ACTEC 2013 Summer Meeting Musings

June 2013

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 2013 Summer Meeting and does not purport to represent the views of ACTEC as to any particular issues.

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BESSEMER TRUST

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Items 1-56 come from the "Stand Alone" program titled "The Anatomy and Life Cycle of a Trust." The program included separate panels addressing issues that arise over the life cycle of a trust. The speakers on the three panels are:

"Core Planning Issues," Dennis I. Belcher, Robert W. Goldman, Suzanne L. Shier, and Lauren J. Wolven

"Planning for Flexibility," Alvin J. Golden, John F. Bergner, Lauren Y. Detzel, and Terrence M. Franklin

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"Trustee Exercise of Discretion," Suzanne L. Shier, John F. Bergner, Terrence M. Franklin, and Alvin J. Golden

"Management of Trust Assets," Robert W. Goldman, Wendy S. Goffe, and Benjamin H. Pruett

"Ethical Issues," John T. Rogers, Lauren Y. Detzel, and William T. Hennessey, III

Core Planning Issues (including personal issues and difficult family issues)

Flexibility Planning Issues

Planning with Unique, Illiquid, or Difficult Assets

Administration Issues: Trustee Duties and Communication with Beneficiaries

Trustee Exercise of Discretion

Management of Trust Assets

Ethics Issues

ITEMS 73-76 ARE OBSERVATIONS FROM A SEMINAR BY LAWRENCE BARTH (PENNSYLVANIA DEPUTY ATTORNEY GENERAL), PROFESSOR SUSAN N. GARY, THE HONORABLE STANLEY R. OTT, PROFESSOR ROBERT H. SITKOFF, AND KURT A. SOMMER, NOTHING LASTS FOREVER – OR DOES IT? PERPETUAL CHARITABLE GIFTS ARE OK, BUT WHAT ABOUT DONOR INTENT?

ITEM 77 IS A COMPILATION OF VARIOUS INTERESTING QUOTATIONS, WORDS OF WISDOM, AND COMMENTS FROM THE VARIOUS SEMINARS.

Introduction

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The "Anatomy and Life Cycle of a Trust" panels all discuss a fact scenario very briefly described as follows. A prospective client has recently sold his business for $900 million. He has significant and complex personal issues, including having a second wife much younger than he is with no pre-marital agreement. He has two lazy and unproductive children from a prior marriage who are financially dependent on the client. He also has a learning-disabled child born out of wedlock after his first marriage that he wants to keep secret but he wants to provide support for the child. His ex-wife is threatening to sue for more than assets than she received in the divorce.

The client has some unique assets, including an extensive auto collection and real estate in various states and countries.

He is the beneficiary of various trusts; because of his relationship with the trustees (who refused to make distributions to him to start his business), he has ill feelings toward trustees and attorneys.

He wants to provide tastefully for his spouse, but not more than 25% of his wealth. He wants to provide trusts for his children and wants to name his three business buddies (all engineers who are now out of a job after the company sold) as trustees. He is concerned family disputes may arise in the future over his money.

The client invested the sale proceeds of his company with an investment firm that was recently successfully sued for mismanagement.

The company had some environmental liability concerns, which were not assumed by the buyer of the company.

The client has never done any sophisticated business or estate planning (he represented himself in the sale of the business). He does not think highly of lawyers.

One of the three business buddies is calling the attorney to explore setting up a relationship between the prospect and an attorney.

CORE PLANNING ISSUES (INCLUDING PERSONAL ISSUES AND DIFFICULT FAMILY ISSUES)

1. Be on High Alert in "Red-Flag" Situations

Look down the road. Anticipate problems. Spot issues that if not addressed properly will become big problems. Addressing problem situations is much easier when the client is still alive.

In difficult family and uncooperative client situations, realize that many others have talked to the client before about planning. Why were they not successful? Why do you think you will be more successful?

Place an emphasis on spotting problems and minimizing risk — both for the client and the planner. "Don't make your clients' problems your problems."

In these kinds of red-flag situations, make clear that the lawyer is just presenting options, and the client makes final decisions. Use CYA letters: "We discussed…You decided to …" Have the client initial that letter. That makes the issue in the client's problem, not the attorney's problem.

Be very careful before accepting difficult client situations. Think long and hard about the arrangements. Use engagement letters that clearly specify the scope of the project. Consider using flat fee arrangements with careful limitations on time frames (to minimize feet dragging by the client). (While clients like flat fee arrangements and they can result in a better working relationship, the speaker proposing them acknowledged "I don't have the nerve to do it yet.")

2. Fact Gathering

A detailed checklist is helpful to identify issues. (For example, a planner typically would not ask if there were other children born out of wedlock that the family does not know about.)

In "red flag" situations, the planner should do the fact-finding very carefully.

3. Substitute Parent

In difficult situations, the patriarch's generosity sometimes results in the children being unproductive and lazy. He has made them trust-fund babies even before there was a trust fund. The patriarch wants the fiduciary to do parenting that he has not done over the years.

4. Goals; Ultimate Goal; Settlor Intent

The ultimate goal in dealing with difficult clients is that the client thinks that the ultimate solution was his or her idea.

Focus on the client's issues and goals. Articulate goals in the underlying documents as much as possible, because the trustees will focus on settlor intent. Having articulated goals provides meaningful guidance to fiduciaries.

5. Litigator Input in Planning Process

In difficult client situations, communication issues are keys. Sometimes it is helpful to have a an attorney who has litigated family issues to "lay out the demons" to focus the client on addressing potential problem issues.

6. Short Meetings

For difficult clients (and most entrepreneurs) the client cannot be fed with a fire hose. The education process happens over time. Short meetings are often best. The planner must pick priorities and pursue those problem areas, realizing that every problem will not get solved. The planner must remember that "I am not his psychologist but his professional advisor."

7. Team Approach

Bring in other advisors so that the planning does not just become "lawyer lectures." Different advisors will learn different things about the client.

8. Spousal Issues

Difficult spousal issues with a much younger spouse include the following: (1) having a spouse as young as the client's children is not a good combination; (2) a young wife will want children; and (3) assisted reproduction technology issues may arise.

Consider using prenuptial agreements. (One planner told his fourth "pre-nup" client that the prior three ended in divorce. Months later, the fourth called the attorney and said "you are now 4 for 4.") To be valid in most states, there must be full disclosure. That may be why some clients will not want to do a prenuptial agreement (even if they had a "bad" prior divorce).

Consider whether to have a spouse attend all meetings. The attorney should make clear who the attorney is representing. If the attorney is representing just one spouse, perhaps have the other spouse join at some point to discuss the plan rather than being involved in all meetings. In any event, make sure there is at least one meeting before documents are signed with just the client to go through the documents carefully.

If the client has sufficient assets, consider giving a spouse $5 million outright. "The more freedom the surviving spouse feels, the better he or she feels and the better the relationship." Having assets in trust (to ensure that the spouse does not blow through the money) can also be helpful. Consider the concept of a separate trust that does not name the children as remaindermen so that the children will not have an incentive to attack that trust.

When a divorced ex-spouse comes back for more money, that is usually because the ex-spouse ran out. Having assets in trust for a divorcing spouse may help avoid that result.

9. Three Bucket Approach to Planning

Recommend that the client consider planning in terms of three different buckets. (1) The *personal* bucket will be filled first to take care of the client and the client's spouse and to make future gifts. (2) The *children's* bucket is the next priority. (It is more efficient to fill the children's bucket during life than at death.) (3) The last bucket is the *charitable* bucket.

Clients will not consider charitable desires until after addressing the spousal and children issues.

10. Children Issues

Encourage separate trusts for each of the children and funding each trust with significant funds. That takes economic pressure off the parent-child relationship. One client related to one of the speakers that having a trust for children created 30 years earlier helped greatly in his relationship with the children. He never had to discuss finance issues with them; they dealt with the trustees regarding their financial needs.

11. Economic Walls

Build economic walls between family members. Do not use pot trusts. Do not mix remainder beneficiaries. For example, consider not having children as remainder beneficiaries of the spouse's trust. By eliminating friction among family members, the planner does the family a great service.

12. Misguided Focus in Trust Planning

There are three main elements in trust planning: trustees, beneficiaries, and terms. The planner usually focuses on trust terms. The planner should also devote significant attention to the trustees and beneficiaries.

13. Trustee Phase-In

One approach to afford children experience in managing assets is to provide that a child can become co-trustee at one age (for example, age 30) and sole trustee at a later age (for example, at age 35). The five-year period gives an opportunity for the child to work with advisers. One client told a speaker that worked very well in a trust created by his parents. He decided to keep the financial institution is a co-trustee after serving with the institution for five years.

An alternative approach is that a child can serve as sole trustee at the later of (1) turning age 35, or (2) having served five years as a co-trustee.

14. Charitable Planning Goals

Focus on the purpose of the charitable planning and what the client wants to accomplish. There are very good consultants to spend time with clients to help them understand what they really want to achieve. Clients' charitable goals will be either topic driven or community driven. Once the mission and purpose is determined, the charitable structure can be designed.

While charitable planning may provide the opportunity for children to work with their parents toward a common goal, that does not always work. Disputes with the children may spill over into disputes about governance of the charity. If parents want to be involved with children regarding philanthropic matters, consider creating a separate donor advised fund for each child with the child and parents as advisors.

Consider using a rotating board, so that the charity does not become the "directors' charity."

Flexibility Planning Issues

15. Balancing Discretion and Control

Balancing discretion versus control ultimately becomes the key issue in trust planning. For example, granting beneficiaries powers of appointment provides a great deal of flexibility to take into account changing circumstances, but results in the client giving up some control over the trust assets.

16. Trustee Selection

a. ***Location.*** Consider the location of the trustees and the trust beneficiaries and where the beneficiaries or trustees may move in the future. The document can allow a change of trustee if the trustee moves to a new jurisdiction.

   If the trustee resides in California, a proportionate part of the trust income is subject to the in California income tax. Does a trustee have a duty to resign if the trustee moves to California? That's probably not a breach of fiduciary duty if the trustee does not resign, but that possibility should be anticipated.

b. ***"Business Buddies" as Trustees.*** The client may want to name business associates or other friends as trustees. Focus on the many duties and responsibilities the trustees will have. Business associates might have no desire or time to be trustee. "It's not an honor, it's a job." Consider utilizing individuals as trust protectors or direction advisers (discussed below) rather than as trustees.

c. ***Corporate Trustees.*** The planner may understand that naming individuals as trustees is a disaster waiting to happen. However, the planner might lose the client's confidence if the planner simply demands that a corporate trustee be used. The planner should discuss the protection that the corporate trustee can provide in being able to guide other co-trustees.

d. ***Capability and Willingness.*** Capability and willingness to serve are keys to selecting good trustees.

e. ***Long Term Trusts.*** "Perpetuity is a long time. Don't forget that." For long-term trusts, having flexibility in the provisions for the appointment of trustees is important.

17. Trustee Removal

Trust instruments often provide provisions for trustee removal. Trust agreements sometime limit the number of times that a trustee can be removed if there are individual trustees – so that the beneficiaries can't shop around to find individual trustees who will "do their bidding."

Provisions are typically included for removing and replacing corporate trustees. For example, that can be helpful if children move to a new location. Removal of corporate trustee provisions generally require replacement with another corporate trustee with a certain minimum amount of assets under management. Time limitations may be imposed so that, for example, the trustee cannot be removed every six months. Limitations on the total number of times that a corporate trustee can be removed may also be used to limit "trustee shopping."

As a practical matter, if trust beneficiaries hold removal powers, that may impact distribution decisions. Consider giving removal powers to third parties rather than to trust beneficiaries in order to avoid that pressure on distribution decisions.

