ACTEC 2011 Summer Meeting Musings

July 2011
Steve R. Akers
Bessemer Trust
300 Crescent Court, Suite 800
Dallas, Texas 75201
214-981-9407
akers@bessemer.com

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Introduction

The following are my observations from the seminars presented at the ACTEC 2011 Summer Meeting held in Atlanta, Georgia on June 22-25, 2011. (At the request of ACTEC, information from the Committee Meetings is not summarized.) I am not attempting to summarize all of the excellent information from the seminars, but merely highlight some of the items that were particularly interesting to me.

Dealing with the Partially Incapacitated Client: How to Prevent Financial Abuse, Undue Influence and Other Ills of Aging — Prof. Lawrence A. Frolik and Deborah J. Tedford

1. Increasing Numbers of Incapacitated Clients. Life expectancy is now well past age 65. At age 65, the average American male will live another 16 years, 20 years for a woman. Affluent individuals would expect to have even longer life expectancies. Therefore, about half of the people turning 65 will be living 20 years from now. A disproportionate number of the increasing numbers of clients age 80 to 90 and older will be women.

   About 1/4 to 1/2 of individuals over age 85 have some sort of dementia.

2. Detecting That a Client Is Suffering From Dementia. Dementia is gradual. It is a process, not an event. Prof. Frolik says "It's like having gray hair – it just creeps up on you." Detecting someone with early stages of dementia is difficult. Lawyers will have increasing numbers of older clients and will not know how much cognition they have.

   This will occur in different types of situations. (1) The attorney may have known the client in the past and may recognize that there is some level of confusion. (2) One spouse may tell the attorney that the other spouse "has not been himself lately." (3) The attorney may not know the client or may not remember the client from the last meeting.

   The difficulty is differentiating between early stages of dementia and the effects of simply growing older. If up to half of the clients over age 85 have dementia, the other half do not, but are just getting older.

   Some have described dementia as being like a glass that is full of water and someone tries to pour more water into it. The individual is filled with what he or she is capable of doing and has difficulty processing new information.

   a. Practical Tips.

      - Old notes from the last meeting 10 years earlier may help refresh the attorney's memory. The attorney can compare the assets and family situation then and now, and assess whether the client can explain the progression from then to now.
      - Ask questions that cannot be answered by yes or no. Elicit a response that requires some expression of cognition. Often, older people smile and say the right things, but deep down there can be significant cognitive deficits.
      - Expressions that "I don't do this or that" for a lot of different things is an indicator of a possible problem (but can also be a symptom of merely growing old).

   b. Resources. The American Bar Association's Commission on Law and Aging has worked with the American Psychological Association to create two handbooks. A handbook for attorneys is entitled "*Assessment of Older Adults with Diminished Capacity: A Handbook for Lawyers.*" The second is a handbook for psychologists entitled "*Assessment of Older Adults with Diminished Capacity: A Handbook for Psychologists.*" The second book is particularly insightful because it covers the issue from a medical perspective that practicing attorneys do not typically see. It describes tools that psychologists use to determine if clients lack capacity.

3. Physical Ailments. Older clients that do not have dementia may still have significant issues that may impact their ability to deal with financial and legal issues. For example, the clients may have physical ailments (sight, hearing, etc.) so that they cannot take in information as well as in prior years, even though they are still sharp mentally. Older clients may simply lose energy.

4. Greater Dependency on Others. Individuals become more dependent on other people as their capabilities decline. There are several categories of dependency, with increasing possibilities of abuse situations.

   (1) The individual may have a spouse.

   (2) The individual may be single with no spouse to rely on. For example, there is a 20% likelihood that a woman older than age 35 will never marry. Many people past age 80 do not have a spouse. If there is no spouse, vulnerability increases dramatically. For example, the "*Handbook for Psychologists*" described above says the biggest red flag for undue influence is to look for single white women aged 75 or older.

   Single older individuals are more likely to be widows and widowers. Statistically, women outlive men. The ratio of widows to widowers is 5 to 1 or 6 to 1.

   (3) A child may be able to assist. A common situation is for an older woman to turn to one of her children, often the child living close by, for assistance.

   (4) There may not be any children or children who live close enough to assist. Increasingly, people are getting married when they are older and are not having children. The birth rate has been declining for years.

   (5) Other possibilities include a more distant relative (for example a niece or nephew), someone in the same church, neighbors, etc. Example cases of abuse in this situation are common. For example, one local probate judge refers to "chicken soup houses"-- houses that have been transferred to a neighbor or other individual in exchange for providing assistance like bringing chicken soup to the older individual. A common abuse situation is the perpetrator managing to get his or her name on the deed to the individual's house. Interestingly, there are a number of abuse cases involving ministers.

5. Trend Away From Pensions Creates More Possibility of Financial Abuse. We are moving away from a pension world to a 401(k) world. Older individuals often have large sums of money rather as opposed to being the recipient of annuities. More clients will find themselves looking for financial advice. There may be little to protect those individuals from financial advisors who appear to have credentials but are not honorable.

6. Psychological Perspective on Undue Influence. The "*Handbook for Psychologists*" described above lists various psychological studies that have addressed conditions leading to the susceptibility of undue influence.

   Margaret Singer, PhD, based her work on cult victims. She emphasizes the following social conditions: creating isolation, fostering a siege mentality, inducing dependency, promoting a sense of powerlessness, manipulating fears and vulnerabilities, and keeping the victim unaware and uninformed.

