renamed the Uniform Fraudulent Transfer Act as the Uniform Voidable Transactions Act (UVTA). The UVTA, among other things:

(i) expands the definition of insolvency compared with predecessor statutes;

(ii) mandates that the law governing debtor-creditor disputes is the law of the individual debtor's principal residence at the time of the transfer, irrespective of contrary provisions in operative documents;

(iii) includes a Comment (comment 2 to §4) suggesting that a distinction between reasonably foreseeable creditors and unknown future creditors no longer exists (which is not a fair statement of the law); and

(iv) includes another Comment (comment 8 to §4) implying that the relationship between §4 and §10 is such that a transfer by debtor resident in a non-asset protection state to an asset protection trust sitused in a state with DAPT legislation would be voidable *per se* (but that same Comment implies that an individual in a DAPT jurisdiction could settle a trust in another DAPT jurisdiction and enjoy protection of that state's statute).

One response to the expanded advantages afforded to creditors under the UVTA may be to continue the passage of DAPT legislation in more states or to make greater use of offshore trusts.

26. DAPT Statutes – Overview

Some form of DAPT legislation now exists in 17 states: Alaska, Delaware, Hawaii, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. Those 17 states cover approximately 20% of the United States population.

Foreign asset protection trusts probably provide more protection than DAPTs, but they can involve much more burdensome issues, such as logistics, time zone differences, language differences, political stability concerns, the need for significant due diligence, etc. Domestic DAPTs will be sufficient for most clients who want to make use of a self-settled spendthrift trust.

The DAPT statutes in the 17 states differ in a variety of ways, but in considering which jurisdiction is best, consider outside factors as well such as the historical jurisprudence of the state regarding creditor issues, the quality and quantity of fiduciaries in the state, and where property is located (trust property located in a particular state, especially real estate, is more likely to be protected if the trust is sitused in that state).

A significant uncertainty about DAPTs is the extent to which a resident in a state that does not have DAPT legislation can create a trust under the laws of a DAPT state and still enjoy protection of the spendthrift clause. (Comment 8 to §4 of the UVTA suggests that would be a voidable transaction and would not be entitled to spendthrift protection.)

27. Transfer Tax Consequences of DAPTs

a. **Completed Gift**. The IRS has acknowledged that a transfer to a DAPT can be a completed gift even though the asset may be distributed back to the settlor in the trustee's discretion. Rev. Rul. 76-103 ("If and when the grantor's dominion and control of the trust assets ceases, such as by the trustee's decision to move the situs of the trust to a State where the grantor's creditors cannot reach the trust assets, then the gift is complete for Federal gift tax purposes under the rule set forth in §25.2511-2").

b. **Estate Inclusion**. If a grantor makes a transfer and retains the right to the income from the property or the property itself, §2036 may cause estate inclusion of the transferred asset. Several cases have held that the ability of a settlor's creditors to reach the assets will be deemed to be retained use and enjoyment of the transferred assets for purposes of §2036. (*Paxton v Commissioner, German Estate v. U.S., Outwin Estate v. Commissioner, Paolozzi v. Commissioner*).

   Will §2036 apply if the trustee has the discretion to make distributions to the settlor but state law does not permit the settlor's creditors to reach the trust assets under a DAPT statute? In Letter Ruling 98337007 the IRS concluded that whether assets in an Alaska DAPT would be excluded from the settlor's estate depended upon the facts and circumstances existing at the settlor's death. Letter Ruling 200944002 similarly refused to rule as to whether the trustee's discretion to distribute trust assets to the settlor, when combined with other facts (such as, but not limited to, an understanding or pre-existing arrangement), may cause inclusion in the settlor's gross estate under §2036.

28. Fraudulent Transfer Effects

Every state with a DAPT statute excludes fraudulent transfers from the protection of the statute if the claim arises within the limitations period of the fraudulent transfer statute. The length of the limitations period under the DAPT statutes often depends upon whether a creditor's claim existed at the time of the transfer. For future creditors, many states have a four-year period (Hawaii and Utah say that future creditors cannot attach DAPT assets at all.) For existing creditors, some states use a four-year period and some states use a two-year period (or one year after the transfer could reasonably have been discovered.) The states vary significantly with respect to the applicable fraudulent transfer periods.

The standard of proof as to whether a transfer to a DAPT was a fraudulent transfer also varies. Some states require clear and convincing evidence, some states require a preponderance of the evidence, and some states are silent as to the issue.

29. Exception Creditors

Every state except Nevada recognizes various categories of "exception creditors" for spendthrift clause purposes. Certain creditors can reach assets in a spendthrift trust even if the transfer to the trust was not fraudulent. The major categories are child-support, alimony and spousal support, and pre-existing tort creditors. Nevada recognizes no exception creditors (emphasized in a May 2017 case, *Klabacka v. Nelson*), and the only creditors that can reach assets in a Nevada DAPT are fraudulent transfers for claims that arise in the limitation period.

30. Nexus Requirements

The states use a variety of minimum contacts required in the state for that state's DAPT statute to apply. For example, seven states require that the settlor provide an affidavit of solvency, and ten do not (but best practices would suggest obtaining affidavits of solvency in those states as well).