18. Trust Protectors; Direction Advisors

a. ***Possible Powers.*** Possible powers in trust protectors include the powers to:

- amend the trust to address changes in law or other changes
- update administrative provisions
- provide for the removal and appointment of trustees
- change the trust situs (possibly as to administration as well to validity and construction issues)
- revise trust investment powers
- alter beneficial interests in the trust (for example, to convert a special power of appointment to a general power of appointment).

b. ***Direction Advisors.*** Section 808(b) of the Uniform Trust Code addresses direction advisors who can authorize the trustee to make certain decisions. (It does not explicitly mention trust protectors, but the Comments state that §808(b) also applies to trust protectors.)

c. ***Liabilities and Duties.*** Consider what duties are owned by the trust protectors and to whom. What is the standard of conduct? Are the powers fiduciary powers or personal powers? State law is murky about this. There is an open question as to whether the protector can be relieved of *all* duties and liabilities. Most courts conclude that the protector has some duty even if it a personal power. For example, there may be liability if the power is exercised in a manner that benefits the trust protector individually.

d. ***Compensation.*** The agreement should address compensation of the trust protector.

19. Powers of Appointment

a. ***Client With Power of Appointment.*** If a client has a power of appointment from prior trusts, the planner should obtain copies of those trust documents and trust accounting statements to understand the client's rights and the mechanics and manner in which the power of appointment could be exercised.

b. ***Flexibility.*** Powers of appointment provide flexibility to deal with changing circumstances, but necessarily cause some loss of control to the client. (Clients can maintain some control by limiting potential takers upon the exercise of the power or the manner in which the power may be exercised.)

c. ***Lifetime or Testamentary.*** There are potential gift tax consequences associated with exercising a lifetime power of appointment. If the power holder has a mandatory income interest, exercising the appointment results in a gift of the value of that income interest. However, if the power holder has a discretionary interest, any gift may be very difficult to value. If the trust provides that the trustee should consider other resources and if the beneficiary has significant resources available, the gift may be negligible. One speaker has filed gift tax returns reporting lifetime exercise of powers of appointment in that type of situation, stating that because of the beneficiary's net worth there have never been nor likely will be any distributions, and valuing the gifts at zero.

d. ***Spouses of Beneficiaries.*** Spouses of beneficiaries may be included as possible appointees. This may be helpful to the beneficiary who wants to make reasonable support provisions for his or her spouse. The instrument may limit spousal interests to being in further trust with the right to only the income or an annual distribution of up to a set percentage of the trust assets.

20. Guidance to Trustee

Broad discretion in making distributions is helpful for flexibility purposes and from a creditor protection standpoint. Settlors still like to have input as to how trustees exercise their discretion.

Guidance may be provided by precatory language in the trust judgment itself or by a "letter of wishes" outside the trust agreement.

One important advantage of the "letter of wishes" approach is that it is private. However, is it a part of the books and records of the trust that the trustee is required to disclose to beneficiaries?

Can a trustee use the "letter of wishes" to defend actions that it takes? There is an issue as to whether the letter can even be admitted in court. Language in the trust document clearly is admissible and is preferable from a legal standpoint. A court may determine that a "letter of wishes" is admissible as evidence only if there is ambiguity. The trust instrument, however, could provide that the trustee could rely on guidance outside the trust instrument itself as to settlor intent.

Planning with Unique, Illiquid, or Difficult Assets

21. Planning Difficulties of Administering Unique, Illiquid or Difficult Assets

a. ***Fiduciary Responsibilities.*** The client must understand that there are fiduciary responsibilities in administering unique assets. It is not sufficient that the client has retained unique assets even though they steadily decrease in value. That may not be permissible for fiduciaries.

b. ***Intentions.*** Understanding the client's intentions with respect to unique assets is important in structuring trusts. Will the special assets be sold? How will the special assets be used? For example, will beneficiaries be able to drive antique automobiles? Is the collection important to the children? Who should pay for maintenance costs?

   For assets with special sentimental or emotional value, the estate planning documents must have a detailed discussion of how to dispose of those assets or else there will be future problems. Dennis Belcher refers to this as a detailed "pots and pans" provision.

c. ***Diversification.*** Fiduciaries have a responsibility to reasonably diversify trust assets. Clients may respond--"But wine is a liquid asset" (pun intended).

   Specific authorization to retain unique assets may be necessary. The more the situation varies from normal fiduciary practices, the more important it is to have specific language regarding retention of special assets. A boilerplate provision negating the duty to diversify is not sufficient.

d. ***Valuation.*** There will be valuation issues with unique assets. For example, if a car collection represents one beneficiary's fractional share of the estate, there will be a fight about the value of the collection.

e. ***Give to Charity Currently.*** One way of avoiding the difficulties of administering unique assets will be to give them to a charity or museum during the client's lifetime.

f. ***Maintenance Costs.*** The special assets may not produce any cash flow but there will be administrative costs to preserve and maintain the assets. For example, insurance expenses may be significant.

g. ***Special Expertise.*** The trust may exculpate the trustee with respect to the unique assets. Even so, the trustee may have little experience with the particular assets and may need to hire special expertise.

22. Directed Trusts

A corporate trustee may be willing to accept unique assets only if there is a trust advisor to give direction with respect to the special assets.

The trust instrument may provide exculpation for a direction advisor, including a non-fiduciary advisor. It is very difficult to get insurance for someone acting in a non-fiduciary capacity.

Total exculpation may not be possible. A direction advisor may have a duty to act in good faith and without willful misconduct. In Delaware, the direction advisor can be indemnified for anything other than fraud or willful misconduct.

Depending on state law, the trustee may still have some duty to oversee the investments to some degree, even though the trustee is directed by a direction advisor. If so, there may be "a bit of a tussle" over fees. A corporate trustee may want to be indemnified for following the directions of a direction advisor.

The trust instrument may make very clear that the trustee's only duty is to carry out directions given by the direction advisor, with no duty to supervise the advisors or evaluate their directions, assuming that is the settlor's intent. The trust instrument may explicitly state that the trustee has no duty to advise the beneficiary or the direction advisor that the trustee would have made a different decision. (The Delaware act makes clear that the trustee just has a duty to carry out directions of the advisor in good faith as long as there is no willful misconduct.)

The trust should make clear how the direction advisor accepts or does not accept responsibilities as a direction advisor.

23. Communication

The planner should communicate carefully with the client to find out about all of the unique assets the client owns. If unique assets are administered in a trust, the trustee should take special steps to communicate with beneficiaries regarding administration issues with the special assets.

24. Inventory

Having a detailed inventory of unique assets is critical, particularly if the trustee or advisor has a particular interest in the assets. (Otherwise, items may disappear.)

Administration Issues: Trustee Duties and Communication with Beneficiaries

25. Breach of Fiduciary Duty Litigation Concerns; Communication is Key

Fiduciary litigation cases often turn on the following six issues: (1) Limitations; (2) estoppel; (3) waiver; (4) consent; (5) ratification; and (6) acquiescence. Each of these is highly impacted by how well the beneficiary was informed by the fiduciary. Waiver, consent, ratification, or acquiescence is only as good as the information the beneficiary had when "knowingly and intelligently" giving the waiver, consent, ratification, or acquiescence. Most important, can the fiduciary *prove* what information was given to the beneficiaries?

26. Participation in Breach of Fiduciary Duty by Attorneys

In Florida, there is a cause of action against attorneys for participating in a breach of fiduciary duty by a fiduciary if (1) the attorney participated in an act or omission that furthers the breach and (2) the attorney knew or had reason to know at the time that a breach was occurring. If the attorney gives bad advice to the fiduciary and the fiduciary gives information to beneficiaries based on that advice, the attorney could get brought into a breach of fiduciary duty action.

27. Requirement of Providing Trust Agreement to Specific Beneficiary Upon Request

If specific beneficiaries who are entitled to receive specific assets or limited pecuniary amounts request the trustee to provide a copy of the trust agreement, the court typically orders the release of the entire document, not just the small portion that may relate to the specific beneficiaries. A possible approach to avoid this result may be to make a specific bequest to a trust under a separate trust agreement for just a particular beneficiary. Once that bequest has been funded, the trustee could argue that the individual is no longer a beneficiary. Alternatively, the will could provide that bequests for other individuals pass to trusts under separate trust agreements — and persons who are not beneficiaries of those separate trusts may have no rights to receive those separate trust agreements.

The problem of not turning over trust documents when requested is that the issue is decided by the judge. The judge typically orders the document released. The trustee gets off on the wrong foot with the judge and with the beneficiaries who requested the information. The beneficiaries will be concerned thereafter that the trustee is not providing full information.

28. Communication With Beneficiaries At Beginning of Trust Administation

At the beginning of a trust administration, a good approach is for the trustee to have a meeting or send an initial letter addressing various aspects of the trust administration, including the following information: Introduction of trustee and key contact persons, preferred manner of communication, how to send distribution requests, standards for distributions under the trust agreement, names of the beneficiaries, what facts or financial information the trustee is required under the trust instrument or state law to consider in making distribution decisions, trust investment plan, and trustee fees. The initial meeting in particular should include a discussion of trustee and attorney fees.

The trustee may provide a flow chart of the trust together with a copy of the trust agreement. The flow chart initially may not include any numbers but as the administration proceeds and as more details become available, numbers may be added.

One panelist prefers to send an agenda to beneficiaries before each meeting with beneficiaries. He starts each meeting with questions from beneficiaries and asks each beneficiary if he or she has questions. The same procedure is used at the end of the meeting.

At the end of the meeting, one panelist prepares a memo of issues discussed. That can be helpful in preparing the agenda for the next meeting. (The memo can also come back to haunt the professionals if they do not implement issues that were discussed in prior meetings, but at least there is documentation of issues that were discussed.)

One face-to-face meeting with beneficiaries may suffice; conference calls may be sufficient after that, depending on the situation. However, recurring personal meetings with beneficiaries may be best. Consider the analogy to medical malpractice statistics. If a physician talks to patients, the likelihood of lawsuits against the physician is dramatically reduced. "We should learn to have personal meetings with beneficiaries — no matter how painful it might be."

The beginning of the administration is typically a "honeymoon" moment. It is a good time to get approvals and to get everyone "marching in the same line." Documentation of that discussion is helpful. If there is a breakdown of expectations later, having a written summary of what everyone agreed to at the outset is quite helpful.

One lawyer told a panelist he never writes anything down because "your memory can bring back what happened." However, juries will never believe anything a lawyer says but will believe the client's perception of the facts.

As a practical matter, staff persons will implement many items discussed at meetings. If staff members are not present at the meeting, it is imperative to have good notes about what specific actions are needed.

29. Email Communication

As a practical matter, planners and administrators do not get many telephone calls now with questions. Instead questions come by email. Keep in mind that email is permanent. The "bad" email messages will surface but the "good" email messages will be hard to locate. Be sure to file all emails of communications with beneficiaries.

30. How Much to Communicate

The attorney and trust administrator must balance how much information to give when discussing issues with beneficiaries — to avoid creating the impression that the attorney or administrator is giving legal advice or representing the beneficiaries. For example, what obligation does the trustee have to tell the surviving spouse of elective share rights that the spouse may have under state law? One panelist said that he would advise the surviving spouse that there are elective share rights but not go beyond that. Another panelist would only inform the spouse that he or she has certain rights and that the spouse should get a lawyer — but not inform that spouse that he or she has elective share rights.

This is contrasted with the process of informing beneficiaries about trust administration issues. "Walking the line is not required. You can inform more than you have to."