   Dr. Bennett Blum describes an "**IDEAL**" protocol: **I**solation, **D**ependency, **E**motional manipulation or Exploitation of a vulnerability, **A**cquiescence, and **L**oss (of a financial nature).

Dr. Susan Bernatz organizes the critical factors in a "**SCAM**" model: **S**usceptibility factors of the victim, **C**onfidential relationship between the victim and perpetrator, **A**ctive procurement of the transactions by the perpetrator, and **M**onetary loss of the victim. The perpetrator creates a feeling of indebtedness and the combination of trust and dependency makes it easier to allow the influencer to gain control.

The Brandler/Heisler/Stiegel model focuses on actions taken by the perpetrator. These actions include: Isolate from others; Create fear; Prey on vulnerabilities; Create dependency; Create lack of faith in own abilities; Induce shame and secrecy; Perform intermittent acts of kindness; and Keep unaware.

7. Role of Attorneys. Prof. Frolik feels strongly that one of the roles ACTEC lawyers should serve is protecting older clients from the outside world. Attorneys typically do not see clients often. However, when attorneys do see older clients, in particular, be very alert for situations of financial exploitation or undue influence.

8. Practical Pointers for Recognizing Abuse Situations and Protecting Clients.

   a. Be Sensitive. Be sensitive in looking for signs of problems.

   b. Implement Standard Procedures. Implement standards that the attorney uses consistently in dealing with clients with suspect capacity issues. The "*Handbook for Lawyers*" described above has a four-page worksheet. It addresses issues such as short-term memory problems, inability to remember things that happened 15 minutes ago or two days ago, language problems, calculation problems, communication problems, and comprehension issues.

   c. Unusual Dispositive Plan. If a proposed plan eliminates a child who has previously been included, that is a potential red flag. If a caregiver is being included in the estate plan, that is a red flag.

   d. Referral to Psychologist If Potential For Litigation. If the attorney knows that the matter has a significant certainty of ending up in litigation, suggest that the client visit a psychologist, even if the client is younger and very sharp mentally. If that is done 100% of the time, regardless of the possible loss of capacity, the attorney can then tell the client that the attorney gives that advice for everyone in these situations. It also provides a good defense in litigation for explaining why the client was referred to a psychologist, without being an obvious indicator of incapacity.

   e. Irrevocable Transactions. Be wary if irrevocable transactions are being proposed, in which the client gives up large assets during his or her lifetime.

   f. Someone Calls on Behalf of Client. Be wary if someone calls on behalf of an elderly client if the attorney has not met with that person previously. Meet with the client alone, even though the other individual brings the client to the office.

9. Steps to Avoid Later Undue Influence. The attorney may be fearful that the client's estate plan will be undone if the client is taken advantage of and taken to another lawyer later to change the plan.

   a. Discuss With Older Clients Routinely. Raise the potential undue influence issue with older clients. Discuss the issues described above, and point out this is a possibility for all of us. We all need to plan for the future in case we are not as capable as we are today. Discuss this in terms of protection for the future. (A good opportunity for having this discussion is when the power of attorney is discussed.)

b. Power of Attorney. The agent under a power of attorney should understand that part of his or her responsibility is to make sure that no one is trying to take advantage of the principal. The attorney may consider contacting an agent under the power of attorney, to impress upon the agent that the principal is expressing extreme confidence in the agent, and the agent should feel a responsibility to make sure that the principal is not taken advantage of. This view is that the attorney can use the agent at as his or her "eyes in the field" to determine if the client needs help. Other attorneys express reluctance to have communications with agents under the power of attorney, for fear that an agent will later allege that there is an attorney-client relationship between the attorney and the agent, raising a potential conflict issue if a dispute erupts between the principal and the agent. Some attorneys merely give written instructions to agents as to when the agent should take steps to act under a power of attorney and to contact the attorney when listed factors apply indicating that a standby power of attorney should be activated.

c. Potential of "Battling Powers of Attorney." A common problematic situation is that a client gives a power of attorney to one child, and then some time later the "bad" child takes the parent to another attorney to prepare a power of attorney for that child.

d. Funded Revocable Trusts. If there is a funded revocable trust, the trustee provides an additional level of protection. An agent under a power of attorney may have to work with the trustee in order to get access to assets for taking care of incapacitated individual. As an example, one child may be the caregiver, but both children may be trustees under the revocable trust.

Another example of a situation where this can help is if the client contacts his or her broker to withdraw large sums of money. If the funds are in a revocable trust, the children as trustees may have more opportunity to intervene with the parent.

As clients get older, encourage them to name one or more children as co-trustees with the client on the revocable trust. If the client is the only trustee, there may be little protection from financial abuse.

If there is a decline in using trusts in future years because of rising estate tax exemptions, clients may want to look to revocable trusts not so much to avoid probate as to avoid undue influence.

e. Irrevocable Trusts. A client who knows that he or she is susceptible to influence may contribute assets to an irrevocable trust for his or her benefit. The client can then respond, "I can't buy the sailboat; you must go through the trustee." The trust must be structured as an "incomplete gift" (for example by retaining a limited testamentary power of appointment) to avoid current gift taxes on the transfer.

f. Brokerage Firm. When the client is younger and clearly competent, consider having the client instruct the brokerage house to alert the attorney if there is an attempt to withdraw large sums from the account. A confidentiality waiver would likely be required.

10. Increasing Tax Exemptions May Reduce Uses of Trusts. If clients tend to create fewer trusts in the future, because of rising federal estate tax exemptions, there may be more potential of financial abuse of assets than would otherwise be present for assets under trust management.