Fifteen of the 17 states require a resident trustee (Alaska and New Hampshire do not).

Do not just comply with the minimum requirements of state law – that may annoy a state judge applying that state's law.

31. Permissible Retained Settlor Powers

The states also vary as to the powers that a settlor may keep over a DAPT, such as a retained power of appointment, a "five or five" withdrawal power, the power to remove and replace the trustee, the power to veto distributions, or the power to direct investments.

32. Conflict of Laws Issues

A primary issue that has arisen in cases addressing DAPTs are the conflict of laws issues as to whether the law of the DAPT state where the trust is sitused or the laws of the debtor's state will apply. For example, *Waldron v. Huber (In re Huber)*, was a bankruptcy case concluding that Washington (the debtor's state) had a strong public policy against asset protection for self-settled trusts and applied the law of Washington rather than Alaska.

33. Best Practices for Attorneys Creating and Funding DAPTs

- Follow normal intake procedures.
- Be wary of new clients with whom you have no connection.
- Fully discuss benefits and limitations (particularly if the client is located or has assets outside the DAPT jurisdiction) to determine if the DAPT is appropriate for the client.
- Ensure a strong connection to the DAPT situs state, at a minimum using a resident trustee (and preferably a corporate trustee) with custody of at least some assets in the state; the resident trustee should not merely be a "potted plant" (in the words of one judge).
- Do not fund the DAPT merely with assets in LLC (liquid funds will be necessary to pay ongoing administration expenses and taxes).
- The engagement letter should be specific about whether the attorney is also involved in funding the trust.

- A properly structured DAPT is merely part of an overall estate plan.
- Do not ignore potential red flags in a client's background.
- The trustee should perform its own due diligence about a prospective client.
- Advise particularly about the limitations against protection from spousal or child support claims.

34. Resources

The course materials include a 50-state chart describing statutes and cases in each state addressing spendthrift protections available to trust settlors and the status of the UVTA in each state. In addition, a separate chart describes the varying provisions in each of the 17 state DAPT statutes.

Items 35-47 include observations from a panel discussing Creditor Protection with Tools of the Trade (i.e., Other Than DAPTs). Panelists were Robert K. Kirkland, Lauren Y. Detzel, and Gideon Rothschild.

35. Ethical Considerations Regarding Asset Protection Planning

Is assisting a client with asset protection planning ethical or, on the other hand, does a duty exist to assist clients with asset protection planning? The real question is not so much whether attorneys can or should assist clients with asset protection planning matters, but what is the appropriate scope of asset protection planning.

Section 4.4 of the Model Rules for Professional Conduct states that "a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person …." A 1991 Connecticut Bar Association opinion concluded that transferring assets, including a residence, to a spouse who was not subject to a debt, even though the transfer was not deceptive or fraudulent, was not proper under Rule 4.4 if the transfer presented a roadblock or discouraged creditors from satisfying their debts against the transferor. The opinion also stated that a demonstrable and lawful estate planning purpose would avoid violation of Model Rule 4.4.

A California State Bar Ethics Committee concluded that furnishing advice regarding asset protection planning techniques to avoid existing identifiable creditors violates ethical constraints. In addition, the California Penal Code says that participating in a scheme to defraud creditors is a misdemeanor.

36. Use Traditional Estate Planning Measures Before Considering DAPTs or Foreign Trusts

The approach of many attorneys (even "asset protection planning specialists") is to make use of traditional estate planning alternatives before considering transfers to DAPTs and foreign trusts. This presentation focused on such traditional estate planning alternatives that can have asset protection planning features.

37. State and Federal Exemptions

Asset protection planning concerns should be considered only in connection with the client's overall estate plan. First, begin with the least risky alternatives, and a starting point is to utilize state and federal exemptions, including exemptions for homestead, life insurance, annuities, retirement plans, etc. Every state has specific exemption laws from the claims of creditors.

Special rules apply for bankruptcy purposes. The Bankruptcy Code establishes a list of exemptions under federal law regarding certain assets such as annuities, life insurance, retirement accounts, and homestead. Each state can determine whether state or federal law exemptions will be available to a debtor in a bankruptcy proceeding in the state. States that require the use of state law exemptions are known as "opt-out" states, and states that permit the debtor to choose either federal or state exemptions are known as "opt-in" states. Most states are "opt-out" states.

Forum shopping to take advantage of state exemption laws is permissible to some degree, but limits exist under the Bankruptcy Code. Under the 2005 Bankruptcy Act, a debtor must maintain domicile within the state for two years prior to filing a bankruptcy petition in order for that state's exemption laws to apply in bankruptcy. If the debtor was not domiciled in a single state for that two-year period, determine where the debtor resided for the 180 days before that two year period.

A special forum shopping rule applies in bankruptcy regarding homesteads. The state homestead exemption varies widely from state to state; for example, the homestead exemption is only $5,000 in Kentucky, but is unlimited in Texas and Florida. Under federal bankruptcy law, the homestead exemption for a homestead acquired within 1,215 days (three years and four months) prior to filing a bankruptcy petition is limited to $125,000 adjusted for inflation (currently $160,375). (The cap may apply even if the debtor owned the homestead more than 1,215 days in certain circumstances.) The home apparently does not actually have to be occupied as a principal residence for the 1,215 days. Some individuals may acquire a second home in a homestead protective state (such as Florida or Texas) to start the 1,215-day period, then move to that state at least two years before filing for bankruptcy.