31. Scrub Communications With Beneficiaries and Scrub Files

In providing information to beneficiaries, be careful not to disclose sensitive personal information about other beneficiaries. For example, don't disclose that the purpose of a distribution to a beneficiary is to pay for an in vitro fertilization procedure.

Furthermore, the trustee should scrub files to remove inappropriate information or notes. One fiduciary litigator says that he has reviewed files of corporate trustees in preparing for litigation and discovered embarrassingly ugly notes about difficult beneficiaries in the administrator's notes.

TRUSTEE EXERCISE OF DISCRETION

32. Administering Distribution Standards

a. ***Different Standards for Different Trustees.*** Distribution powers may be bifurcated. For example, beneficiary-trustees will be limited by a health, education, maintenance and support (or "HEMS") standard, but other trustees may have broader distribution standards. The client may be unwilling, however, to give a corporate trustee an absolute discretion standard.

b. ***Absolute Discretion.*** Absolute discretion does not mean *absolute* discretion — the trustee still owes fiduciary duties, even if the instrument says the trustee has the same discretion as if the trustee owned the assets individually. Courts will generally uphold the trustee's decisions under an absolute discretion standard. The trustee is entitled to a presumption of good faith. Possible court intervention may occur if there is bad faith on the trustee's part or disregard of the trust purposes. A good litigator will argue bad faith but probably cannot succeed unless the trustee has taken egregious actions. A challenger has a heightened bar to overturn the trustee's exercise of "absolute" discretion.

c. ***Broader Standard Than HEMS Standard.*** Some clients may be unwilling to give complete discretion to an independent trustee. If beneficiaries are not trustees, using a broader standard than a HEMS standard may provide helpful flexibility. For example, the trust agreement may authorize distributions for the "best interests" of the beneficiaries. Actions taken under a broad distribution standard are subject to judicial review but generally merely to correct for an abuse of discretion considering the trust terms and settlor intent.

d. ***Above Subsistence Level.*** A support standard means something above a mere subsistence level of support.

e. ***May vs. Shall.*** Panelists believe that a HEMS standard comes within the exception of §2041 whether the instrument directs that the trustee "may" or "shall" make distributions for HEMS purposes. *See* Estate Planning and Administration Group of Schiff Hardin LLP, *What Language Should Be Used to Avoid a General Power of Appointment Over a Trust?,* 36 EST. PL. 40 (April 2009).

f. ***"As May Be Needed."*** An instrument may direct that distributions be made "as may be needed" for various purposes. The beneficiary may then come to the trustee with reasons that a distribution is needed and argue that the instrument requires that the distribution be made. This language gives room to the litigator to pressure the trustee to make distributions. However, "needed" is in the eye of the beholder and the trustee must still make a determination of whether the distribution is actually "needed."

g. ***Considering Other Available Resources.*** The panelists believe that an ascertainable standard exists under §2041 whether the instrument directs that trustee may, shall, may not, shall not, or may but need not consider other resources.

   It is *very important* that beneficiaries understand that requiring the trustee to consider outside resources has real economic consequences and may limit the ability to make distributions.

   If the instrument directs that distributions should be made for the beneficiary's support without considering other resources, if trust assets are not used first for the beneficiary's support, the beneficiary may be deemed to have made an indirect contribution to the trust.

If a beneficiary of a trust with a HEMS distribution standard exercises an inter vivos limited power of appointment, the "considering other available resources" phrase may impact the amount of the gift that is made by the appointing beneficiary.

If the instrument provides that the trustee *may* consider outside resources, what is the trustee's responsibility to exercise due diligence to ascertain what outside resources are available? Under the literal language of the instrument, the trustee is not *required* to do so. Arguably, a duty of impartiality may in some situations indicate that the trustee should inquire about outside resources if the trust instrument gives the trustee the clear authority to do so. However, the panelists generally believe that the trustee does not have a duty to investigate outside resources if the trustee merely has the authority but not the direction to consider outside resources.

If the trustee seeks information about outside resources and the beneficiary refuses to provide information, the trustee would be justified in not making distributions to that beneficiary if the instrument or state law gives the trustee the authority to consider outside resources.

Requiring the trustee to consider outside available resources may result in a frozen trust for a long period of time. For example, if a bypass trust permits distributions only to the surviving spouse during the balance of his or her lifetime and requires the trustee to consider outside resources, the trustee may not be able to make any distributions during the spouse's lifetime (if the spouse has plenty of outside resources).

If the trust is silent about considering outside resources, state law may vary as to the result. For example, in Illinois, the trustee would not have to consider outside resources but probably would have to consider outside resources in California. As other examples, if the trust instrument is silent, the trustee is forbidden from considering outside resources in Georgia but the trustee *may* consider other resources in Virginia. The Comments and Reporter's Notes to Section 50 of the Restatement (Third) of Trusts summarizes the diversity of state law regarding the consideration of outside resources if the trust instrument is silent on the issue.

State law regarding this issue can have an effect on decanting decisions. Decanting a trust from an Illinois trust to a California trust may mean that the trustee can no longer make discretionary distributions to the surviving spouse. Decanting the trust to California in that circumstance may subject the trustee to potential liability for breaching the duty of impartiality.

h. ***Accustomed Standard of Living.*** If a trust authorizes distributions to maintain the beneficiary's "accustomed standard of living," various uncertainties arise. For example, what if the beneficiary is eight years old when the trust is created and has a restricted standard of living at that time?

i. ***"Station in Life."*** Trust agreements sometimes authorize distributions to beneficiaries in accordance with their "station in life." The meaning of that phrase is quite uncertain. For example, if a beneficiary is at the poverty level, does the trustee determine that his station in life is that he is destitute and broke, and therefore not make any distributions?

j. ***Trustee Guidance; Example of Factors That the Trustee May Consider.*** Giving guidance to the trustee about specific factors to consider will be helpful for the trustee to know the settlor's intentions as particular fact scenarios arise. Examples of factors that the trustee may consider include a beneficiary's desire to begin a profession or to buy a home. The trustee may also consider whether distributions will provide a disincentive to the beneficiary to become productive. Defending a trustee's actions is easier if the trustee has more specific guidance on which the trustee's decisions are based. A possible concern is that listing a variety of specific factors may give rise to an implication that other factors should not justify distributions.

For various sample clauses providing guidance to trustees regarding distribution intentions, see Benjamin H. Pruett, *Tales from the Dark Side: Drafting Issues from the Fiduciary Perspective* (2013) (available from the author, Pruett@bessemer.com).

k. ***Budgeting Issues.*** A beneficiary may request a higher level of distributions than can be justified. For example, a surviving spouse may tell the trustee that the deceased spouse had previously paid for a variety of things. However, the trustee may explain that if the prior level of expenditures is continued the trust run out of money during the beneficiary's lifetime. A good trustee will discuss budgeting with the beneficiaries and address a level of distributions that will allow the trust to continue on a long-term basis. One panelist cautions that if the trustee sets a budget, it should be followed.

One panelist said that he uses a "Mercedes and Chevrolet" analogy. Even though the decedent had paid for a Mercedes in the past, that may not be affordable in the future.

A primary concern is that remainder beneficiaries may allege that the trustee violated the duty of impartiality by making excessive distributions to the current beneficiary. There is also concern that even the current beneficiary may complain after the trust has run out of money.

l. ***Concern of Individual Trustees Ignoring Stated Standards.*** Individual trustees often forget that there is a document that places limits on distributions. They think they know better than anybody else what the beneficiaries need regardless what the document says. If there are individual trustees, a large part of the professional's role is educating them about their responsibility in the execution of trust.

m. ***Tax Minimization.*** The higher income tax brackets that apply to trust income above a very low threshold and the 3.8% Medicare tax may impact distribution decisions. Is tax minimization factor that may be considered by the trustee? What if the stated distribution standard is simply a HEMS standard? That depends upon the purpose of the trust. If the purpose is to minimize taxes, there may be broader authority to consider income tax effects in making distribution decisions.

n. ***Reliance on Waivers.*** If a distribution cannot be justified under the standard in the trust instrument, do not rely on waivers by trust beneficiaries to justify the distribution.

33. Structure and Process for Distribution Decisions

Providing structure and process in making discretionary distribution decisions is imperative. Following a process provides significant insulation for trustee decisions, regardless of the trustee's ultimate decision. In reviewing a particular decision, the court will consider whether the trustee has complied with the normal procedures established by the trustee for making decisions. Discretionary decisions are subject to judicial review, but the court generally just addresses whether there has been an abuse of discretion, considering the extent of the discretion, the overall trust purpose, the nature of discretionary power, the existence of external standards, the trustee's motive, and whether a conflict of interest exists. All of that is considered in determining whether a trustee acted reasonably.

Decisions regarding modest amounts are typically made directly by the fiduciary officer of a corporate trustee. Requests for more significant amounts would be made by a committee staffed with experienced officers (so called "distribution committee"). The committee will keep notes and minutes to document the decisions and rationale for decisions (without copious comments). If the fiduciary officer anticipates that a request will be denied or that a corporate trustee may be a dissenting trustee with respect to a distribution decision, the decision may be decided by the committee even if it does not involve an otherwise significant amount.

It is important that the established structure and process be followed. "The only thing worse than not having a policy or practice is having a policy or practice but not following it."

34. Loans to Beneficiaries

a. ***Possible Situations.*** Possible considerations that may suggest that loans to beneficiaries may be preferable to distributions include GST planning, creditor planning, if a particular beneficiary has plenty of outside resources, or if substantially more distributions have been made to some beneficiaries than others.

b. ***Rent-Free Use of Property.*** An analogous issue to loans is whether a beneficiary may use trust assets without paying rent. For example, if a trustee must consider outside resources, and beneficiary has substantial outside resources, the trustee may not be able to justify allowing the beneficiary to use a residence owned by the trust without paying rent.

c. ***Creditworthiness of Beneficiaries.*** A prime consideration is the creditworthiness of the beneficiary. To assist with this concern, the loan documents may authorize the trustee to charge an outstanding loan balance against the beneficiary's share of the trust upon termination of the trust. At a minimum, a beneficiary may commit to an understanding that future distributions will be used to repay the loan. (Spendthrift provisions may impact the legal enforceability of such provisions. That is why at least having a clear informal understanding and commitment from the beneficiary to have loan payments made out of future distributions is important.)

d. ***Beneficiary's Attitude Toward Loan.*** A recurring difficult issue in administering trusts is the sense of entitlement by beneficiaries. Beneficiaries may view loan proceeds as "free money" and not confront the reality of making interest and principal payments. The trustee should explain that the debt repayment process is a lesson in management and credit responsibility. If payments are not made on schedule, future distributions will be limited (or will be used to make the loan repayments).

e. ***Terms of Loan.*** A note should be used to document the loan. A market interest rate is typically used (especially if a distribution of the loan amount cannot be justified under

   the trust distribution standard). Current interest payments are typically required. The loan should not be used as a run-around a distribution standard that cannot be satisfied. Otherwise, every beneficiary will want a loan on favorable terms.

35. Facilities of Payments Clause

A "facilities of payment" clause allows the trustee to make distributions directly to a person providing goods and services to a beneficiary. This flexibility is helpful to avoid making distributions to a beneficiary and therefore subjecting those distributed assets to the beneficiary's creditors.

36. Distributions to Beneficiary's Dependents

Beneficiaries may have legal obligations to support their children. The trustee may be permitted to make a distribution to a parent-beneficiary so that the parent can support his or her child. However, being able to make the distribution directly to the younger petitioner may be preferable, so that the trust income can be taxed at that younger beneficiary's lower income tax bracket.