11. Ethical Constraints. A particularly problematic situation in dealing with undue influence is if the client retains some capacity. The ethics rules then constrain the attorney, who must do what the client ultimately decides.

12. Requiring Attorney or Judge Consent to Amendment of Estate Plan. In a 2009 Illinois case, *Dunn v. Patterson*, the client created a revocable trust. The attorney recommended and the client agreed to include a provision that the attorney or a judge would have to agree to any amendment of the revocable trust. The client later went to another lawyer, who contacted the original attorney to obtain consent to amend the trust. The original attorney reviewed the situation and refused. Ultimately, the Illinois appellate court said that was an appropriate way for the original attorney to construct the estate plan. (However, it is likely that the prior attorney expended significant attorneys' fees in defending this transaction.)

The Attorney as a Defendant in a Malpractice Action— Bruce Stone and Stanley Wakshlag

1. Privity Requirement. The traditional common law rule is that a plaintiff must show that an attorney-client relationship existed between the lawyer and plaintiff before being able to sue the lawyer in a malpractice action. At the other end of the pendulum is the California view abolishing the privity defense, and applying a "balancing factor test."

   There are intermediate views in some states. A "four corners" rule is applied in various states, including Florida, Iowa, Michigan and Pennsylvania. *E.g., Espinosa v. Sparber, Shevin, Shapo, Rosen & Heilbronner*, 612 So. 2d 1378, 1380 (Fla. 1993). Under this approach, an attorney can be sued if there is no privity only if negligence is reflected within the four corners of the document that the client signed.

   Another intermediate approach is to bar suits by beneficiaries, but recognize that a personal representative of a deceased client's estate has the requisite privity to bring an action against an estate-planning lawyer for damage to the estate. *See Belt v. Oppenheimer, Blend, Harrison & Tate, Inc.*, 192 S.W. 3d 780 (Tex. 2006), *see also Hosfelt v. Miller*, 2000 WL 1741909, 2000-Ohio-2619 (Ohio App. 7 Dist. Nov 22, 2000) (NO. 97-JE-50)(case of first impression, personal representative of client's estate may bring claim based on preparation of estate documents or estate planning); *Nevin v. Union Trust Co.* 726 A.2d 694, 701 (Me. 1999). In a unanimous opinion in *Estate of Saul Schneider v. Finmann*, 15 N.Y.3d 306 (2010) the New York Court of Appeals changed the long-standing privity rule in New York by ruling that a personal representative of an estate had privity "or a relationship sufficiently approaching privity" to bring a malpractice action against the decedent's estate planning attorney.

2. Adopting Another State's Privity Rule; Conflict of Laws Issue. What if a Florida resident owns real estate in another jurisdiction, which has a strict privity requirement? Is it appropriate for a Florida lawyer somehow to cause that state's law law to apply for a malpractice action against the attorney? The attorney must make sure that there is no unauthorized practice of law occurring in that state, and must work with a lawyer authorized to practice in that state. The attorney must discuss with the client why that state's law law is being chosen. Choosing that state's law may be satisfactory to the client, who may want to avoid future litigation. (Analogously, in terrorem clauses are not allowed in Florida. Florida attorneys sometime try to incorporate the law of another jurisdiction to be able to use in terrorem clauses.)

3. When Statute of Limitations Begins to Run in Malpractice Actions. The traditional discovery rule is that a cause of action accrues when an individual knew or should have known of the claim. However, in malpractice actions, the statue of limitations typically does not begin to run until actual damages accrue. That may not happen in an estate planning malpractice action, for example, until after there is an underlying adjudication of a will contest. Most courts will stay the action against the attorney until the underlying case has been determined with either a tolling agreement or a stay.

Accordingly, malpractice claims may stay alive for a very long period of time. An exception occurs a shortened statute of limitations may apply (such as two years). under the laws in many states if the attorney dies. If a claim is not timely filed in the probate proceeding,

4. Malpractice Insurance.

   a. Claims Made Policies. Most malpractice insurance policies are "claims made" policies, covering claims that arise during the coverage. They do not cover an attorney for mistakes that occurred during coverage period (but may not result in a malpractice claim until years later), but only cover claims made during the period. As discussed below, this is why it is critical for attorneys to advise their insurance carriers when a claim is made.

      If a policy expires without the carrier having notice of a claim, there would be no insurance coverage. If a new policy is purchased, the new policy may not cover the claim if circumstances that may lead to the claim are not disclosed at the time of purchasing the new policy.

   b. Tail Coverage. Tail coverage covers the attorney for actions that happened in prior years. This is important for an attorney who switches firms or retires. If the attorney does not keep tail coverage alive, the attorney may be unprotected. Attorneys traditionally are good at keeping tail coverage when they switch firms, but often do not keep it intact after they retire.

      Tail coverage is typically purchased for a particular time period. Usually, it is not possible for an attorney to make an election to continue tail coverage on a year by year basis.

   c. Switching Carriers. Be wary of switching carriers unless there is a strong reason to do so. When the policy comes up for renewal, do not just look at the lowest premium cost that may be possible from other carriers. A subsequent carrier will look for the one scintilla of evidence that points to the prior policy being responsible, and the subsequent carrier will try to avoid coverage based on a "prior event" exclusion. There are cases where both carriers claim that they are not responsible, and litigation over that issue can take years to resolve.

5. Estate Planning is High Risk Category. The level of damages may be very high in dealing with large estates. There can be huge damages decades later depending on the appreciation in value of estate or trust assets and depending on tax laws.

