

Chapter 6

Fiduciaries and Administrative Powers

- § 6:1 Designation of Fiduciaries
 - § 6:1.1 Selection of a Trustee
 - § 6:1.2 Formal Qualifications
 - § 6:1.3 Designation of Successor Fiduciaries; Additional Fiduciaries
 - § 6:1.4 Resignation and Removal
 - [A] Situs of Fiduciary
- § 6:2 Bond
- § 6:3 Commissions and Fees
 - § 6:3.1 Commissions of More Than Two Fiduciaries
 - [A] Drafting Under the Multiple Commissions Statute
 - § 6:3.2 Commissions of Corporate Fiduciaries
 - [A] New York Executors' Commissions Legislation
 - [B] New York SCPA Section 2312: Commissions of Corporate Trustees
 - [C] Clauses Regarding Compensation of Corporate Fiduciaries
 - § 6:3.3 Attorney-Fiduciaries
 - [A] Commissions for Attorney-Fiduciary and Employees of Attorney
 - [A][1] The Current SCPA Section 2307-a and Model Disclosure Agreement
 - [A][2] Problems Caused by the 2004 Amendments to SCPA Section 2307-a
 - [A][3] Execution Formalities for Disclosure Agreements
 - [A][4] When a Disclosure Agreement Is Not Required
 - [B] Executors' Commissions for Attorneys; Multiple Commissions
 - [C] Attorney As Beneficiary
 - [D] Calculation of Attorneys' Fees
 - [E] Legal Disbursements

	[E][4] Distinctions Between the Final Regulations and the Proposed Regulations
	[E][5] Open Issues
§ 6:9.4	Other Provisions Relating to Investments
§ 6:9.5	Lending
§ 6:9.6	Sale
§ 6:9.7	Mortgage, Lease, Repairs
§ 6:9.8	Borrowing
§ 6:9.9	Renewing Obligations; Settling and Arbitrating Claims
§ 6:9.10	Voting Rights, Reorganizations
§ 6:9.11	Distribution in Kind
§ 6:9.12	Dividends
§ 6:9.13	Amortization
§ 6:9.14	Consolidated Investments
§ 6:9.15	Services of Others
§ 6:9.16	Accumulations, Powers in Trust
§ 6:9.17	Authority After Trusts Terminate
§ 6:9.18	Administrative Provisions in Absence of Trusts
§ 6:9.19	Pourover or Decanting Powers
	[A] New York Decanting Statute
	[B] 2011 Amendments to the New York Decanting Statute
	[C] Model Pourover/Decanting Language
§ 6:10	Duties of Executors and Trustees
§ 6:10.1	The New York Model
§ 6:10.2	The Uniform Codes
Appendix 6A	Designating New York Standby Guardian
Appendix 6B	Definition of Executor and Trustee; No Bond; Accounts
Appendix 6C	Administrative Powers for Executors: Compact Alternative (Where No Trusts Are In Will)

§ 6:1 Designation of Fiduciaries

The selection of executors and trustees is a matter to which the testator must give the most serious attention. The proper discharge of the duties of a fiduciary, particularly in the case of a will that leaves property in trust, requires a high degree of diligence, loyalty, and business acumen (particularly where broad investment power is granted) as well as knowledge of and compliance with many technical rules. Furthermore, the responsibility imposed by law on a fiduciary is of the highest and strictest character, and failure to observe the requisite standards properly may result in criticism and surcharge of the fiduciary.

§ 6:1.1 Selection of a Trustee

When selecting a trustee, there are a number of characteristics that the settlor should consider. As mentioned above, a trustee should have a high degree of diligence, loyalty, and business acumen; and as

mentioned below in section 6:1.4[A], a settlor should consider the residence of the trustee, which may impact the jurisdiction of the trust. Additionally, a settlor should consider a potential trustee's willingness and availability to take on the sometimes time-consuming responsibilities of maintaining and distributing the assets held in trust.

A trustee should be able to maintain objectivity and impartiality towards the beneficiaries, which suggests that a settlor's child or other relative may not be the best choice for a trustee in situations where there is significant family discord. A trustee should also be fiscally responsible and either knowledgeable about investing or willing to seek out expert investment advisors. Lastly, reliability and good organizational skills are important characteristics for trustees to possess.

§ 6:1.2 Formal Qualifications

In New York, an infant, an incompetent, a nondomiciliary alien (except under certain circumstances) or a felon cannot serve as an executor or trustee.¹ "[O]ne who does not possess the qualifications required of a fiduciary by reason of substance abuse, dishonesty, improvidence, want of understanding, or who is otherwise unfit" is also ineligible to serve as an executor or trustee.² In addition, the court has the discretion to declare a person ineligible to act as a fiduciary if he or she is unable to read or write English.³ With regard to preliminary letters testamentary, a court may deny their issuance to named executors on the basis of a bona fide allegation of undue influence or wrongdoing.⁴ Additionally, a court has the power to appoint a temporary fiduciary where there are questions concerning the eligibility of named executors and where the appointment of such a temporary fiduciary would be in the best interests of the estate.⁵