37. Impact of Duty of Impartiality on Distribution Decisions

a. ***Overview.*** The duty of impartiality impacts a number of decisions by the trustee, including investments, distributions, protection of the trust estate, and carrying out administrative functions. The trustee must consider the diverse beneficial interests of multiple beneficiaries. There is a tendency to make distributions to beneficiaries with the loudest voice. Trustees must be very sensitive to avoiding the "squeaky wheel" syndrome.

b. ***Priority Among Multiple Beneficiaries.*** Trust instruments should provide guidance to trustees regarding the distribution decisions with respect to the interests of multiple beneficiaries, whether current beneficiaries or successive beneficiaries. The trust instrument should address whether the trust is primarily for the benefit of current beneficiaries or whether the intent is to preserve assets for later generations. As to current beneficiaries, should the trustee give priority to some beneficiaries over others? The instrument should specify whether distributions to beneficiaries must be equal and to what extent the trustee should preserve principal for remaindermen.

c. ***Equal Distributions (or Loans)?*** Making any distribution or loan to one beneficiary should not automatically require the same distributions or loans to beneficiaries under the duty of impartiality. Having a "pot trust" creates challenges for trustees. The trustee should provide periodic accountings for beneficiaries including distributions that have been made to others. The trustee typically merely responds to requests for discretionary distributions by beneficiaries and does not have an obligation to reach out to other beneficiaries to determine if they want similar distributions.

   The issue of equal distributions can arise even if there are separate trusts. If beneficiaries learn that another beneficiary has been receiving distributions out his or her trust, the beneficiaries might want equal distributions from their respective trusts.

d. ***Equitable Not Equal.*** Impartiality means equitable, not equal.

38. Communicating Distribution Decisions

The trustee should communicate distribution decisions and explain that the decisions were made after complying with a process. The trustee will have to exercise its judgment in how much communication to provide regarding the factors that the trustee considered.

39. Best Practices for Beneficiary Requests

Beneficiaries ultimately will come to understand that they are more likely to receive affirmative decisions regarding distribution requests if the requests appropriately explain the purpose of the distribution. A distribution request should explain in detail the purpose of the request and focus on language of the trust instrument, settlor intent, and any other applicable guidelines. If the trustee is authorized or required to consider outside resources, the beneficiary should address the reasonable availability of outside assets.

In representing trust beneficiaries, tell them they need to meet with the trustee at the beginning of the trust administration. Try to work with the trustee and understand how trusts work. One panelist gives this advice to beneficiaries: "If you will cooperate with the trustee and work together with the trustee, your life can go on. The first thing you need to do is assume the trustee is your friend and try to work together with the trustee to maintain your lifestyle to the extent the trust assets permit."

Management of Trust Assets

40. General Areas of Concern Regarding Management Issues

The trustee's management duties include gaining control of trust assets, protecting assets, conserving assets for beneficiaries, and paying only reasonable expenses and fees. That must be done while avoiding conflicts of interest. Tensions may arise in balancing beneficiary requests with the trustee's fiduciary duties. Individual trustees in particular may just assume that they know what the settlor wanted and not even bother to read the trust instrument or be concerned with fiduciary duties.

41. Stay on Task; Checklists

Professional advisors must keep trustees on task in addressing management issues that arise. For both individuals as well as corporate trustees, checklists are helpful to remind the trustee of issues that must be addressed. However, checklists are just reminders of things to think about. Trustees should not get arbitrary and just "check boxes." There must be evidence that the trustees are acting in a thoughtful manner, and merely having checklists is not sufficient.

42. Brief Trust Summaries

Trustees and professional advisors may find it helpful to have a brief trust summary of each trust being administered that is readily available in the "front of the file." This is especially important if a client has a number of separate trusts.

43. Residence

A residence or vacation home as the only major asset trust is a classic trust management problem. There are no assets available to maintain the residence, and remainder beneficiaries may complain that the trustee did not preserve the trust value by maintaining the residence.

The trust may have to borrow money from other trusts to pay maintenance expenses. Life insurance payable to the trust is another possible source of funding for maintaining a residence in a trust.

44. Communication — Confront Problem Issues Head-On With Beneficiaries

The trustee first and foremost must squarely address difficult administration issues with beneficiaries. For example, if a trust owns a residence with no assets for maintenance, discuss the situation with trust beneficiaries. The intent might have been for the surviving spouse to live in the residence. Borrowing from another trust may provide sufficient liquidity, depending on the other assets and remainder beneficiaries. Try to get all parties on board with solutions.

Even if trust instruments are less than perfect, if trustees and beneficiaries can cooperate in a reasonable manner, many problems can be solved. If one beneficiary will not agree, the trustee may seek court approval and provide notice to beneficiaries who have not given their consent. (Many times they will not show up at the court hearing.) The threat of going to court, with the trust paying attorneys fees, may provide a big incentive for the beneficiaries to come to an agreement with the trustee on a solution.

45. Periodic Review; Ratifications and Consents

Ratifications and consents are not a "one shot deal." For problem situations, send a letter to beneficiaries every year reminding them of the situation and the agreed-upon course of action. (Many lawsuits arise because the plaintiff feels that he or she was left in the dark.)

There are many investment cases involving a trustee who received consent to a particular investment approach and foolishly rested on that consent for years. At least revisit the issue once a year.

46. Over-Concentration Issues

Periodic reminders about consents are particularly important for over-concentration investment issues. Even the Uniform Prudent Investor Act acknowledges that there may be cases in which diversification is not absolutely necessary (for example, if there is a special relationship with particular assets). For over-concentration situations, the trustee should repeatedly remind the beneficiaries in writing that the best course of action is to diversify and that trust assets are at greater risk if the concentration is maintained but that the beneficiaries want to keep the high concentration. If the beneficiaries get enough communications, they may eventually realize that over-concentration carries high risk and is not a great idea.

The famous New York *Matter of Dumont* case involved a trustee who held onto Kodak stock over a 20 year period while it declined in value. The trust instrument said that the trustee should not sell for purposes of diversification. Nevertheless, the trustee was held liable, primarily for the lack of process over 20 years. An earlier New York case (*Matter of Kettle*) involved the reverse situation. The trust instrument had very similar language, expressing a desire to maintain a concentration in a particular stock. The trustee nevertheless diversified, after notifying the beneficiary (who objected). The diversified portfolio did not perform as well as the concentrated stock position, and the court required the trustee to reimburse the trust. The key is communication with beneficiaries. The trustee should either obtain consents of beneficiaries or go to court and get authorization to maintain the over-concentration.

47. Insuring Trust Assets

If a trust insures assets, pay attention to the insurance policy details. For example, insurance policies for art contain many details about how the art must be handled for the insurance to remain effective.

The settlor may have not insured particular assets for years, but once the assets are in trust, the trustee cannot take that same attitude just because that is what the settlor did.

Ethics Issues

48. Ethical Issues — Summary of Potentially Applicable Model Rules

Potentially applicable Model Rules that may apply in the context of representing families in estate planning matters are the following:

Rule 1.1, the duty of competence

Rule 1.2, scope of representation (defining it and the allocation of authority between attorney and client)

Rule 1.3, duty to act diligently on behalf of the client

Rule 1.4, communications (including the issue of dormant representation of clients)

Rule 1.6, duty of confidentiality in the attorney-client relationship (and in some cases the exceptions under the Rule)

Rule 1.7, dealing with conflicts between current clients (concurrent conflicts of interest)

Rule 1.8, conflicts of interest (involving the lawyer and the lawyer's personal interest)

Rule 1.13, representation of an organization as a client

Rule 1.14, dealing with the client with diminished capacity

Rule 1.16, declining or terminating representation

Rule 3.7, the lawyer as a witness or prospective witness

Rule 4.3, dealing with unrepresented persons

Rule 5.5, unauthorized practice of law and multijurisdictional practice.

49. Conflicts of Interest Issues

a. ***Model Rule 1.7.*** Rule 1.7 of the Model Rules addresses conflicts in representing multiple concurrent clients. Representing multiple clients involving "a concurrent conflict of interest" generally is not permitted. That includes situations involving "directly adverse" interests and situations in which there is a significant risk that representing one client "will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer." However, Rule 1.7(b) permits representing multiple clients in certain situations, even if there is a concurrent conflict of interest, if "each affected client gives informed consent, confirmed in writing." Model Rule 1.7(b) provides that representing multiple clients is not permitted even with written informed consent if the lawyer will not be "able to provide competent and diligent representation to each affected client" or if the representation involves the assertion of a claim by one client against another client "in the same litigation or other proceeding before a tribunal."

   In light of the inherent limitations of when informed consents may allow representing multiple clients with conflicts, realize that it is very difficult (if not impossible) to get an iron-clad prospective waiver from clients.

b. ***Spouses.*** Joint representation of spouses is typical, with the spouses signing letters authorizing the joint representation. However, in problematic situations (such as where one spouse wants to hide an illegitimate child from the other spouse), joint representation would not be permissible even with consent.

c. ***Parents and Children.*** Because estate planning is not generally adversarial, representing multiple members of the family (such as parents and children) with their estate planning may be allowed. The ACTEC Commentaries take the position that representing multiple family members in estate planning matters may be desirable, resulting in efficiencies, decreased costs, and the ability to better integrate planning. However, there can be situations in which multiple representations would not be allowed. While there may not be current conflicts, potential future conflicts could arise.

   If a potential conflict arises about changes to one client's will in a manner that may affect the other client, that may not present a legal impediment to the representation of both clients because ABA Opinion 05-434 makes clear that a beneficiary has no legal rights to a *bequest* until after the testator dies. Therefore, if mom wants to change her will because son sold his company for zillions of dollars and she wants to leave her assets to her other children, representing both mom and the son is permitted. Even though the multiple representation is permitted, the son may feel strongly that the attorney has not been loyal to son by keeping the revision to mom's will a secret. (For example, the son may assert that he would not have made certain estate planning transfers if he had known mom had written him out of her will.)

   Other situations could arise that would prevent representation of both parties. For example, if mom wants to reform the trust or decant it to remove the son as a beneficiary, a clear current conflict exists because the son has a vested right in the current trust for his benefit.

d. ***Trustee and Beneficiary.*** Potential conflicts are more readily apparent in representing both a trustee and the beneficiary of a trust. For example, a beneficiary may want to remove the trustee at some point.

e. ***Giving Preference to One Beneficiary in Case a Future Conflict Arises.*** Can the engagement letter give preference to one client over the other if a conflict arises in the future? The ACTEC Commentaries contain sample engagement letters doing that, but there is no clear authority recognizing the effectiveness of such provisions. Typically, engagement letters involving representation of multifamily members provide that the attorney can continue representing the older generation if a clear conflict arises. As part of the waiver process, make sure that the older generation client understands and acknowledges that there is a risk that the lawyer might have to stop representing both parties if a significant conflict arises later.

f. ***Limiting Scope of Engagement to Avoid Conflicts.*** Can the scope of the representation be narrowed in such a fashion as to avoid future conflicts? For example, could the engagement letter provided that the attorney will represent the party as to general estate planning matters but not his interest as the beneficiary of trusts (if the attorney also represents the trustee)? One panelist has done that in representing estates, to make

   clear that the attorney is representing family members regarding their estate planning generally but not in their capacity as a beneficiary of the estate. The limitation on the scope of representation must be reasonable. Also recognize that there are duties of loyalty as well as avoiding conflicts. Prospective waivers may not be effective if one client later takes action that is adverse to another client.