   Particularly in a split family situation, the risk is high of a potential malpractice claim. The attorney is doing what he or she is asked to do by the client, but unhappy beneficiaries may have the motivation to sue someone.

   Part of the high risk occurs because the attorney often has no relationship with the children or other estate beneficiaries. Malpractice potential liability is minimized if the attorney has a relationship with the client and is willing to correct mistakes. There is a much higher risk when an estate planning attorney does not have a relationship with unhappy beneficiaries.

6. Engagement Letters.

   a. Forms. The ACTEC Commentaries have sample engagement letters. The seminar materials include a sample engagement letter used by Bruce Stone's law firm. (It is written in an easy-to-understand manner for laypersons.)

   b. Subsequent Law Change. One malpractice case involved a prenuptial agreement challenge based upon a subsequent change in the law. The claim was made that the attorney failed to adequately consider a future change in the law that invalidated the prenuptial agreement. The engagement letter could have been drafted in a way that would have avoided the problem with the subsequent law change.

c. No Duty After Engagement Completed. Engagement letter should be clear that there is no ongoing duty after estate planning documents are completed, unless the client engages the attorney in a separate engagement. For example, Bruce Stone's engagement agreement provides:

> "When you have executed the estate planning documents that we will prepare for you (such as a will, trust agreement, or related documents such as living will and health care surrogate designations), the attorney-client relationship between us will end unless both you and we have separately and expressly agreed in writing that it will continue…
>
> … After you have executed your estate planning documents, we will not have any responsibility to notify you of changes in the law or in your circumstances that may affect your estate planning. On occasion we may send out general mailings of communications to our existing and past clients informing them of a change in the law for general informational purposes, but you understand and agree that we have no obligation to notify you of any such changes. You understand and agree that if we do send you a communication, our attorney-client relationship with you will not resume unless and until you and we enter into a separate and new client engagement agreement.
>
> …
>
> When we finish your work, the attorney-client relationship between us will end unless you and we have expressly agreed to a continuation for other matters. Either you or we can terminate the attorney-client relationship before our work is finished, subject to ethical restraints."

Similarly, there is a section providing that the attorney has no duty to oversee the implementation of family limited partnerships or other ongoing matters involving the funding or maintenance of trusts.

The materials also include a sample "exit letter" used by Bruce's firm when a particular engagement is completed.

Bruce indicates that he has not had one client object to his engagement letter.

d. Duty of Disclosure in Representing Spouses Jointly; Sample Form. Bruce Stone's engagement letter provides that there is no confidentiality of communications that the attorney receives from either of the spouses, and the attorney can disclose information that it receives from one spouse that it deems relevant to the other spouse's estate planning. The agreement carves out an exception from disclosing extraneous irrelevant information (for example, such as learning that one spouse had an affair a decade ago that has no impact on the current estate planning).

The engagement letter can make clear that if an attorney determines that a conflict of interest arises due to the disclosure of information from one spouse, the attorney can issue a "noisy withdrawal letter," indicating that the attorney is withdrawing because of a conflict of interest that has arisen between the clients.

Florida Ethics Opinion 95-4 holds that there is no inherent conflict at the outset in representing a married couple in estate planning matters. A mere potential for conflict is not the same as actual conflict. If a conflict arises later, the attorney has a duty to withdraw from representing both spouses. The ruling gives comfort in being able to issue a "noisy withdrawal letter" stating "we can no longer represent you because a conflict has arisen."

Relying on getting an Ethics Opinion when a conflict issues arises is typically not possible. It is not possible to get a ruling in time to avoid conflict problems in the ongoing joint representation. Also, ethics opinions in most jurisdictions are merely advisory.

The issue of how to deal with disclosure of information in joint representations is always difficult. Bruce Stone's engagement letter provides as follows:

> "We will represent both of you jointly in your estate planning. We owe duties to each of you, and each of you has an obligation to disclose to us all information that is relevant to both spouses' estate planning. You agree that among us (the two of you and our firm), there will be no confidentiality of communications or information, unless and until one of you instructs us otherwise. If one of you discloses information to us that is relevant to the other spouse's estate planning, we can disclose that information to the other spouse if we think it is necessary to fulfill our duties to the other spouse in your estate planning.
>
> Either of you can terminate your permission for us to disclose information to the other spouse at any time, if you give us clear directions not to disclose. However, if you do terminate that permission, we must then decide if a conflict of interest has arisen that prevents us from adequately representing the other spouse. We will make that decision in our sole professional judgment. If we believe that we cannot adequately represent the other spouse without the disclosure, we will notify each of you separately in writing that a conflict of interest has arisen that prevents us from representing either one of you in your estate planning. We could not represent either one of you in your estate planning after that without the consent of both of you. Even if you revoke our permission to disclose information, you should be aware that if there is ever litigation between the two of you, we could be compelled to testify about information we obtain from you or about advice that we gave to you in your estate planning.
>
> If this agreement concerning confidentiality is not acceptable to you, you must advise us immediately so that other arrangements can be made."

e. Arbitration Provisions. Arbitration provisions are generally enforceable, even for malpractice claims. Engagement letters often say that fee disputes are arbitrated, but they could provide that any and all disputes between the parties are subject to arbitration. (If malpractice claims are subject to arbitration, make sure that the insurance policy covers arbitration as well as court litigation.)

f. Jury Waivers. Another possible approach is a jury trial waiver including malpractice action. There begins to be a client management issue. Including more and more things in the engagement letter restricting lawsuits against the attorney can present problems with the client. However, the parties may prefer a judge to decide the case rather than juries, and jury trial waivers tend to be favored. They must be conspicuous in the document. Some states require that they be boldfaced. Many clients would be agreeable to a jury trial waiver.