38. Tenancy by the Entirety

a. **Description**. Tenancy by the entirety is a unique form of property ownership in which each spouse owns the undivided whole of the property, and neither spouse can dispose of any part of the property without the consent/joinder of the other spouse. Twenty-six states recognize some sort of tenancy by the entirety between spouses. Two unique characteristics of tenancy by the entirety property are particularly significant.

   (1) **Right of Survivorship**. On the death of one spouse, the surviving spouse is entitled to the entire property.

   (2) **Creditors' Rights**. Creditors of one spouse may not attach the interest of that spouse in property held as tenants by the entirety. If both spouses are indebted to a creditor, however, tenancy by the entirety assets may be attached by such creditor.

The asset protection provided by tenancy by the entirety status is a very important aspect of estate planning considerations for clients with property in tenancy by the entirety states.

b. **Qualified Spousal Trusts for Revocable Trust Planning with Tenancy by the Entirety Property.** Cases in a few states have addressed whether tenancy by the entirety property can be held in the spouses' respective revocable trusts, with varying results but generally concluding that the property would no longer enjoy protection from the creditors of one spouse. The response has been the creation of statutory "qualified spousal trusts" in 10 states – Delaware, Hawaii, Illinois, Indiana, Maryland, Missouri, North Carolina, Tennessee, Virginia (which was the first state to adopt such a statute in 2001), and Wyoming. Alaska is studying the possibility of such a statute.

The state statutes differ as to whether the trust must cite the supporting state statute in the governing instrument, and whether the property must be held as tenancy by the entirety property immediately prior to the transfer to the trust. A very important difference is whether the qualified spousal trust can be split into separate shares upon the first spouse's death (Illinois specifically allows such a division, Missouri clearly allows it, and the other eight states appear to allow such a division by implication). This allows the first decedent's interest in the property to pass into a trust that can be sheltered from the surviving spouse's creditors (for regular tenancy by the entirety property, all of the assets pass to the surviving spouse and remain exposed to the surviving spouse's creditors).

A 2015 bankruptcy case (*In re Brewer*) concluded that property transferred to a qualified spousal trust that gave each spouse the right to "restrict, transfer, or withdraw one-half of the assets in this trust" did not meet the requirements of a qualified spousal trust under the Missouri statute. That case has been roundly criticized by Missouri attorneys, who generally continue to use qualified spousal trusts.

39. Emphasis on General Estate Planning Purposes Has Increased Significance Under UVTA

Several comments in the Uniform Voidable Transactions Act (UVTA) suggest that the use of traditional planning alternatives (other than self-settled trusts) may be voidable transactions if the only benefit is to avoid future potential creditors (as discussed below in Item 49). Establishing that such measures have general estate planning benefits provides a better chance of achieving asset protection advantages that may be available with that planning arrangement. A court following the rationale of those comments, however, may be more likely to find that a traditional planning measure will fail if the client also makes significant transfers to a DAPT or foreign trust. "Pigs get fat and hogs get slaughtered" – the purpose of asset protection planning is not to protect everything and make a client judgment proof, but to provide a nest egg that is protected from creditors.

40. Spendthrift Trusts; Discretionary Trusts

The U.K. still does not recognize spendthrift trusts. The concept of the spendthrift trust is based on a public policy rationale that an individual can make any desired disposition of his property subject only to public policy considerations. For this reason, certain "exception creditors" can still attach assets in spendthrift trusts, especially for child support, spousal support, and governmental obligations (taxes). The settlor's creditors can generally reach the settlor's interest in the trust (unless state DAPT statutes provide to the contrary), but the spendthrift trust feature protects the interests of third-party trust beneficiaries.

For additional protection, use "discretionary trust" provisions, under which trustees have absolute discretion in making distributions to beneficiaries (generally without regard to any ascertainable standard). Discretionary trusts have additional protection as compared to trusts that merely use the spendthrift clause. Because the interest of a beneficiary of a discretionary trust does not qualify as a property right in the first place, even exception creditors are generally precluded from accessing assets in a discretionary trust to satisfy claims against the beneficiary. (A Florida case [*Castleberry*] held that assets in a discretionary trust were subject to child support claims, but that case is considered an outlier.)

Beneficiaries can still be given a certain degree of control with discretionary trusts, such as having the power to remove and replace the trustee, or having testamentary powers of appointment. Do not give a beneficiary the power to withdraw assets – such property that could be withdrawn would be available to the beneficiary's creditors.

41. Entities – Corporations, Limited Partnerships, LLCs

An individual's transfer of assets to an entity may restrict that individual's creditors from being able to reach those assets. Entities provide two forms of asset protection. (1) Inside out protection – liabilities of the entity itself can be satisfied only by other assets in the entity. (2) Outside in protection – creditors of an owner cannot reach assets inside the entity (for example, with respect to LLCs and limited partnerships, the creditor's only remedy may be to obtain a "charging order" allowing a creditor to reach assets once they are distributed from the entity to the owner).