50. Scope of Representation

a. ***Ticking Time Bomb.*** Communication with the client may disclose facts that may give rise to future legal problems if not addressed, but the client might not want to address all those problems initially. That is a ticking time bomb as the unresolved issues fester. The engagement letter should carefully limit the scope of representation to include only matters that the attorney is actively addressing. Unless the engagement letter carefully limits the scope of representation, a trap is that there will be a disconnect between client expectations and what the lawyer perceives as his or her responsibility.

b. ***Represent Self; Be Specific.*** The preparation of the engagement letter at the outset of representation is the one time that the lawyer is expected to represent himself. An attorney-client relationship may arise as to an issue either by express agreement or by implication if a reasonable person in a similar situation would have thought that the attorney was handling the matter. The engagement letter can make the scope of representation clear.

   Be as specific as possible in identifying what the attorney will and will not do. (If a dispute arises about who was responsible, juries do not like lawyers and may tend to believe the client instead of the lawyer.) Rather than just relying on the engagement letter, be careful in actually communicating with the client about what the attorney is and is not doing.

c. ***Model Rule 1.2.*** Model Rule 1.2 provides that "a lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent." Therefore, there must be a discussion with the client about the scope of representation.

d. ***Preparing Scope of Representation.*** There are three important issues to cover. (1) Determine client objectives and what the client wants the attorney to do and not do. (2) Who is responsible *among the professionals* to handle each particular issue (for example, who prepares income tax returns?) (3) Who is responsible as between the attorney and the client for various specific activities (such as funding of the revocable trust or partnership or who will obtain insurance in the name of the partnership for assets transferred to a partnership).

e. ***Engagement Letters Are Essential.*** The concept of an attorney-client relationship without a written engagement agreement is a thing of the past. Do not feel embarrassed to ask multiple clients to consent to representation of both and to waive potential conflicts that could arise.

   While engagement letters are routinely used for new clients, attorneys may have some clients they have represented for decades, before engagement letters were routinely used. One panelist is working on the preparation of letters and communication to contact prior clients about signing engagement letter

51. Competence

Model Rule 1.1 requires that a lawyer provide competent representation to a client, which requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation. That Rule is the key between the overlay of the Rules of Professional Conduct and malpractice claims. One panelist indicated that when he is involved in malpractice actions, he is always asked if the attorney fell below the standard of care and violated the Rules of Professional Conduct. The defense attorney will object that such testimony is just meant to inflame the jury. Judges generally allow testimony from expert witnesses, however, about the violation of ethical rules.

52. Communicating With Trust Beneficiaries Regarding Legal Representation

The attorney for the trustee must make clear to beneficiaries that the attorney is not their lawyer. The communication may proceed somewhat as follows: "I am not your lawyer. I will occasionally send out information about the trust administration. If you want advice regarding any trust administration issues, you should retain your own counsel." The attorney must carefully advise the trustee that the trustee has duties to beneficiaries, including the duty to inform. Lines of communication must be kept open between the trustee and beneficiaries to satisfy the duty to inform as well as the general duties of loyalty, impartiality, and fairness.

53. Identify Client

An essential element of complying with ethical rules is clearly identifying the client. The client is not necessarily the person paying the attorney's fees. For example, if the attorney represents only the husband regarding estate planning, but the wife attends all meetings, the wife might reasonably believe that the attorney represents her as well. Having clear communications with the husband in that example is not sufficient; the attorney must communicate directly with the wife to make clear that the attorney represents only the husband and the she needs her own counsel. (That may be a difficult conversation.)

54. Marginally Competent Client

What is the attorney's duty if the attorney thinks that the client's competence is marginal? A panelist described one case in which the attorney had doubts, but prepared estate planning instruments carrying out the client's desires. The attorney was subsequently sued by a disgruntled beneficiary. The court held that the attorney did the best he could under the circumstances. The court reasoned that the lawyer was not placed in the position of being judge and jury to determine the client's competence. Determining whether the client had capacity was left to the court to decide after the fact.

55. Attorney's Response If Trustee is Breaching Trust

If a trustee's attorney discovers that the trustee is clearly doing improper things resulting in a breach of trust, what should the attorney do? If it is just a matter of prudence, the attorney should not substitute his or her judgment for the judgment of the trustee, and possibly not even comment on the issue. However, if the trustee is seriously breaching the trust and the client refuses to change, the attorney should withdraw from representing the trustee, and do it in a "noisy" manner. If the trust is under court supervision, the attorney can ask for court permission to withdraw from representation, or if not, the attorney should write a letter to the trustee *and beneficiaries* saying that the attorney no longer represents the trustee.

56. Attorney's Responsbility Regarding Trust Accountings

If the attorney is preparing an accounting, the attorney will want to be comfortable with information in the accounting, including confirmation with account statements. However, if the attorney is merely mailing out an accounting that was prepared by the client, there is no duty to look beyond the information that the client prepared.

Items 57-65 are observations from a seminar by Stephanie B. Casteel and Lawrence P. Katzenstein, Charitable Tricks and Traps for the Estate Planner

57. Charitable Lead Trusts — General Features

a. ***General Description.*** A charitable lead trust (CLT) provides for annual payments to charity during the term of the trust, and at the termination of the trust the remainder passes to non-charitable beneficiaries.

b. ***Term.*** The term can be for the life or lives of one or more individuals or for a term of years.

c. ***Annuity or Unitrust Payments.*** The charitable payments may be annuity or unitrust payments. Charitable lead trusts are usually structured as annuity trusts so that anticipated appreciation will pass to family members at the termination of the trust.

d. ***Selection of Charitable Beneficiary.*** The charitable beneficiary may be set forth in the trust agreement or may be left to the discretion of an independent trustee or made by some other method beyond the settlor's control. The charitable amount may be sprinkled among several charitable beneficiaries in the trustee's discretion. Discretion over the charitable beneficiaries cannot be held by the settlor, because that would cause the trust assets to be included in the settlor's gross estate under §§ 2036(a)(2) and 2038(a)(1).

   A private foundation can be charitable beneficiary of the payment. However, the settlor cannot have control over payments from the foundation or the trust assets will be included in settlor's gross estate.

e. ***Grantor or Non-grantor Trust.*** The trust can be structured as either a grantor or a nongrantor trust. The nongrantor trust approach is typically used. The economic result is the same as if the grantor received the income each year and made a donation to charity without any percentage limitations for income tax charitable deduction purposes.

   If the trust is structured as a grantor trust, the settlor receives an upfront income tax charitable deduction for the present value of the charitable interest, but in future years, the income of the trust is taxed directly to the settlor under the grantor trust rules. (This may be helpful if the settlor has a large income in one year that the settlor wishes to offset with a charitable deduction.) If the grantor trust status of the trust is later terminated, §170(f)(2)(b) provides that the upfront tax deduction is recaptured (i.e., included in the grantor's gross income) to the extent the grantor did not recognize income equal to that amount from the trust income (even though the charity actually may receive a much larger amount). The regulations adopt a fairer position, stating that the deduction is recaptured only to the extent the charity has received less (on a present value basis) than the income tax deduction. However, the sample grantor trust CLAT form in Rev. Proc. 2007-45 adopts the harsher recapture rule contained in the Code. Therefore, the law regarding the amount of recapture is quite unclear.

f. ***Transfer Tax Advantages.*** The big advantage of the charitable lead trust from a transfer tax standpoint is that a gift tax charitable deduction is allowed for the present value of the charitable lead interest. The present value of the remainder is a taxable gift. The amount of the charitable payments can be structured so that the remainder interest has a nominal, if any, value, in which event there is no significant taxable gift when trust is created. Combined appreciation and income of the trust in excess of the §7520 rate will remain at the termination of the trust to pass to family members free any gift or estate tax.

g. ***Determining Present Value of Charitable Payments.*** The present value of the stream of charitable payments is made using the §7520 rate. As a practical matter, commercial software (such as the Tiger Tables software developed by Larry Katzenstein) is used to make these calculations.

h. ***Particularly Advantageous in Low-Interest Rate Environment.*** Charitable lead trusts are particularly advantageous in a low interest rate environment. The present value of the charitable payments is determined using the §7520 rate. In effect, if the trust assets outperform the §7520 rate, there will be value at the trust termination to pass to family members transfer tax-free.

i. ***Discounted Assets.*** It discounted assets are transferred to the charitable lead trust, but the assets produce cash flow that can be used to make the charitable payments, it is even more likely that the trust will pass significant value to family members at the termination of the trust. For example, if $1 million is contributed to a charitable lead trust with a 4% annual payout, the annual payment would be $40,000. However, if those same assets have a discounted value of only $700,000, a 4% payout would require an annual payment of only $28,000. The lower annual charitable payments mean it is more likely that value will remain at the termination of the trust.

j. ***GST Planning.*** There are complexities with allocating GST exemptions to charitable lead annuity trusts. Therefore, charitable lead annuity trusts are not helpful for GST planning.

k. ***Additional Contributions.*** Additional contributions to a charitable lead annuity trust are probably not permitted because the amount of the annual annuity payments must be determinable at the inception of the trust. *But see* PLR 200149016. Additional contributions may be made to a charitable lead unitrust (though CLUTs are uncommon).

l. ***Private Foundation Rules.*** The CLT must prohibit acts of self-dealing between the CLT and disqualified persons (§4941), excess business holdings (§4943), taxable expenditures (§4945), and jeopardizing investments (§4944). However, the excise tax on excess business holdings and jeopardizing investments does not apply if (1) the value of the charitable interest is less than 60% of the initial value of the trust property (meaning that there would be a substantial gift for the value of the remainder interest), and (2) the entire income interest and none of the remainder interest is devoted exclusively to charitable purposes. §4947(b)(2)(A).

m. ***No Commutation.*** The trust cannot authorize a commutation of the charitable interest. Rev. Rul. 88-27. However, a PLR permitted prepayment without discounting for the higher present value of the early payment. PLR 9844027.

n. ***Sample Forms.*** The IRS has published sample annotated forms for charitable lead annuity trusts (Rev. Proc. 2007-45 [inter vivos grantor and nongrantor trust forms] and Rev. Proc. 2007-46 [testamentary]) and charitable lead unitrusts (Rev. Proc. 2008-45 [inter vivos grantor and nongrantor trust form] and Rev. Proc. 2008-46 [testamentary]). The forms are not mandatory but provide a safe harbor if the trust is substantially similar to one of the published sample forms.

58. Variable Charitable Lead Trusts; "Shark Fin CLATs"

a. ***Volatility.*** In light of the historically low current interest rates (and low §7520 rates) it would seem that trust assets could outperform the §7520 rate to leave substantial value at the trust termination. However, volatility may upset that plan. Losses in early years may be hard to overcome — even if the trust on average has investment returns above the §7520 rate. The path of return is just as important as the overall amount of the return. One way of decreasing the volatility risk is to provide relatively low payments to charity in the early years. This approach actually benefits both the charity (making it more likely that the trust will be able to make the full amount of the charitable payments) as well as the remainder beneficiaries.

b. ***Variable Charitable Payouts Permitted.*** The regulations allow varying the amount of the annuity payments, because they state that the annuity amount "may be changed by a specified amount" at the expiration of a term of years or at the death of an individual. *See* PLR 201216045 (20% increasing annuity payments in testamentary CLAT). The sample forms in Rev. Proc. 2007-45 allow variable charitable annuity payments by referring to "an annuity amount that is initially stated as a fixed dollar amount or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time the trust is funded."

c. ***Shark Fin CLAT.*** A "shark fin" CLAT provides only a nominal payment each year to charity (for example $1,000 per year), with a substantial balloon payment to charity at the end of the trust term. While the regulations and sample form permit varying amounts, the IRS has not provided any specific guidance or details regarding the permissibility of such increases and has never endorsed the shark fin CLAT strategy. While there is no clear authority for shark fin CLATs, there is no authority that they cannot be used and they appear to meet the definitional requirements for qualified annuity payments. The speakers think that they work — as long as the present value of the charitable payments is ascertainable when the trust is created.