Even if the parties waive the right to a jury trial in the engagement letter, is that binding on beneficiaries who sue the attorney but who did not sign the engagement agreement? There is an argument they are not bound, but the broader the language in the engagement letter, the more likelihood that the jury waiver will be binding even on beneficiaries.

g. Notify of Opportunity to Consult Separate Counsel. The attorney may notify or even encourage the client to speak with separate counsel regarding the engagement letter or conflict waivers. It is very rare that clients will exercise their right to do so, but the clients will appreciate an express statement of their opportunity to do so.

7. Initial Notice of Malpractice Claim. Notice of a potential claim typically comes from another lawyer. If notice of the claim comes in a letter, the attorney can deliberate and determine an appropriate response.

If the notice comes in a phone call, it is important that the attorney react in a way that does not constitute an admission that would not be privileged. For example, do not respond "I'm really sorry for what happened." That statement could be deemed to be an admission. Instead, respond "Thanks for letting me know. We will get back to you."

8. Actions After Receiving Initial Notice of Claim.

- Review the client's file.
- Notify the risk management partner or other partners in the law firm.
- Give notice to the insurance carrier. Most policies require disclosing the "circumstances of a claim" even before a formal claim or lawsuit commences. If the attorney does not notify the carrier of the circumstances of the claim, and if the policy is renewed or if there is a switch of insurance carriers, there may be no coverage for that particular client. (The carrier may argue that the renewal premium would have been set differently had it known of the claim.)

9. What If Attorney Discovers Mistake Rather Than Claim Being Made By Client? If the attorney discovers a mistake, but there is not yet a claim or "circumstances of a claim," the attorney has a duty to the client to disclose the mistake in order to keep the client fully informed. Even if the client does not know about the mistake, the law is crystal clear that the attorney has a duty to notify the client of the mistake. In the real world, the "no-harm no-foul rule" applies. In most cases, no harm occurs. However, even if it is likely that the mistake will never come to light, the attorney still has a duty to advise the client. The client has a right to know, because the client's rights may conceivably become time barred. Failing to disclose just makes matters worse for the attorney.

10. Generally Communicate Orally Within Law Firm and with Defense Counsel About the Claim. Any communication with other partners or with the insurance carrier is potentially discoverable. For example, if the attorney receives a communication while still representing the client, it will be impossible to claim privilege between the attorney and the partners or between the attorney and the insurance carrier. (There is the potential that even communications with other partners would be discoverable.) If there is a necessity of reducing communications to writing, be cognizant that they may be discoverable.

The case law is not clear in this area. Some case law indicates that the attorney has a right to consult with counsel and have those communications privileged, as long as they are not adverse to the client while the attorney is representing the client. But the basic rule of thumb is not to communicate in writing.

11. Selection of Defense Counsel. Who gets to choose the defense counsel? The malpractice policy will cover this.

When the terms of the malpractice policy are being negotiated, the law firm has leverage regarding provisions affecting the selection of counsel. If that is not negotiated, the policy may not allow the defendant-attorney to select its own counsel or to allow the firm to represent the defendant partner in the firm. (The law firm of the attorney who is being sued sometimes also serves as co-counsel, and its fees may be chargeable against the policy limits.)

If the selection of counsel is not negotiated in the policy terms, some policies give the insurance company carte blanche to select who they want. The carrier will use one of their "panel firms." The carrier will want to use the law firm that "wines and dines" them and has a relationship with them. (Carriers have been known to deny the attorney being sued from having the ability to select his own counsel and pay the difference between rates being charged by that attorney and rates that would be charged by the insurance carrier's preferred counsel.) Even if it costs a little more premium to negotiate the ability to select one's own defense counsel, it is worthwhile.

12. Duty to Preserve Evidence. Once the attorney has knowledge of circumstances of a claim, the attorney is ethically required to preserve all evidence, whether good or bad. (The Federal Rules of Evidence have been updated to deal with electronic communications.) Even if there is nothing incriminating in the evidence, preserve it. If the evidence disappears, there may be inferences of presumptions that the evidence was incriminating.

For e-mails, some firms automatically write over e-mails after 60 days. If that is the case, if a claim is made against an attorney, the firm put must put in process a manner of freezing the e-mails and other information in place.

13. How Served? Can the attorney avoid the embarrassment of being served in the law office? Generally, there are professional courtesies. The plaintiff's attorney will ask if the defendant is willing to accept informal service of process to avoid that kind of embarrassment.

14. How Defense of Case Proceeds. At the front end, a lot of time will be spent in going over all documents and in discussions with the defense counsel. After the initial flurry, some considerable time may elapse before formal discovery begins. There will be various court motions in the interim. The practicing attorney goes on about his or her business and relies on the defense lawyer to take care of the case.

15. Sitting In On Depositions? Should the defendant lawyer sit in on depositions? The defendant clearly has a right to be present in depositions. Some defendants want to be there "to stare down the other party." Mr. Wakshlag does not think that is important.

16. Settlement. Most malpractice cases settle. If the carrier denies a demand within policy limits, the carrier can be liable for claims in excess of policy limits.