The concept of the charging order is that a judgment creditor can merely step into the shoes of the owner and receive whatever distributions are made from the entity, but cannot demand distributions, cannot become a full-fledged limited partner or member, cannot vote on management, and cannot interfere with management activities. The charging order varies among the states, and even varies in the Uniform Acts for limited partnerships versus LLCs. The Uniform Limited Liability Company Act provides that if a creditor can show that distributions will not be sufficient to pay the owner's liability within a reasonable time, a court may foreclose upon assets to satisfy the debt. A recurring issue is whether a charging order is the creditor's exclusive remedy or if the creditor can foreclose on assets within the entity.

Three significant issues in determining the extent of protection for assets transferred to an entity are (1) legal remedies, (2) equitable remedies, and (3) conflict of laws issues.

a. **Legal Remedies**. Some state statutes provide that the charging order is the exclusive remedy. Some states provide more protection for limited partnerships than for LLCs.

   Some states allow more protection for multi-member LLCs than for single-member LLCs (in Florida, a creditor can foreclose on a single-member LLC if it can show that it will not be paid within a reasonable time under a charging order.) The rationale of the charging order is to protect other owners of the business, but that rationale does not apply to a single-member LLC.

Even for multi-member LLCs, a creditor may still allege (i) the lack of a business purpose, (ii) the interest of other owners is nominal or derivative, or (iii) the transfer to the LLC was fraudulent.

b. **Equitable Remedies**. Traditional "veil piercing" aims to hold an entity's owners liable for the entity's debts. "Reverse veil piercing" aims at holding the entity's assets liable for the owners' debts. Various recent cases have addressed the reverse veil piercing concept as an equitable remedy.

Curci Investments, LLC v. Baldwin (Calif. App. 4th Dist. 2017) includes a general discussion of veil piercing and reverse veil piercing as equitable remedies. It acknowledges that the comments to the Revised Uniform Limited Liability Company Act state that charging order provisions are "not intended to prevent a court from effecting a 'reverse pierce' where appropriate." It distinguished prior California cases that had rejected reverse veil piercing but those cases involved corporations where the creditors could actually foreclose on the individual owner's stock. Under the facts, the LLC made distributions of $178 million to the spouses for six years before the charging order was entered, and distributed nothing to them for five years afterward. The court concluded that reverse veil piercing was available.

Transfirst Group, Inc. v. Magliarditi (May 24, 2017) is a Nevada U.S. District court preliminary injunction opinion applying Nevada law that addresses whether reverse veil piercing (which the court also referred to as alter ego) would apply to an LLC, partnership, and spendthrift trust in Nevada. (Nevada treats the charging order as the exclusive legal remedy for LLCs and partnerships, but that would not necessarily preclude apply veil piercing/alter ego as an equitable remedy.) The district court predicted that the Nevada Supreme court would find that the alter ego remedy does apply to LPs, LLCs, and spendthrift trusts, but a subsequent Nevada case about spendthrift trusts led the court to certify this question to the Nevada Supreme Court about reverse veil piercing/alter ego for entities and spendthrift trusts.

In *PNC Bank v. Udell*, (N.D. Ill. Aug. 2017), an Illinois attorney had transferred almost all of his assets to a Delaware LLC. The defendant made various arguments on a summary judgment motion, one of which was to dismiss the plaintiff's reverse veil piercing claim. The opinion rejected all of the defendant's arguments except the reverse veil piercing claim (so the case will proceed to trial). As to the reverse veil piercing claim, the opinion reasoned that courts should apply the law of the state of the LLC's formation (here, Delaware), that Delaware law generally appears not to recognize reverse veil piercing (though a recent Court of Chancery opinion "suggests that it would"), and that federal courts in diversity cases generally refuse to "expand the state law of another jurisdiction."

c. **Conflict of Laws Issue**. The *Curci* case applied California law even though the LLC was formed and maintained in Delaware, without any discussion of the conflict of law issue.

The *Udell* opinion cited other 7th Circuit opinions for the proposition that the law of *where the entity was formed* should apply regarding veil piercing issues.

On the other hand, in *Wells Fargo v. Barber*, a U.S. District court addressed a situation in which a Florida resident created a Nevis single-member LLC. Under Nevis law no foreclosure was permitted for even a single-member LLC, but under Florida law, foreclosure is permitted against a single-member LLC. The court reasoned that under the Florida choice of law rules, because the LLC is intangible personal property, the law of the *debtor's residence* should apply.

J.P. Morgan v. McClure, decided by the Colorado Supreme Court in April 2017, discussed conflicting precedents, one applying the state law of the debtor's residence [*Barber*] and one applying the law of the state where the entity was formed [*Koh v. Inno-Pacific Holdings, Ltd.*, 54 P.3d 1270, 1271-72 (Wash. Ct. App. 2002)], and concluded that the law of the state of the entity should apply (reasoning that a debtor's state of residence could change considerably over time and little certainty about what law might apply would exist if the law of the state of residence controlled).