   For an excellent resource about shark fin CLATs (including the various arguments about whether they work), see Paul S. Lee, Turney P. Berry, Martin Hall, *Innovative CLAT Structures: Providing Economic Efficiencies to a Wealth Transfer Workhorse,* 37 ACTEC L.J. 93 (Summer 2011).

   An advantage of the shark fin CLAT is that it allows funding the CLT with assets (such as real estate, private equity interests, concentrated stock positions, or even life insurance) that would not have been appropriate for a traditional CLAT because they did not provide liquidity for funding annual annuity payments or because of their extreme volatility (or low value) in early years.

   If a CLT purchases a life insurance policy, it is not clear whether the split dollar rules apply. *See* Lee et. al. *Innovative CLAT Structures,* 37 ACTEC L.J. 93 at 160-161.

59. Lifetime Charitable Gifts Preferred to Testamentary Gifts

Lifetime charitable gifts are preferable to testamentary gifts, because the donor also receives an income tax deduction. In addition, the donor can have the enjoyment of seeing the charity's use of the funds during his lifetime.

If a client makes a charitable bequest in a will, consider using a power of attorney authorizing prepayment of the bequest. The agent could take steps to get the charity to sign a release that it is willing to accept a current contribution in lieu of the bequest.

If a trust provides for charitable distributions at the settlor's death, consider including a provision authorizing a trustee to prepay the bequest.

One alternative for turning a testamentary gift into a lifetime gift is to make a gift of the donor's residence with a retained life estate. At low §7520 rates, the charitable income tax deduction is very large, the gift does not affect the donor's lifestyle, and there are no complications of administering a split interest trust.

60. Private Foundation With Donor as Director or Trustee

If the donor is a director or trustee, the assets will be in the donor's gross estate, but there will be an offsetting estate tax charitable deduction. Such estate inclusion may be desirable because the foundation will have a stepped-up basis in the assets included in donor's gross estate. That is significant because there is an excise tax on investment income (including capital gains) of private foundations.

61. Estate or Trust With Charitable Beneficiaries

a. ***Section 642(c) Deduction for Charitable Distributions.*** Charitable distributions from an estate or trust qualify for a deduction under §642(c) rather than a distribution deduction.

   There are various advantages of this deduction for trusts as compared to the charitable deduction for individuals: (1) there are no percentage limitations; (2) the deduction is allowed for amounts paid to foreign charities; and (3) an election can be made to treat charitable distributions as having been made in the prior year (in effect there is a "365-day rule" rather than the normal 65-day rule that applies to complex trusts).

   Two special requirements that apply to obtain the charitable deduction under §642(c) are that (1) the distribution to charity (literally "paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)") is made pursuant to the terms of the governing instrument during the taxable year, and (2) the distribution is made from gross income. (Normally, distributions from a trust carry out the DNI whether the distribution is from income or principal. However, a distribution must be made from gross income in order to qualify for the charitable deduction under §642.)

   If the charitable distribution is not made from gross income, it would seem that the trust estate should be able to take a distribution deduction. However, two cases from the 1970s disagree. (*Mott v. United States*, 462 F.2d 512 and *Estate of O'Connor*, 69 T.C. 165). Those cases arose before there was a separate share rule applicable to trusts; perhaps the distribution deduction was denied in those cases because the effect would have been to shift almost all of the trust DNI to charity so that individual beneficiaries would have paid very little income tax when they received distributions in a later year. Those cases seem to reach the wrong result, and a future case may allow a distribution deduction.

b. ***Charitable Set-Aside Deduction, §642(c)(2).*** If an estate cannot make distributions currently (for example, because of outstanding creditors' claims, a will contest, or a pending estate tax audit), income that is accumulated for eventual distribution to charity qualifies for a charity set-aside deduction under §642(c)(2). This is a huge advantage; it keeps an estate that will ultimately pass to charity from having to pay income taxes, even if there are not current distributions of income to charity each year. This set-aside deduction is available for all estates but only for trusts created before 1969. Revocable trusts generally do not qualify for this special deduction, unless the estate makes the

§645 election to treat the revocable trust as part of the probate estate for income tax purposes.

c. ***Section 642(c) Deduction for Appreciated Property.*** If appreciated property is distributed to charity, is the §642(c) deduction allowed for the full value of the property or just the basis of the property? CCA 201042023 concludes that the deduction is allowed only for the estate or trust's basis in the property. This is probably the correct result. Otherwise the estate or trust would receive a double benefit: (1) avoidance of tax on the unrealized gain; and (2) the current income tax deduction for the gain element.

d. ***Delayed Funding of Charitable Remainder Trust.*** Deferred payments from testamentary CRTs can be delayed for a reasonable period of administration but must bear interest at a statutory rate. Rev. Rul. 82-165 and Rev. Rul. 88-81.

   Whether interest must also be paid for a deferred funding of the trust itself from the estate is not clear. The answer should be no, but some careful planners do require that. This should be a state law issue.

62. Estate Tax Apportionment

a. ***Apportionment to Charitable Bequests.*** If the residuary estate passes partially or entirely to charity and the will has a "pay all taxes from the residue" apportionment provision, will the charity bear part of the estate taxes (even though a charitable deduction is available for assets passing to the charity)? If estate taxes are apportioned to charity, an interrelated calculation is required to compute the estate taxes. Under equitable apportionment principles, the clause may be construed to apportion estate taxes only to recipients other than recipients qualifying for a charitable (or marital) deduction. Various cases have reached that result unless the will is very explicit in directing that the charity bear the estate tax. *E.g., Estate of Cohen v. Crown* (Mo. App. 1997).

b. ***Uniform Estate Tax Apportionment Act.*** The Uniform Estate Tax Apportionment Act (adopted in only 9 states) provides that unless a decedent expressly directs to the contrary, if an apportionment provision directs apportionment of the estate tax to an interest in property that passes to charity (or to a surviving spouse) and to others, the estate tax is first apportioned among the holders of the portion that does not qualify for the marital or charitable deduction. Various other states have apportionment statutes with similar provisions.

63. Curing Non-Qualifying Charitable Transfers

If estate charitable transfers do not satisfy the detailed requirements for a charitable deduction, the mistake may be correctable by either a disclaimer or a qualified reformation. The statutory reformation procedures under §2055(e) are incredibly generous, and almost any technical problem in a split interest transfer can be corrected using that procedure.

64. Impact of Pease Limition on Charitable Deduction

The phase-out of personal exemptions and itemized deductions (the "PEP" and "Pease" limitations) was reduced under the 2001 Act in steps from 2006-2010 (with a total elimination of the phase-out in 2010, extended by TRA 2010 through 2012). ATRA reinstates the phase-out (as under pre-2001 law) for individuals with *adjusted gross income* in excess of new indexed threshold amounts ($300,000 for a joint return, the indexed threshold amount would have been about $175,000 under the pre-2001 statutory provisions). Some donors have been concerned that the Pease limitation will impact the amount of charitable deduction for charitable gifts. However, most taxpayers will have other deductions that are phased out first (for example, home mortgage deductions). In effect, the taxpayer will receive a full deduction for charitable gifts.

65. Effect of Very Low Interest Rates

The current very low interest rates have various impacts on charitable planning.

- Gifts to charitable remainder annuity trusts have become almost impossible. There must be a remainder value of at least 10% and there can be no more than a 5% chance that the trust will be exhausted before it terminates. Because there is a 5% minimum payout requirement, and the actuarial tables assume that the trust will produce income only at the §7520 rate (currently 1.4%), the tables assume that the trust value will be diminishing each year. An individual has to be about age 79 to do a one-life CRAT. (The exhaustion test will not be violated if the §7520 rate is higher than the annuity payout rate.)
- If a client is receiving an annuity from a CRAT, the present value of the annuity may be significantly greater at the current low rates than when the trust was created. Consider having the client give the annuity to charity to receive a substantial large income tax deduction. (In drafting CRATs, include an exception in the spendthrift provision allowing a gift of the annuity interest to charity).
- A gift of a remainder interest in a residence is tax advantageous at very low interest rates. The retained life estate value is calculated assuming it produces an income stream equal to the low §7520 rate, so it is valued relatively low and the charitable remainder interest is valued relatively high. For example, a gift of a remainder interest in a $1 million residence 10 years ago would have produced an income tax deduction of only about $330,000, but would produce an income tax deduction currently of about $660,000.

Items 66-72 are observations from a seminar by Edward J. Beckwith and Bridget A. Logstrom Koci, Serving Charitable Boards: Legal Challenges and Ethical Pitfalls

66. Increased Scrutiny on Board Members of Nonprofit Organizations

Government scrutiny of board members of public corporations has increased significantly, in light of the Sarbanes-Oxley regulations. Similarly, many state governments are increasing their scrutiny of board members of nonprofit organizations, recognizing that these organizations control large sums of money. As an example, New York has a “Charities Bureau” to investigate nonprofit organizations. New York has even explored possible criminal sanctions as well as making civil complaints against board members.

67. General Concerns With Attorneys as Board Members

Attorneys have particular concerns when serving as board members of public as well as nonprofit corporations. Private wealth lawyers may be viewed as preferred board members because of their contacts in the business and social world and their presumed legal and non-legal skills, but the attorney who serves on the board of a nonprofit organization must understand potential hazards. This is particularly true if the attorney also represents the nonprofit organization. Many of these concerns exist for serving as board members of for-profit organizations, but the attorney may be lulled into complacency and ignore real hazards that exist in serving on the board of nonprofit organizations. These hazards can include ethics issues, such as possible loss of independence, conflicts of interest for the attorney and the attorney’s law firm, and potential loss of attorney-client privilege.

Part of the concern is that other board members may believe that the attorney-director is always wearing an attorney's and a director's hat. The lawyer was probably asked to serve on the board in part because of his or her legal skills. The concern is especially relevant for nonprofit organizations that lack the resources to hire outside counsel. The ethics rules do not absolutely prohibit an attorney from serving as director of nonprofit organizations, but the attorney must be sensitive to looming ethical issues.

The concern is so severe that speakers cautioned that attorneys should consider carefully whether to accept positions as board members of nonprofit organizations.

68. Duties and Responsibilities of Board Members of Nonprofit Organizations

Board members of nonprofit organizations owe a duty of care, duty of loyalty and fidelity, and duty of obedience.

The *duty of care* requires discharging duties in good faith. The standard of care is what a prudent person in a like position would reasonably believe under similar circumstances. Attorney-directors are held to a higher standard of an ordinary attorney as compared to other directors who are not attorneys.

The *duty of loyalty* requires that the director avoid conflicts of interest and usurping corporate opportunities, and should maintain confidentiality. Difficult conflict of interest issues can arise, as discussed below in the discussion of ethical considerations.

The *duty of obedience* is unique to directors of nonprofit organizations. This requires the director's obedience to the organization's founding principles as embodied in its corporate articles and bylaws. Various parties may sue the organization and its board members for failure to hold true to the nonprofit organization's mission.

69. Common Challenges

Some of the issues that will arise in serving as a board member will involve issues with which the attorney has little experience. These include issues involving: compensation, managing employees (human resources and employee benefit issues), conflicts, donors and their families, sponsors, lobbying, political activities, intellectual property, goodwill, providing goods and services, charitable solicitation, and even mergers and acquisitions.

As an example of challenges that may arise, if the organization leases office space (or something as mundane as leasing a copy machine) the attorney-board member may be expected to give input regarding the decision, and other board members may view the attorney as reviewing that issue from a legal standpoint as well as a business standpoint.

70. Ethical Concerns

Attorney-board members of nonprofit organizations may face an ethical minefield.