Most policies give the insurance carrier the ability to decide whether to settle the case if the settlement is within policy limits. The lawyer may prefer not to settle in order to preserve the lawyer's reputation. However, the carrier will often settle the case despite the attorney's objection if the policy permits. Alternatively, the carrier may agree not to settle, but have an agreement that the carrier is only liable up to the amount of the settlement that was rejected.

Settlements are typically confidential, with teeth to enforce confidentiality, including substantial penalties and disgorgement and injunctive relief if there is any disclosure at all of the settlement terms.

17. Violations of Professional Conduct. Violations of the Rules of Professional Conduct do not establish negligence. However, in malpractice litigation, the plaintiff's attorney will always pursue whether there were any ethical violations. They look very damaging to the jury.

18. Wisdom of Learning From Mistakes. Bruce Stone's materials include some terrific quotations about the general wisdom of learning from mistakes. They are included verbatim.

    a. "The only real mistake in life is the one from which you learned nothing." -John Powell (British composer)

    b. "Learn from the mistakes of others; you can never live long enough to make them all yourself." -John Luther Long (American lawyer and author)

    c. "All men make mistakes, but only wise man learn from their mistakes." -Winston Churchill

    d. "Anyone who has never made a mistake has never tried anything new." -Albert Einstein

    e. "Computers have enabled people to make more mistakes faster than almost any invention in history, with the possible exception of tequila and handguns." -Mitch Ratcliffe (American technology journalist)

19. Bruce Stone's Concluding Advice and Perspective.

    > "Most important of all: remember that you are not alone! Everyone makes mistakes. As much as we dread making mistakes, at least the mistakes of a trust and estate lawyer do not result in the loss of life or limb. If you know or think that you have made a mistake, don't keep things bottled up. Ignoring a problem will not make it go away, and the consequences of a mistake cannot be covered up forever (just ask a former governor of the most populous state in the U.S.). Lean on your Fellows and friends! No Fellow or true friend will ever feel imposed upon or resent spending time with you to help you walk through a problem situation. If you don't have anyone you feel you can call, call me!"

Anticipating the Mathematics of Planning Gifts Under Current Law -- Using Shelters, the Impact of Portability, Structuring GRATs and More — Diana S.C. Zeydel and Robert A. Weiss

1. Overview. There is a concern that high exemptions and the portability of the exemptions has frozen clients who think there is no further need to for planning. Financial modeling can dispel the notion. The modeling described below generally assumes portability is permanent. Of course, the effects of doing no planning will be much worse if the system reverts back to a $1 million exemption with no portability. The results of the modeling indicate that there are substantial long-term opportunities for planning.

    The presentation deals with two major areas: First, overcoming planning procrastination in turbulent times; and second, an analysis of the optimal manner for structuring GRATs.

2. Overcoming Planning Procrastination in Turbulent Times.

    a. Overview. Four scenarios are examined: (1) no planning; (2) using a testamentary credit shelter trust; (3) using a "Supercharged Credit Shelter Trust"SM (described below); an (4) having each spouse make $5 million gifts. In addition, the analysis looks at the financial impact of a "clawback" of the estate tax if the estate tax exemption is reduced below the current $5 million gift exemption amount and the relative value of using grantor trusts.

    b. Assumptions and Modeling Approach. The various options are analyzed under the following assumptions. The family has $30 million, with $500,000 annual spending (inflation-adjusted). Husband dies in year 5 leaving everything to Wife (except in the testamentary credit shelter trust scenario) and Wife dies in year 20 leaving the entire estate to children. The estate tax exemptions are inflation adjusted, assuming 3% annual inflation (4 years for husband and 19 years for wife).

Financial effects of the scenarios are estimated using "simulation-based modeling" rather than assuming straight-line appreciation. "Monte Carlo" modeling is the trend of financial analysis, using hundreds or thousands of example simulations based on varying financial possibilities, determined on a random basis, for a particular assumed overall "equilibrium" return and volatility factors appropriate for a particular asset class.

The financial effects of planning under each of the four different scenarios reflect the value of assets passing under a 5th percentile, 50th percentile, and 95th percentile of the simulations for each scenario. This summary generally describes the results of the 50th percentile, or median simulation result for each of the scenarios.

c. Scenario 1 — No Planning. At the end of 20 years, when assets pass from the wife's estate to the children, the median result is that children would receive $42.1 million.

d. Scenario 2 — Testamentary Credit Shelter Trust at Husband's Death. At the end of 20 years, the children would receive $44.1 million at Wife's death in the median situation, or an increase of $2 million. In the median situation, 45.6% of the total assets would be GST exempt.

e. Scenario 3 — Supercharged Credit Shelter Trust SM. The concept of a Supercharged Credit Shelter Trust SM is described in an article by Prof. Mitchell M. Gans, Jonathan Blattmachr, and Diana S.C. Zeydel, Probate & Property at 52 (July/August 2007). Supercharged Credit Shelter Trust SM is a service mark of those authors. The concept is generally designed to create a credit shelter trust for the surviving spouse that is a grantor trust as to the surviving spouse for income tax purposes but is not included in the surviving spouse's estate for estate tax purposes. The concept is rather complex; to say the least, it is not an easy straightforward strategy.

(1) General Description. The concept is rather involved, but is described briefly. For simplicity, assume Husband is expected to predecease wife. Wife would create a revocable inter vivos QTIP trust for Husband. The power to revoke the trust lapses at the Husband's death; the trust becomes irrevocable, and provides that the assets pass to a bypass trust for wife that allows discretionary distributions for health, education support and maintenance of the first spouse and other family members (and if assets in the trust exceed Husband's remaining estate tax exemption, the excess would pass to a QTIP trust for Wife or outright back to wife). The gift from Wife to Husband is completed at Husband's death, when the revocation power lapses. The completed gift to the QTIP trust for Husband should qualify for the gift tax marital deduction if the QTIP election is made for the year of the gift to the trust.