42. Spousal Trusts ("SLATs")

Asset protection planning can be easier for a married individual by transferring assets to a trust for the benefit of the individual's spouse (at least having the spouse as a discretionary beneficiary). Third-party spendthrift trust protection would be available, but the spouse could use discretionary distributions to pay living expenses of the couple. Both spouses may create "non-reciprocal" trusts that have sufficient differences to avoid the reciprocal trust doctrine. Assets are available for the settlor-client's spouse (and possibly even for the settlor-client if the spouse predeceased the client) in a manner that is excluded from the estate for federal and state estate tax purposes.

The original settlor could even become a discretionary beneficiary if the spouse predeceases as long as the settlor's creditors could not reach the trust assets under applicable state law, which could occur if DAPT laws apply to the trust or if state spendthrift trust law specifically protects against the settlor's creditors in the "surviving settlor" scenario. *E.g.*, TEX. PROP. CODE §§112.035(d)(2) (settlor becomes beneficiary under exercise of power of appointment by a third party), 112.035(g)(1) (marital trust after death of settlor's spouse), 112.035(g)(2) (any irrevocable trust after death of settlor's spouse), 112.035(g)(3) (reciprocal trusts for spouses).

To maximize the creditor protection feature of SLATS (i) the trustee should have the ability to sprinkle distributions among various beneficiaries, (ii) at least one independent trustee should consent to distributions, (iii) any named trust protector should be someone other than the settlor, and (iv) the trustee should be authorized to permit beneficiaries to use assets (rather than having to make distributions for them to enjoy benefits of the trust).

For a detailed discussion of SLATs and "non-reciprocal" SLATs, see Items 16-17 of the Current Developments and Hot Topics Summary (December 2013) found **here** and available at **www.Bessemer.com/Advisor**.

43. Split Interest Trusts, Such as GRATs, QPRTs, CRATs, CRUTs

"Where the only interest that the settlor has created for himself under the trust is a right to the income for life or for some other period, it is this interest alone that his creditors can reach, unless the creation of the trust was a disposition in fraud of his creditor." 2A AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS at §156, at 167 (4th ed. 1989). The settlor's creditors can reach the trust assets only to the extent of the settlor's retained benefit.

For a QPRT, the proportionate interest of the settlor decreases each year, and near the end of the trust term, the value of the settlor's interest may be relatively small. Because the transfer of a residence to a QPRT has a clear estate planning motive, the client should be able to counter a future creditor's claim that the transfer should be voided as a fraudulent transfer. Of course, if the client lives in a state that has substantial homestead protection or protection by owning the residence as tenants by the entirety, the QPRT may not achieve any asset protection advantages.

For a GRAT, even if the creditor could reach the annuity portion of the trust, the accumulated appreciation in the trust would be free from the reach of creditors.

44. Reciprocal (But Non-Reciprocal) Trusts

Utilizing significantly different terms in the trusts that the spouses create for each other should withhold IRS attack under §2036, and similarly should withstand creditor attacks for "uncrossing" the trusts. The speakers know of no cases in which creditors have attacked reciprocal trusts. Some states (such as Arizona and Texas) have specific laws protecting reciprocal trusts from creditors' claims of the respective settlors. See Item 42 above.

45. Inter Vivos QTIP Trusts

Inter vivos QTIP trusts have similar creditor planning issues as SLATS (discussed in Item 42 above). A distinction is that a QTIP trust must continue for the life of the spouse even following a divorce, so a post-nuptial agreement may be considered to treat assets in the QTIP trust as part of the equitable distribution provisions of marital property in the event of a divorce.

46. Trust Structuring To Maximize Asset Protection

Various planning considerations for maximizing the creditor protection feature of trusts include using

- spendthrift provisions,
- sprinkling provisions,
- trust protector provisions (naming someone other than the settlor as the trust protector),
- "may-type" ascertainable standards (do not provide that the trustee "shall" make distributions within the ascertainable standard),
- longer (or even "perpetual") trust terms,
- permitting beneficiaries to use trust property (minimizing the necessity of making outright distributions to beneficiaries),
- split-interest trusts,
- terminating a beneficiary's interest upon insolvency or at an attempted attachment by the beneficiary's creditors [*see In re Fitzsimmons,* 896 F.2d 273 (9th Cir. 1990) (trust protected against federal tax claim)],

- conversion of mandatory trust interest into discretionary trust interest or giving trustee the power to exclude beneficiaries by revising the trust's beneficial interests,
- limited powers of appointment,
- trustee having the authority to exclude beneficiaries from receiving a Crummey withdrawal power with respect to future contributions,
- specific authority to hold assets in separate limited liability companies or to divide a trust into separate trusts,
- power to withhold mandatory distributions,
- power to change trust situs, and
- the authority to hold assets in a limited partnership or LLC.

47. Retirement Plans

Maximizing the permitted funding of qualified retirement plans is "low hanging fruit," but amazingly many wealthy people don't even have a retirement plan or have funded it minimally.