Under the common-law doctrine of "merger," if the life beneficiary is the sole trustee, the legal estate of the trustee merges into the equitable

-
1. SCPA § 707(1)(a)-(1)(d).
 2. SCPA § 707(1)(e). *See, e.g.*, Estate of Isaacson, 2008 N.Y. Misc. LEXIS 3975, N.Y.L.J., June 23, 2008, at 35 (Sur. Ct. Kings Cnty. 2008).
 3. SCPA § 707(2). *But see* Matter of Toribio, 24 Misc. 3d 1024, 885 N.Y.S.2d 182 (Sur. Ct. N.Y. Cnty. 2009) (holding that a deceased toddler's father who could not speak English could nevertheless be awarded letters because he was a competent loving family member of the toddler and had English-speaking family members who were willing to hire an interpreter to help him).
 4. *See In re Efras*, 859 N.Y.S.2d 902, 19 Misc. 3d 1113(A) (Sur. Ct. N.Y. Cnty. 2008) (citing *In re Jurzykowski*, 321 N.Y.2d 438, 36 A.D.2d 488 (App. Div. 1st Dep't 1971); *In re Pullman*, 452 N.Y.S.2d 456, 89 A.D.2d 608 (App. Div. 2d Dep't 1982)).
 5. *See In re Estate of Lurie*, 2008 N.Y. Misc. LEXIS 3406, N.Y.L.J., June 4, 2008, at 40 (Sur. Ct. N.Y. Cnty. 2008).

life interest and the trust is converted into a legal life estate, thereby defeating the terms of the trust. In a state that has retained this rule, the life beneficiary of a trust cannot be the sole trustee of a trust for his own benefit; therefore, a co-trustee or trustees should always be provided for if the life beneficiary is made a trustee. Even in states that do not so require (New York abolished the merger doctrine by statute in 1997, for example),⁶ good practice may make that advisable.

Since a number of states have prohibitions or restrictions regarding nonresidents acting as fiduciaries, the laws of the testator's state must be consulted if he desires to name a fiduciary who is not a resident of that state.⁷

If a testator wishes to appoint a corporate fiduciary to act in a state in which it is not located or incorporated, the drafter should inquire as to whether it can and will act in that state, since specific statutory prohibitions and local court guidelines are common, particularly in southern states, for example, North Carolina.⁸ References herein to banks and trust companies are intended to be interchangeable and to include any financial institution with authority to exercise trust powers. In some jurisdictions, nonresident banks may not be so authorized.⁹

An example of a clause appointing executors and trustees follows:

Appointment of Executors and Trustees

I appoint my brother, Thomas Jones, and X Trust Company of the City of New York, Executors of and Trustees under this my Last Will and Testament. If my brother, Thomas Jones, [predeceases me or] fails [to qualify, dies, resigns,] or ceases to act [for any reason] as Executor or Trustee, I appoint my attorney, Arthur Green, as Executor and Trustee in place of my brother. I direct that my Executors and Trustees shall serve in both capacities, whether in the State of New York or elsewhere, without being required to give any bond or other security for the faithful performance of their duties as such.¹⁰

-
6. EPTL § 7-1.1.
 7. In New York, a United States citizen may act as executor or trustee upon giving bond even though objection is established that he is a nondomiciliary. SCPA § 710. A nondomiciliary alien, however, is ineligible, except in certain cases. SCPA § 707. Curiously, there is no provision directly disqualifying unbonded nondomiciliary United States citizens, as is suggested by SCPA § 710.
 8. *E.g.*, N.C.G.S. § 28A-4-2(5).
 9. *See* 2 SCOTT AND ASCHER ON TRUSTS § 11.1.6.3 (Mark L. Ascher et al. eds., 5th ed., 2010).
 10. Note that there are certain limitations on commissions regarding attorney-fiduciaries. *See* section 6:3.3, *infra*.

Any power and authority, including any discretion, conferred upon my Executors and Trustees by this will, may be exercised by such of them as shall qualify and be acting as Executor or Trustee from time to time, and by the survivors or survivor and the successor or successors of them.¹¹

§ 6:1.3 Designation of Successor Fiduciaries; Additional Fiduciaries

The contingencies that an executor or trustee may refuse to act or may not qualify for some other reason, or may seek to resign after qualification, or may die before the closing of the estate or the termination of the trust, should be considered and provided for. In any case, but particularly in the case of a small estate, if the testator wishes to appoint a trust company to act, it is advisable to consult it in advance of the execution of the will to ascertain whether it is willing to act. It may also be desirable to submit a draft of the will to the trust company for comments and suggestions. Many trust companies publish suggested forms of wills, which are of assistance to counsel.

Trust companies may also request special agreements requiring commissions, and in the large estates it may be possible to negotiate a favorable rate. Conversely, in the small estate a greater percentage fee may be a prerequisite of the trust company.

Where more than one executor or trustee is appointed, the failure of any one to qualify, or his ceasing to act after qualification, will ordinarily not create a serious problem, since the survivor or survivors may generally act without filling the vacancy, unless the will specifically directs that the vacancy must be filled.