The trust assets are included in Husband's estate under §2044. Under the trust, assets up to Husband's remaining estate tax exemption amount pass to a bypass trust for Wife; assets over that pass to a QTIP trust for Wife or to Wife outright. Thus, there is no estate tax in Husband's estate on assets passing to the bypass trust. Husband can allocate his GST exemption to the bypass trust (i.e., Wife would not make the "reverse QTIP" election). Thus, the bypass trust can be GST exempt, using Husband's GST exemption.

Trust assets are not includible in Wife's estate at Wife's subsequent death under §2036 or 2038 despite her retained beneficial interest or powers because of Treas. Reg. § 25.2523(f)-1(f) Ex. 11 ("because S is treated as the transferor of the property, the property is not subject to inclusion in D's gross estate under section 2036 or section 2038"). The risk of inclusion under §2041 is not addressed in Treas. Reg. § 25.2523(f)-1(f) Ex. 11. To forestall the risk that the IRS might argue that Wife's creditors might be able to reach the trust assets (because she contributed her assets to fund what eventually passed to the trust for her benefit), and that Wife's ability to allow trust assets to be used to satisfy her creditors might be a §2041 general power of appointment, provide that distributions may only be made to Wife or her creditors for health, education, support and maintenance, thus falling within the HEMS exception under §2041. [However, under some states' laws, the entire trust might still be reachable by Wife's creditors despite the existence of the standard, thus raising the possibility of a §2041 risk.]

Assets in the bypass trust are treated as a grantor trust as to Wife because there is a disconnect in the way the regulations treat who is the transferor of the trust that is created as passing under a QTIP trust for estate vs. income tax purposes. While the first decedent spouse is treated as the transferor for estate tax purposes (as to §§2036 and 2038), the original donor spouse continues to be treated as the grantor for purposes of the grantor trust rules. **Treas. Reg. §671-2(e)(5)** provides:

> "**If a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust.** However, if a person with a general power of appointment over the transferor trust exercises that power in favor of another trust, then such person will be treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust under subpart E of part I, subchapter J, chapter 1 of the Internal Revenue Code [i.e., the grantor trust rules]."

The second sentence does not apply because Husband does not have a general power of appointment over the trust (let alone exercise a general power of appointment). Therefore, the first sentence clearly says that the person who was the grantor of the original trust (i.e., Wife in our example) is also treated as the grantor any trust to which those trust assets pass (including the bypass trust as well as a QTIP trust if part of the assets pass to a QTIP trust for Wife).

(2) <u>Financial Effects</u>. This approach shifts additional wealth as compared to merely using a testamentary credit shelter trust, because the surviving spouse's estate is further depleted by payment on the income taxes (and the credit shelter trust can grow faster because it does not have to bear income taxes), and because GST exemption is allocated currently rather than waiting until Husband's death to allocate his GST exemption. Under the median result, $48.8 million is transferred at Wife's death, or $6.7 million more than the "no planning" scenario and $4.7 more than the "testamentary credit shelter trust" scenario. Stated differently, there is 15% more wealth transfer compared to doing nothing. In addition, about 65% of the assets are GST exempt (interestingly for almost all percentiles of the financial results).

f. Scenario 4 — Immediate Use of Gift Exemptions.

(1) How Much Can Client Give and Maintain Lifestyle? The client's assumed consumption needs are $500,000, inflation adjusted. The clients want to have a cushion of $10 million after 20 years to provide a very high comfort level that the clients can satisfy their consumption needs for their lifetimes. The financial analysis reflects that in even a "weak market" (i.e., bottom 5th percentile) situation, the clients can give $19 million currently and still have over $10 million left in 20 years. Therefore, the clients can afford to make gifts of the full $10 million gift exemptions currently available.

(2) Financial Effects. At Wife's death, $51.3 million will pass from her estate. This is $9.2 million greater than in the "do nothing" scenario, and about 70% of the assets would be GST exempt (in weak, median, and strong markets).

(3) Financial Effects If "Clawback." Even if the estate tax exemption is subsequently reduced below the current $5 million-dollar gift exemption, and if estate tax is imposed on the amount by which the gift exceeds the estate tax exemption at death, the financial results are still compelling. The median market result is that $47 million would pass at the Wife's death, or $4.9 million more than the "do-nothing" scenario. (This is illustrative of the general maxim that there is no more overall transfer tax even if the recapture applies, compared to doing nothing. Indeed, the advantages of making gifts have resulted in substantial additional wealth transfer to the family.)

g. Effects of Portability and Increased Estate Tax Rates. The financial effects of all four scenarios are further tested under the assumption that the exemption amount remains at $5 million, but with the following variables: (1) 35% rate with portability, and (2) 55% rate without portability. The financial results of all four scenarios are obviously somewhat worse under the 55% rate/no portability assumption. In particular, the "no planning" scenario fares significantly worse without portability ($30.5 million vs. $42.1 million passing at Wife's death in 20 years for the median market situation). The advantage of implementing current planning is increased if one assumes that the estate tax rate will return to 55% without portability ($30.5 million passing under do nothing approach vs. $48.0 million with current $5 gifts by the spouses in the median market situation).