Inherited IRAs may or may not be entitled to creditor protection. In *Clark v. Rameker*, the Supreme Court unanimously concluded that inherited IRAs are not "retirement funds" entitled to the federal exemption for retirement funds under the federal bankruptcy laws. A majority of states, however, opt out of the federal bankruptcy exemption scheme and use their own exemptions, and some states do afford creditor protection for inherited IRAs.

Items 48-50 summarize observations from a panel discussing the Uniform Voidable Transactions Act. Panelists were George D. Karibjanian, Richard W. Nenno, and Daniel S. Rubin.

48. Uniform Voidable Transfers Act (UVTA) Overview

In 2014, the Uniform Law Commission renamed the Uniform Fraudulent Transfer Act as the Uniform Voidable Transactions Act (UVTA). It renamed what had previously been known as fraudulent transfers to be referred to as voidable transfers. The UVTA has been adopted in 15 states – Arkansas, California, Georgia, Idaho, Indiana, Iowa, Kentucky, Michigan, Minnesota, New Mexico, North Carolina, North Dakota, New Mexico, Utah, Vermont, and Washington. Arkansas provides that certain Comments do not represent Arkansas law and should not be considered in interpreting the act, and the Indiana statute provides that the Comments to the Uniform Act "shall not be considered as authority."

The following are among the things that the UVTA did that are important to estate planners: (i) expands the definition of insolvency, (ii) mandates applying the law of the debtor's residence at the time of a transfer, and (iii) suggests that no distinction applies between reasonably foreseeable and future creditors. See Item 24 above.

Of particular significance to estate planners are comments to the UVTA suggesting that the use of traditional planning alternatives (other than self-settled trusts) may be voidable transactions if the only benefit is to avoid future potential creditors (see Item 39 above), and stating that the creation of a DAPT in a DAPT state by person who resides in a non-DAPT state would be a voidable transaction.

49. Traditional Planning Measures That May be Voidable Transactions if the Only Benefit is to Avoid Future Potential Creditors

a. **Asset Substitution**. Section 4(a)(1) of the UVTA provides that a transfer is voidable if the transfer was made "with actual intent to hinder, delay, or defraud any creditor of the debtor." (This applies to any creditor, whether an existing or future creditor.) The third paragraph to Comment 8 to §4 begins as follows:

> A transaction that does not place an asset entirely beyond the reach of creditors may nevertheless "hinder, delay or defraud" creditors if it makes the asset more difficult for creditors to reach. Simple exchange by debtor of an asset for a less liquid asset, or disposition of liquid assets while retaining illiquid assets, may be voidable for that reason.... Likewise, it is voidable for a debtor intentionally to hinder creditors by transferring assets to a wholly owned corporation or other organization, as may be the case if the equity interest in the organization is more difficult to realize upon than the assets (either because the equity interest is less liquid, or because the applicable procedural rules are more demanding).

This Comment makes no reference to the debtor's intent, whereas §4(a)(1) requires "actual intent." While the last sentence quoted above says that the transfer "may be voidable for that reason," the effect to this Comment seems to imply that a substitution by an individual of liquid for more illiquid assets is voidable unless proven otherwise by the debtor.

b. **Other Traditional Self-Settled Trusts (Other Than DAPTs)**. That same Comment (the third paragraph of Comment 8 to §4) might also apply to traditional trusts that include the settlor as a discretionary beneficiary, but would likely "make the asset more difficult for creditors to reach "as compared to having the individual own the asset outright. (In addition, the seventh paragraph of Comment 8, discussed in Item 50 below, regarding its specific reference to "self-settled trusts" could apply.) These traditional trusts could include GRATs, QPRTs, CRATs, CRUTs, INGs, the "back end" of inter vivos QTIP trusts, tenancy by the entirety trusts, etc. While those more traditional trusts may have other reasons for their creation than just asset protection, the settlor might clearly understand that one of the advantages of the trust (and perhaps one of the specific reasons the settlor is using the trust) is to afford some degree of asset protection.

The fifth paragraph of Comment 8 to §4 may provide a limitation on the broad application of this Comment to more traditional types of self-settled trusts. That Comment acknowledges that

> it would be absurd to suggest that every grant of a security interest contravenes § 4(a)(1). The line between permissible and impermissible grants cannot coherently be drawn by reference to the debtor's subjective mental state, for a rational person knows the natural consequences of his actions, and that includes the adverse consequences to unsecured creditors of the grant of a security interest. Whether a transaction is captured by § 4(a)(1) ultimately depends upon whether the transaction unacceptably contravenes norms of creditors' rights, given the devices legislators and courts have allowed debtors that may interfere with those rights. Section 4(a)(1) is the regulatory tool of last resort that restrains debtor ingenuity to decent limits.

c. **Entity Formation**. The final sentence of the third paragraph to Comment 8 of §4 (quoted in Item 49.a above) says that transferring assets to a corporation "intentionally to hinder creditors" may be a voidable transaction.