Some of the ABA Model Rules of Professional Conduct that may apply are the following:

- Rule 1.1: Competence
- Rule 1.2 (c): Scope of Representation and Allocation of Authority Between Client and Lawyer (allowing the attorney to limit the scope of representation if reasonable and if the client gives informed consent)
- Rule 1.6: Confidentiality of Information
- Rule 1.7: Conflict of Interest

In addition, the Circular 230 rules applicable to the tax practitioners include §10.29 (Conflicting Interest) and §10.33 (Best Practices for Tax Advisors).

The ethical concerns are particularly problematic if the attorney-board member also represents the organization, or represents other board members, donors, or persons who may want to oppose actions of the charitable organization.

One of the concerns under Rule 1.7 is adopting a dual role that may compromise the lawyer's independence of professional judgment. For example, should the attorney-director keep silent during board deliberations regarding actions that she opposes for fear that vocal opposition will impair her ability to represent the nonprofit organization later? Making the best businesses decisions may necessarily involve potential conflicts from a legal standpoint. The Attorney Registration and Discipline Commission of the Supreme Court of Illinois has opined that "[s]erving in a dual capacity as director and as the lawyer for a corporation has many inherent difficulties that should be avoided." The Commission warned of potential conflicts of interest under Rule 1.7, destruction of the lawyer's independence, loss of the attorney-client privilege, and potential disqualification from representation in litigation because the lawyer, as a director, may be a necessary fact witness.

Potential conflict of interest issues that could arise include whom to use as legal counsel, fee disputes, malpractice claims, and deciding whether to sue another client of the law firm (especially if the client is one of the lawyer's most significant clients). These conflicts might be ameliorated by having the attorney-director excluded from board votes on these matters and having a clear conflict of interest policy in place. However, judicial opinions addressing the dual role as board member and lawyer in the context of nonprofit corporations are sparse.

71. State Statutes Limiting Liability of Directors; Liability Policies

Many states have statutes limiting the liability of uncompensated directors and officers of nonprofit organizations. However, there will be limits to this exculpation. For example, the Illinois statute does not apply if "the act or omission involved willful or wanton conduct," which is defined as a "course of action which shows actual deliberate intention to cause harm or which, if not intentional, shows an utter indifference to or conscious disregard for the safety of others or their property." The New York statute does not apply to actions constituting gross negligence or "intended to cause the resulting harm to the person asserting such liability" (and the New York statute does not protect against actions brought by the attorney general).

An attorney-director should inquire whether the organization indemnifies the directors and assumes defense costs. Inquire whether the organization has a Directors and Officers Liability Policy and an Errors and Omissions Policy. Policy exclusions should be closely reviewed; for example, the terms of the policy may only protect actions "solely" undertaken as a director. The attorney-director must also evaluate whether legal malpractice insurance will cover activities as a director that may have legal implications.

72. Best Practices

a. ***Documents for Review Before Accepting Director Position.*** The attorney should obtain and review the organization's articles of incorporation and bylaws and the organization's mission statement, and should review policies and guidelines governing the charitable organization and the board including internal control policies. The attorney may wish to review the donor list to consider possible conflicts with existing clients.

b. ***Conflicts Check.*** Before accepting a director position, the attorney may want to perform a conflicts check to determine if the firm represents the organization, other board members, staff members, or even significant donors.

c. ***Make Clear That Not Representing Organization.*** It the attorney-board member is not representing the organization, make that clear to other board members to avoid any implication that the member is serving as the organization's lawyer. Consider sending a letter to the board members that the person is not acting as a lawyer and that if representation is needed, a separate engagement letter will describe the scope of the specific engagement. The concern is that if a legal issue arises during a discussion, and another board member looks to the attorney and says "is that right," the attorney-board member's response may raise the implication of giving legal advice to the board.

d. ***Fulfill General Board Member Responsibilities.*** All board members, including attorney-board members, should satisfy the general responsibilities including (1) reviewing financial statements, budgets, expenditures and fundraising reports, (2) preparing for and attending board meetings and otherwise being active, (3) exercising an informed vote on all issues, and (4) reserving sufficient time and energy for the board. (These tips are from an Appendix article by Lawrence Wojcik, Raj Shah and Erin Krejci.)

   Another Appendix discusses each of the following as "best practices" for nonprofit organization governance: Follow policies; Be transparent; Oversee finances; Establish a rebuttable presumption of reasonableness of compensation with the IRS; Establish an audit committee; Adopt and abide by a substantive conflict of interest policy; Use ethical fundraising measures; Establish a means for employees to report compliance concerns anonymously; Conduct board and committee self-evaluations; Ask the hard questions; Implement a system of internal controls; Define roles and responsibilities; and Assemble an appropriate board.

e. ***Voting on Minutes of Prior Meetings.*** Do not vote to approve minutes of prior meetings that the board member did not attend. Abstain from that vote.

f. ***Disputes.*** If the organization is involved in matters that might lead to legal disputes, the attorney-board member must exercise good business judgment, but also must be sensitive that comments not be perceived as legal advice. The lawyer should say that the organization should obtain separate counsel and include that recommendation in the formal minutes of the meeting.

   With respect to matters that may involve legal disputes, having detailed minutes with detailed comments from each board member is not advisable.

g. ***Technology Policies.*** Technology policies are important and should be prepared with professional input. Using a nonprofit organization's computers for personal purposes is an area that has gotten some charities in trouble. There are strong prohibitions against using charitable assets for non-charitable purposes. Using the copy machine or the telephone occasionally for personal purposes if incidental is probably ok, but be careful.

h. ***Compensation.*** Approval of the compensation package of the CEO and organization managers is a very serious manner. This is an area that has involved lawsuits against board members. There can be no private inurement, and excess compensation puts the exempt status of the organization at risk. Particular managers whose compensation is being reviewed should not be present at the time of the review by the board. Experts in compensation of managers and employees of nonprofit organizations should be consulted, considering each employee's entire compensation package.

i. ***Use of Funds For Purposes Other Than Organization's Mission.*** If an issue arises that organization funds have been used for purposes contrary to the organization's purpose, be wary. These are difficult issues. There is a balancing act between the concern of using money for an purpose different than intended by donors versus adverse publicity for the organization that may cause a loss of future contributions. At a minimum, board members should satisfy the business judgment rule that the money previously lost for the organization's mission is less than what would be lost by public acknowledgment of the issue. Make sure there are no whistleblower laws requiring reporting.

j. ***Fundraising.*** Solicitation for contributions by the law firm's clients is problematic. At the very least, when approaching clients as prospective donors make clear that the attorney is on the board of the organization. It is easier if the client is a prior donor but there is still an obligation of disclosure. At least one of the speakers is uncomfortable with an attorney-board member soliciting contributions from clients.

   If a board member is requested to solicit contributions from a particular individual who happens to be a client, the lawyer may be unable to disclose why he cannot make a solicitation from that individual without violating the duty of confidentiality to the client.

   An alternative is for the attorney-board member to provide services regarding solicitations generally, such as providing information regarding planned giving strategies available to donors, etc.

   If a client wants to make a donation to an organization of which the lawyer is a board member, at a minimum the lawyer should advise the client that he or she is on the organization's board.

   The panelists believe that an attorney-board member should not "take credit" when a client makes a donation to the charity.

k. ***Expressing Disagreement With Board Actions.*** As an example, the organization may have used a particular fund raising consultant in the past. The attorney-board member may have concern that the fees are unreasonably high, but all other board members want to continue the relationship. The dissenting board member should state his or her concern and have the minutes reflect that concern.

   What if the new attorney-board member is concerned with many actions from the past that the organization wants to continue? Will the minutes reflect that the attorney-board member is questioning everything done by the organization? The attorney-board member may consider abstaining versus voting with respect to some issues but must still be concerned that the business judgment rule has been satisfied.

l. ***Doing Legal Work for the Organization.*** As an example, assume that the organization is going to acquire additional property and requests the attorney-board member to serve as counsel for the acquisition. The panelists are uncomfortable and believe it is much preferable to use independent counsel.

   If the organization does not have the budget to pay outside attorneys, it is difficult to balance "I am not your lawyer" with the practical concern that the organization cannot afford separate representation. One alternative is for the attorney not to serve as a board member but to do pro bono legal work for the organization.

m. ***General Tips for Attorney-Board Members.*** The Wojcik, Shah and Krejci article (an Appendix to the materials) include the following as tips specifically for attorney-board members:

- Recognize that it is very difficult for a lawyer to stop being a lawyer to put on a "director only" hat;
- Clearly identify on the record, whenever possible, whether the attorney-director is acting as a lawyer or only as a director;
- Inform the board that, when acting as an attorney, the attorney represents only the organization and not the individual directors and officers;
- Keep in mind the ethical issues related to dual service and warn the organization about possible issues relating to loss of independence, conflicts of interest, and loss of the attorney-client privilege;
- Be cognizant of the possible heightened standard of care applicable to attorneys;
- Be aware of local, state, and federal laws relating to nonprofit corporations (such as laws relating to charities and fundraising);
- Discuss the directorship with law firm management prior to accepting a board position, disclosing potential risks of disqualification, conflicts of interest, loss of independence, or concerns with "necessary witness" testimony;
- Decide whether to select lawyers from the law firm to perform any legal services;
- Evaluate the lawyer's professional malpractice insurance and any risks from dual services; and
- Be aware of the existence of D&O and E&O insurance policies as well as the breadth of coverage and existence of exclusions related to dual service.

Items 73-76 are observations from a seminar by Lawrence Barth (Pennsylvania Deputy Attorney General), Professor Susan N. Gary, The Honorable Stanley R. Ott, Professor Robert H. Sitkoff, and Kurt A. Sommer, Nothing Lasts Forever – Or Does It? Perpetual Charitable Gifts Are OK, But What About Donor Intent?

73. Doctrines of Deviation and Cy Pres

Charitable trusts can last in perpetuity. Circumstances and conditions change and modifications may be necessary. This can also happen because a donor imposes restrictions on the trust that make no sense as conditions change. Two doctrines developed to allow necessary modifications.

The *deviation* doctrine applies to non-charitable as well as charitable trusts. The deviation doctrine allows a court to make changes to the administrative terms of a trust. The doctrine is based on furthering donor intent, because restrictions are modified when continued compliance would impair the accomplishment of the settlor's purpose. RESTATEMENT (THIRD) OF TRUSTS §66; UNIF. TRUST CODE §412.

The *cy pres* doctrine permits a court to modify a *purpose* restriction applicable to a charitable trust or corporation, the satisfaction of which has become illegal, impossible, or impracticable. The modification should be a new purpose "as near as possible" (the literal meaning of "cy pres") to the original purpose. RESTATEMENT (THIRD) OF TRUSTS §67; UNIF. TRUST CODE §413. (The Restatement (Third) of Trusts and Uniform Trust Code add the word "wasteful" to the types of restrictions that can be modified.)

The two doctrines are discussed as separate doctrines but in practice they are hard to distinguish. They are often merged in the cases.

The cy pres doctrine, applicable only to charitable organizations, is justified in modern times in part by the tax exemption that is afforded to charitable organization. The freedom of disposition, to implement donor restrictions, is not as well respected for charitable organizations because of the added tax subsidy afforded charitable organizations and the desire that the organization therefore serves the public interest.

74. Barnes Foundation Litigation

One of the most well publicized recent deviation cases involves the Barnes Foundation.