h. Longer-Term GST Effect. The financial results summarized above reflect the amounts that would pass in year 20 at Wife's death. If the financial model is run another 25 years, there would be huge differences in the scenarios with a higher percentage of GST exempt assets.

i. "Window of Opportunity" Effect If Transfer Tax Reverts to Pre-EGTRRA System. If the transfer tax system reverts to the pre-EGTRRA system ($1 million exemption, 55% rate with 5% surtax), the planning advantages are obviously even larger. If transfer taxes revert to pre-EGTRRA levels, at Wife's death in 20 years under the median market situation, $48 million would pass under Scenario 4 (current gifts) compared to $26.7 million passing under Scenario 1 (no planning), or a $21.3 million difference.

j. Importance of Grantor Trust Status. Making the $10 million gifts under Scenario 4 to grantor trusts with 0% discount has about the same effect as making $10 million gifts to a nongrantor trust with an upfront 30% discount. The grantor trust effect is continuing, and results in further advantages over time. Conclusion: you do not need to be "off the charts" in pressuring the appraiser for very high discounts if grantor trusts are used. Of course, using grantor trusts with upfront discounts result in even larger wealth transfer. If discounts are limited or reduced in future legislation, it will be more important than ever to start planning early so that the grantor trust status effect will have time to shift substantial additional value.

3. Planning GRAT Terms and Payout Structures.

a. Future Legislation Changes? An informal poll of the audience suggests that a majority thought that there will not be GRAT legislation in the next two years.

b. General Considerations About Financial Modeling With GRATs. A problem with simulation-based modeling is that it is excellent for 10 years or longer. Over just two-to-three years, however, the markets are more volatile than simulation-based modeling can reflect. The modeling of GRATs obviously depends upon the § 7520 rate and whether low or high rates apply. The rates have been relatively low in recent years (declining from 19.0% in 1981). Over a longer term (since 1962), however, estimated § 7520 rates would have a medium range of 6.8-9.0%. The analysis below assumes a low hurdle rate environment.

c. Longer vs. Shorter Term Single GRATs; Large Cap vs. Small Stock. For maximum remainder scenarios (perhaps nearing the 95th percentile of simulations), for both large-cap stocks (i.e., S&P 500 index) and small cap stocks, the speakers concluded that a GRAT term of six-to-seven years seems to produce the optimal financial result. The remainder passing to the family is about 125% of the amount originally transferred to the GRAT for large-cap stocks, and about 250% for small-cap stocks in GRATs with a term of six-to-seven years. (The results are considerably better for small-cap stocks.)

For median remainder scenarios (obviously the most likely result), almost no value is transferred with GRATs of six years of longer for large cap stocks, but there is still significant transfer for small-cap stocks (about 50% of the original amount transferred to the GRAT).

d. Rolling GRATs Preferable. An analysis of comparing a single nine-year GRAT with a series of two-year rolling GRATs reflects a substantially higher wealth shift with rolling GRATs. This analysis uses the following assumptions: 3% or 6% § 7520 rate throughout the term, $10 million initial funding amount of a single U.S. large cap stock. The median simulations reflect that rolling GRATs have considerable advantage ($8.65 vs. $2.39 million at 3% rate and $7.26 million vs. $170,000 at 6% rate).

e. Escalating Annuity. For a U.S large cap single stock GRAT, using escalating annuities is not a significant factor. It does not hurt, but it does not help much either. Using escalating annuities results in lower payouts in early years. Leaving assets in the trust for a longer period of time means that the assets have more time to appreciate, thus resulting in a larger expected reminder. However, assuming a GRAT is funded with a single U.S. large cap stock valued at $10 million in a nine-year term GRAT with a 3% § 7520 rate, the median remainder transfer only ranges from $2.4 million to $3.0 million for escalation rates ranging from 0 to 20%. While the end result is not substantially different, there is a significantly higher probability that a GRAT with an escalating annuity will be at least somewhat better than a GRAT with a level annuity. However, the risk to using escalating annuities is if poor investment returns occur near the end of the GRAT term.

f. Frontloading. Frontloading of annuity payments occurs if the annuity payments de-escalate. For example, if the annuity de-escalates by 99%, almost the entire annuity is paid at the end of year one, effectively changing the GRAT to a one-year GRAT. A substantial advantage results from high frontloading, but a de-escalation rate of about 20% or less results in very little difference. The analysis assumed a $10 million single U.S. large cap stock was contributed to two-year rolling GRATs over a nine year period, with a 3% § 7520 rate. The median remainder was about $9.8 million with a 99% de-escalation rate vs. $8.7 million with a level annuity).

Observations from the Analysis: The risk of frontloading is a poor first-year investment return, a risk that is mitigated with a rolling GRAT strategy. In addition, the final GRAT in a rolling GRAT strategy might optimally be structured with a frontloaded annuity.

g. "Zero Out" the GRAT. The financial analysis bears out the commonly held belief that the optimal approach is to structure the annuity so that a very minimal current gift results from the creation of the GRAT.

Observations from the Analysis. (1) Structuring a significant gift element in the GRAT results in a greater probability of wasting some or all of the exemption if a shorter time horizon or more volatile asset is used. (2) A non-zeroed out GRAT will never be better than a separate zeroed out GRAT and gift. (3) If a zeroed out GRAT succeeds, there will be no difference between the two strategies. (4) If the GRAT fails, the gift assets will be used to make annuity payments back to the donor, and the remainder will be lower than if a separate zeroed out GRAT and gift had been used.