Paragraph 6 to Comment 8 to §4 includes the following;

> Thus, for example, suppose that entrepreneurs organize a business as a limited liability company, contributing assets to capitalize it, in the ordinary situation in which none of the owners has particular reason to anticipate personal liability or financial distress and no other unusual facts are present. Assume that the LLC statute has the creditor-thwarting feature of precluding execution upon equity interests in the LLC and providing only for charging orders against such interests. Notwithstanding that feature, the owners' transfers of assets to capitalize the LLC is not voidable under § 4(a)(1) *as in force in the same state.* The legislature in that state, having created the LLC vehicle having that feature, must have expected it to be used in such ordinary circumstances. By contrast, if owners of an existing business were to reorganize it as an LLC under such a statute *when the clouds of personal liability or financial distress have gathered over some of them, and with the intention of gaining the benefit of that creditor-thwarting feature, the transfer effecting the reorganization should be voidable under §4(a)(1)*, at least absent a clear indication that the legislature truly intended the LLC form, with its creditor-thwarting feature, to be available even in such circumstances. (Emphasis added.)

This is the only time that the phrase "ordinary situation" is used in the Comments. Does paragraph 6 mean that any time owners contribute to a LLC operating a business that involves some form of danger, the owners runs the risk of the contribution being a voidable transaction? The reference to "in the same state" suggests that a transfer from an individual in a state that does not recognize the charging order as an exclusive remedy, to an LLC organized in a state that does do so, may be a voidable transfer (especially in light of Paragraph 7 of Comment 8, discussed below regarding DAPT trusts). The Comment suggests that if an owner who is under "financial distress" contributes assets to an LLC, with the intention of taking advantage of state laws restricting the ability of creditors to reach assets of the LLC, the transfer "should be voidable." Does the reference to "some of them" suggest that the entire formation of the LLC would be voidable if any one member has the intent to avoid creditors?

d. **Entity Conversion**. A business may modify its initial choice of legal entity for various tax and nontax reasons. For example, shareholders of an S corporation may decide that converting to an LLC in another state provides more valuation discounting opportunities or results in lower tax rates and may also recognize that the other state does not have a history and body of case law favoring creditors and that the conversion may result in stronger creditor protection. The fourth paragraph of Comment 8 addresses entity conversion:

> Under the same principle, § 4(a)(1) would render voidable an attempt by the owners of a corporation to convert it to a different legal form (*e.g.*, limited liability company or partnership) with intent to hinder the owners' creditors, as may be the case if an owner's interest in the alternative organization would be subject only to a charging order, and not to execution (which would typically be available against stock in a corporation). [Citations omitted.] If such a conversion is done with intent to hinder creditors, it contravenes § 4(a)(1) regardless of whether it is effected by conveyance of the corporation's assets to a new entity or by conversion of the corporation to the alternative form. In both cases the owner begins with the stock of a corporation and ends with an ownership interest in the alternative organizations, a property right with different attributes.

This Comment appears to apply to future creditors as well as existing creditors, suggesting that an entity conversion to take advantage of LLC charging order protection (i.e., an actual intent to "hinder" future unknown creditors), would be a voidable transaction. What if the conversion occurs when one member has foreseeable creditors but others do not? Is the entire reorganization voidable? What if the owner with a foreseeable creditor issue is only a very small owner of the entity?

e. **Homestead**. Some states exempt homestead property from creditor claims. Even the states that recognize homestead creditor protection have strongly varying degrees of protection. For example, Tennessee provides very little protection and Florida provides almost absolute protection (even if the purchase of the Florida homestead was made with the express intent of avoiding creditors).

Section 10(b) of UVTA provides: "A claim in the nature of a claim under this [Act] is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred."

Assume that a physician in Tennessee decides to retire in Florida and purchases a Florida residence while still living in Tennessee. The physician is sued by a patient in Tennessee who wants a lien on the house, claiming a violation of UVTA. Assume that Florida and Tennessee have adopted the UVTA when these events occur. Because the purchase of the Florida property occurred while the physician resided in Tennessee, Tennessee's voidable transaction law applies. If a Tennessee court determines that the purchase of the Florida residence is voided, will the judgment against the residence be enforced in Florida?

If both the protected-homestead state (*e.g.*, Florida) and the original domiciliary state have adopted the UVTA (including §10), the initial purchase could be considered a voidable transaction. A Florida court may consider the adoption of the UVTA in Florida (with §10) as a statement that Florida would allow another state to pass judgment on a transaction involving what would subsequently become the homestead of a Florida resident. Would a Florida court necessarily be required to afford the judgment in the debtor's jurisdiction Full Faith & Credit, thereby allowing another state's courts to dictate an exception to Florida homestead laws?

50. Application of UVTA to Creation of DAPTs

a. **Comment in UVTA Regarding Self-Settled Trusts**. Perhaps the most controversial position in the UVTA Comments, for many estate planners, is the final paragraph of Comment 8 to §4 (§4 specifies the transfers that are deemed voidable).