Dr. Albert Barnes was a chemist who invented Argyrol, which was commonly prescribed as eye drops for all newborns to prevent blindness. The invention made him very wealthy, and he bought a great number of paintings from European artists, amassing a collections of 180 Renoirs, 60 Cézannes, and a number of pieces from a wide variety of now famous artists, but the pieces were not well known when he acquired them. He assembled them into "ensembles" of paintings in separate rooms of a gallery that he built in Merion (a suburb of Philadelphia). (Some of the paintings were four and five deep up the walls, and some of the more famous works were placed near the ceiling and difficult to examine closely.) His collection was panned by the established critics and scholars in the U.S. (particularly where he lived near Philadelphia). After his collection became famous, he sought his revenge on the establishment by refusing to allow them to see it.

The Barnes Foundation was established in 1922 by trust indenture as an educational institution, not as an art gallery. Classes were open to students to observe the ensembles of paintings and to learn Barnes's theories of art aesthetics.

Dr. Barnes died in 1951, and the bylaws for the Barnes Foundation imposed a wide number of restrictions. No painting could be moved, and no paintings could be sold or added to the collection. The gallery was open to the general public only on Saturdays and only during part of the year. Entrance fees were prohibited and no "society functions" (which he described as "receptions, teas, dinners, or banquets") could be held at the gallery. The trustees could invest only in government bonds. The collection could not be loaned to other institutions.

In 1961, the court ordered that the gallery be open to the general public 2 ½ days per week to keep the Foundation's tax exempt status.

In 1988, after the last of the trustees named by Dr. Barnes died, Lincoln University took control of the management of the Foundation. Due to the severe restrictions on the Foundation (and perhaps due to less than stellar management decisions), the Foundation became impoverished (with an endowment of only about $10 million despite the fact that the art collection itself was worth many billions [yes, billions with a "b"] of dollars). For example, the Foundation did not have the funds to secure the entire gallery at once, and it opened half the gallery for two hours in the morning and the other half for two hours in the afternoons.

In the 1990s, a series of lawsuits approved further deviation from the rigid restrictions. The changes permitted the trustee to open the gallery 3 ½ days a week, to charge a $5 admission fee, to hold fundraising events in the gallery, and to have greater discretion in investing the endowment.

Later in the 1990s, the court approved a world tour of some of the priceless masterworks, netting about $17 million for the Foundation. The Foundation used much of that to modernize the gallery.

The townspeople of Merion were outraged that the Foundation had been transformed from an educational institution into an art museum drawing thousands of people in their cars, overwhelming the sleepy town. The Foundation ran into constant complaints from the town of Merion about the traffic problems.

The most recent highly publicized deviation action began in 2002. The Foundation's financial condition was so dire that the survival of the Foundation was threatened and something had to be done. Two foundations in Philadelphia promised to raise $150 million for the foundation, if the Foundation would move the gallery to Philadelphia and would expand the number of trustees on the Foundation's board. The Foundation presented to the Pennsylvania attorney general a draft of a petition requesting court approval for deviation of the restrictions to permit the changes. The attorney general reviewed the petition and the factual background and became convinced that the changes were in the best interest of the Foundation. The requests were negotiated with the attorney general — for example, the attorney general demanded that the paintings must continue to be assembled in the same ensembles as dictated by the trust agreement, to carry out Dr. Barnes intent as much as possible.

The 2002 petition requested deviation rather than cy pres, because the 1922 trust document had a "poison pill" cy pres provision stating that if the collection was destroyed or the trust became impossible to administer, the assets would be contributed to another institution located in Philadelphia or its suburbs that could carry out the purposes as near as possible. Therefore, the Foundation sought deviation rather than cy pres to avoid losing control of the collection. (The court's eventual opinion is worded in terms of carrying out the donor's intent and outlining reasons why the changes effectuate Dr. Barnes' intent.)

In January 2004, the court ruled that the gallery could be relocated if necessary, but the court was not convinced of that necessity based on the evidence that it had heard. The trustees submitted a petition, again seeking permission to make the move to Philadelphia and offering more evidence. After six days of hearings, the court authorized the move to Philadelphia in December 2004.

Several subsequent attempts have been made by various groups who were unhappy with the decision to re-open the 2004 ruling. The court has ruled in each of those subsequent cases that the petitioner lacked standing and dismissed the actions.

75. Role of the Attorney General and General Nature of Deviation Actions for Charitable Trusts, Including in Barnes Foundation Case

The court's 27-page January 2004 opinion, concluding that the evidence had not established the necessity of moving the gallery to Philadelphia, contained one paragraph, which received a great deal of publicity in the Philadelphia press, that was critical of the attorney general's approach in the litigation. The opinion presents a good lesson for attorneys planning deviation actions. The paragraph pointed out that three students were granted *amicus curiae* status, limited to exploring the impact of the proposals on the Foundation's educational goals. Otherwise, the attorney general was the only other party involved, and there was no adversarial element with parties asking hard questions to explore the alternatives:

> "Thus, the Attorney General was the only party with the authority to demand, via discovery or otherwise, information about other options. However, the Attorney General did not proceed on its authority and even indicated its full support for the petition before the hearings took place. In court in December, the Attorney General's office merely sat as second chair to counsel for The Foundation, cheering on its witnesses and undermining the students' attempts to establish their issues. The course of action chosen by the Office of the Attorney General prevented the court from seeing a balanced, objective presentation of the situation, and constituted an abdication of that office's responsibility. Indeed it was left to the court to raise questions relating to the finances of the proposed move and the plan's financial viability."

Judge Ott said that he believed the attorney general had fully vetted the transaction and was convinced the proposal was in the best interest of the Foundation. Still, the judge was the only person cross examining the witnesses, and he was left wondering what questions he had not asked. If he had been an attorney in a case like this, he could prepare detailed outlines of issues, seek evidence, conduct detailed depositions of many witnesses, etc. But he could not do that as the judge. He was frustrated that all of the information that he wanted in making this important decision was not available to him, and he needed an adversarial process to get that information.

Larry Barth, who was the representative of the attorney general's office overseeing this litigation, relayed that he was "devastated" by this paragraph in the opinion. He did understand the judge's frustration with the absence of anyone in the proceeding to present an opposite view. But Larry said that it did not occur to him to ask questions opposing his client's (i.e., the office of the Attorney General) point of view.

Professor Sitkoff observed that he did not read the paragraph as being critical of any particular lawyer in the attorney general's office, but expressing frustration with the process in which there is not a normal adversarial proceeding and there is no real adversity between the attorney general and the Foundation. In that situation the normal adversarial safeguards do not exist. That situation commonly exists in these types of actions, in which the attorney general does its vetting before the court hearing, and is not an active adversary in exploring opposing viewpoints in the hearing itself.

76. Standing Issues

In these types of actions involving modifications of charitable trusts, generally there is no individual with an economic interest that clearly has standing in the case. That leads to the concern discussed in the preceding item of having a court hearing with no opposing viewpoints (assuming the attorney general agrees with the position proposed by the trustees requesting a modification).

Concerns with relying solely on attorneys general to supervise charitable governance include (1) a resources constraint (the attorney general may not feel that it is getting the "best bang for the buck" by overseeing the daily operations of charitable organizations), and (2) a political constraint (the attorney general — almost by definition an aspiring Governor — may view securities fraud as getting much more public attention, so will devote more resources to that activity rather than charitable oversight).

The Uniform Trust Code gives standing to the donor of the charitable trust. UPMIFA does not address the standing issue. However, even granting standing to the donor provides an individual with standing only when the donor is still alive.

There have been few cases granting standing to individuals in these types of cases. A New York case granted standing to the deceased donor's estate. A concern is that charitable trusts last for a long time and deciding who should have standing is quite difficult. Allowing descendants of the donor to have standing raises other problems (not the least of which is that the descendants probably can't come to unanimous agreement if they are anything like most families).

Some attorneys attempt to draft standing provisions into charitable trust documents. However, there is little case law regarding the actual use of those provisions. Constitutional difficulties could exist if an individual does not have a legally recognizable interest. Delaware statutes recognize standing by designated persons and make standing assignable.

Could the trust protector concept be used in the charitable area to avoid the standing issue? A concern is that the person designated as trust protector does not have the funds to pay for litigation.

Item 77 is a compilation of various interesting quotations, words of wisdom, and comments from the various seminars.

77. Interesting Quotations and Golden Gems of Wisdom

a. *Perception of Attorneys*. "Clients might view lawyers not as problem solvers but as grit in the wheels of commerce." –Dennis Belcher

b. *Fundamental Principles*. Lou Mezzullo's three fundamental principles of estate planning: (1) One size does not fit all; (2) Respect the "KISS" principle; and (3) Do not let the tax tail wag the dog.

c. *Financially Dependent Children*. "Having financially dependent children will be irritating to everyone — the children as well as the parents." –Dennis Belcher

d. *Red Flags*. "When a client has a child and does not tell anyone, that's what we call a red flag." --Dennis Belcher

e. *Clients With Various Prior Lawyers*. "Realize that many others have talked to this client before about planning. Why were they not successful? Why do you think you will be any more successful?" –Dennis Belcher

f. *Pre-Nuptial Agreements*. Dennis Belcher told his fourth "pre-nup" client that the prior three ended in divorce. Several months later, the fourth called Dennis and said "you are now 4 for 4." –Dennis Belcher

g. *The American Dream*. During a debate in Congress about the home mortgage interest deduction, one Congressman said that the dream of every American is to own a home. Dick Armey responded: "No, the dream of every American is to have children with jobs and medical insurance." –Dennis Belcher

h. *Wealth*. Despair.com has a poster with the caption "All I ask for is a chance to prove that money can't buy happiness." Another: "Money can't buy love, but it can buy exotic cars and yachts. Once you have those, you'll be fighting love off with a stick." –Dennis Belcher

i. *The Great Multiplier.* "Having a great deal of money or a great lack of money exaggerates character strengths and character flaws." –Dennis Belcher

j. *Pots and Pans.* For assets with special sentimental or emotional value, the estate planning documents must have a detailed discussion of how to dispose of those assets or else there will be future problems. Dennis Belcher refers to this as a detailed "pots and pans" provision. –Dennis Belcher

k. *A Fiduciary Litigator's View of Individual Trustees.* "Individual trustees don't even know what they don't know. It's a beautiful perfect storm." –Bob Goldman

l. *Perpetuity.* "Perpetuity is a long time. Don't forget that." –Dennis Belcher

m. *Agreeing to Serve as Trustee.* Al Golden cautions individuals to be wary of agreeing to serve as a trustee. "It's not an honor, it's a job." – Al Golden

n. *Anyone Can Be Sued for Anything.* "Just because it's not a tort does not mean someone cannot sue you for 'wrongful necktie.'" –Wendy Goffe

o. *Fundraising for Charity.* The charitable fundraiser says to a prospective donor, "I have good news and bad news. The good news is that we have all of the funds that we need. The bad news is that they're in your pocket." –Ed Beckwith

p. *The Extra Mile.* Regarding providing information to beneficiaries about administration issues, "walking the line is not required. You can inform more than you have to." –Bob Goldman

q. *Compliance With Procedures.* "The only thing worse than not having a policy or practice is having a policy or practice but not following it." –Suzanne Shier

r. *Thoughtfulness.* "Arbitrariness is evil. Thoughtfulness is your friend." –Bob Goldman

s. *Tangible Assets and Diversification.* If a trust has a significant portion of the trust devoted to a tangible asset collection (such as horses, antiques, car collection, etc.), trust diversification is often an issue. Some assets can be rented or portions of an asset may be sold, but that does not always apply. "You cannot diversify a horse. (But that's not what they said at the glue factory)." –Bob Goldman

t. *Stupidity and Laziness.* "The courts are far more tolerant of stupid trustees than lazy trustees." –Ben Pruett

u. *Personal Meetings.* "We should learn to have personal meetings with beneficiaries — no matter how painful it might be." –Bob Goldman