> Because the laws of different jurisdictions differ in their tolerance of particular creditor-thwarting devices, choice of law considerations may be important in interpreting § 4(a)(1) as in force in a given jurisdiction. For example, as noted in Comment 2, the language of § 4(a)(1) historically has been interpreted to render voidable a transfer to a self-settled spendthrift trust. Suppose that jurisdiction X, in which this Act is in force, also has in force a statute permitting an individual to establish a self-settled spendthrift trust and transfer assets thereto, subject to stated conditions. If an individual Debtor whose principal residence is in X establishes such a trust and transfers assets thereto, then under §10 of this Act the voidable transfer law of X applies to that transfer. That transfer cannot be considered voidable in itself under § 4(a)(1) as in force in X, for the legislature of X, having authorized the establishment of such trusts, must have expected them to be used. (Other facts my still render the transfer voidable under X's enactment of § 4(a)(1).) By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such

> trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under § 10 of this Act, the voidable transferor law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y.

Accordingly, a resident of a DAPT state that creates a DAPT under that state's laws, the transfer to the DAPT is not in itself a voidable transaction (unless the fraudulent transfer provisions in the state's DAPT statute are violated). In contrast, if a resident of a non-DAPT state creates a DAPT in a DAPT state, some view the Comment as stating that the transfer would be voidable *per se*. (The Comment does not use the term "voidable *per se*," but that seems to be the clear inference.)

This Comment has been subject to severe criticism of commentators. *See e.g.,* George Karibjanian, Richard W. Nenno & Daniel Rubin, *The Uniform Voidable Transactions Act: Why Transfers to Self-Settled Spendthrift Trust by Settlors in Non-APT States Are Not Voidable Transfers* Per Se, 42 BNA TAX MANAGEMENT ESTATES, GIFT & TR. J. 173 (July 2017). The criticism has been met with an impassioned defense of the Comment by the Reporter of the UVTA. Kenneth Kettering, *The Comments to the Uniform Voidable Transactions Act Relating to Self-Settled Spendthrift Trusts Are Correct*, 42 BNA TAX MANAGEMENT ESTATES, GIFT & TR. J. 267 (September 2017).

The broad reference to "self-settled trusts" could apply to transfers to "traditional" self-settled trusts other than DAPTs, such as GRATs, QPRTs, CRATs, CRUTs, INGs, the "back end" of inter vivos QTIP trusts, tenancy by the entirety trusts, etc. See also Item 49.b above.

Commentators who are critical of the Comment recommend that states adopting the UVTA expressly provide that such Comments not be considered when interpreting the Act. For example, the Arkansas statute provides as follows:

> The General Assembly finds that although the text of this act is in agreement with and will improve Arkansas law, the Official Uniform Law Commission comment no. 2 and comment no. 8 to Section 4 of the uniform act, which is codified at § 4-59-204, is intended to be persuasive authority but does not represent Arkansas law and should not be considered when interpreting this act.

The Indiana version of the UVTA states more broadly that "in interpreting solely this chapter, comments released by a committee of the National Conference of Commissioners on Uniform State Laws shall not be considered as authority."

b. **Conflict of Laws Issues.** This scenario raises conflict of laws issues as to fraudulent conveyance matters and as to trust matters.

Law Selected by Settlor. As to the applicable spendthrift law that applies to a trust, Section 273 of the Restatement (Second) of Conflict of Laws (1971) provides that the governing instrument controls as long as sufficient contacts exists with that state. It provides that for an inter vivos trust the applicable law is the local law of the state, if any, in which the settlor has manifested an intention that the trust is to be administered, and otherwise by the local law of the state to which the administration of the trust is most substantially related. Comment c to that section provides that "if the settlor has manifested an intention that the trust is to be administered in a particular state, such as by naming as trustee a trust company of the state, the applicable law is the local law of that state."

Strong Public Policy Exception. Section 270(a) of the Conflict Restatement provides a different approach than merely using the settlor's choice of law. Interestingly, §270 is titled "Validity of Trust of Movables Created Inter Vivos." While this section deals with whether the trust is valid, it is often cited with respect to the validity of particular provisions in the trust, and says that the choice of law designated in the trust agreement does not necessarily control:

> An inter vivos trust of interests in movables is valid if valid,
>
> (a) under the local law of the state designated by the settlor to govern the validity of the trust, provided that the state has a substantial relation to the trust and that the application of its law *does not violate a strong public policy* of the state with which, as to the matter at issue, the state has its most significant relationship under the principles stated in §6 … (Emphasis added.)

Comment b provides insight to the "strong public policy" clause:

> [the designated law] will not be applied if this would violate a strong public policy of the state with which as to the matter in issue the trust has its most significant relationship. Thus, where the settlor creates a revocable trust in a state other than that of his domicil, in order to avoid the application of the local law of his domicil giving his surviving spouse a forced share of his estate, it may be held that the local law of his domicil is applicable, even though he has designated as controlling the local law of the state in which the trust is created and administered.

Tension. The tension between these two different sections of the Conflicts Restatement often arises in conflict of law issues regarding trusts, and courts sometimes rely on one of those sections without even mentioning the other. *E.g., In re Huber,* 493 B.R. 798 (Bank. W.D. Wash. 2013) (extensive discussion of §270 but failed to reference §273). See Jonathan D. Blattmachr and Jonathan G. Blattmachr, *In re Huber: Alaska Self-Settled Trust Held Subject to Claims of Creditors of Grantor-Beneficiary*, LEIMBERG ASSET PROTECTION PLANNING NEWSLETTER #225 (May 22, 3013).