But if, for example, a sole executor should die and no alternate is designated in the will, an application must be made to the court for the appointment of an administrator "with the will annexed," or c.t.a. Such administrator may be required to give bond, regardless of the fact that the executor was not required to give a bond. Similarly, if a sole trustee should cease to act and no alternate is designated in the will, an application must be made to the court for the appointment of a substitute trustee, who likewise may be required to give bond even though the will did not require a bond from the trustee named therein.

11. EPTL § 11-1.1(b) contains provisions on this topic in language that varies between paragraphs. Paragraph (11) thereof gives the survivor of two or more fiduciaries authority to continue to administer the property without appointment of a successor and to exercise the powers of the original fiduciaries unless contrary to the express provisions of the will. Paragraph (12) gives the successor or substitute fiduciary the powers of the original fiduciary unless expressly prohibited by the will. SCPA § 706 has a provision similar to paragraph (11).

It is permissible to provide that a vacancy among the executors or trustees may be filled by appointment by some specified person or persons. Frequently the surviving executors or trustees are authorized to fill a vacancy; and in the case of a sole executor or trustee, authority may be conferred upon such executor or trustee to name his successor, to take effect in the event of death or resignation. In default of such naming, authority to do so might be conferred, for example, upon the then adult income beneficiary, a majority of the then adult presumptive remaindermen, or a majority of the adult (grand)children. The mechanics for such appointment can likewise be provided for in the will. Such a provision can obviate the need for a bond for the successor that might otherwise apply. Preferably, the provision should require a written designation in acknowledged form to be filed in the court where the will is probated, especially where (as in New York) the fiduciary's authority arises from court-issued "letters testamentary" or "letters of trusteeship." An example of such a provision follows:

I appoint my wife, _____, my son, _____, and my friend, _____, as Executors of and Trustees under this my Last Will and Testament. I give them and the survivors and survivor of them and the successor or successors to them the right at any time and from time to time, by unanimous action, to designate a bank or trust company as an additional or successor Executor and Trustee, it being my intent that at no time shall only one individual be acting as Executor or Trustee.

If at any time there is only one individual acting as Executor or Trustee, and if such individual fails to designate a bank or trust company as additional Executor or Trustee within one month after first becoming such sole acting Executor or Trustee, or if at any time there is no Executor or Trustee acting, my then adult children or, if no adult child of mine is then living, my then adult grandchildren, may by unanimous action designate a bank or trust company as additional or successor Executor or Trustee, and in default of such designation within one month thereafter, any court having jurisdiction over my estate or any trust under this will shall appoint a bank or trust company as additional or successor Executor or Trustee, after taking into account any preference expressed by my then living adult children or, as the case may be, by my then living grandchildren.

Any such designation shall be set forth in an instrument signed and acknowledged before a notary public, and shall be filed with the court in which this will is probated; any such designation shall take effect at the time, or in the event specified in such instrument. I direct that no bond or surety or security be required of any person named, designated, or appointed as Executor or Trustee pursuant to the preceding provisions of this Article, in any jurisdiction.

Consideration should be given whether there is any legal limitation on the power to name an executor or a trustee in this manner, namely, that the appointment cannot provide that the appointee serve without bond. The purpose of such a limitation would be to protect the estate against improper conduct by a fiduciary who is not specifically selected by the testator. A 1966 amendment removed this limitation in New York.¹² Where a corporate fiduciary is appointed successor, such a fiduciary, at least in states such as New York, is not required to furnish bond.¹³

Another possible limitation may relate to the qualification of the corporate fiduciary. Although it has been common to limit the power to designate a corporate fiduciary to institutions with capital in excess of a stated amount, a more relevant limitation would be assets under management, for example, a requirement that there be at least \$10 billion under management by the institution.

If a corporate fiduciary is designated, it is helpful to include a provision, such as the following, that would permit a successor in interest to the institution to qualify automatically, without court intervention:

Any corporation resulting from any merger, conversion, reorganization or consolidation to which any corporation acting as executor or trustee under this will shall be a party, or any corporation to which shall be transferred all or substantially all of any such corporation's trust business, shall be the successor of such corporation as executor or trustee without the execution or filing of any instrument or the performance of any further act and shall have the same powers, authorities and discretions as though originally named in any Last Will and Testament; and any references in this will to the prior corporate fiduciary shall instead be deemed to refer to such successor corporate fiduciary.

§ 6:1.4 Resignation and Removal

The drafter should consider granting fiduciaries the power to resign in the instrument. Some fiduciaries may be reluctant to serve without such a provision. Moreover, an out of favor fiduciary may gracefully resign pursuant to such a power without the necessity of a litigated court proceeding to accomplish the task,¹⁴ although a pro forma

12. The amendment applies to letters issued after March 8, 1966, to executors and trustees qualifying under wills of decedents dying after May 2, 1936. EPTL § 14-1.1(b)(1)(A)(xvii).

13. See SCPA § 708(4).

14. However, not all fiduciaries will avail themselves of a graceful exit. When a will gives fiduciaries the power to resign, failure to do so despite an

application to the court for revocation of the resigned fiduciary's "letters" and issuance of new letters to his successor may be required. This is because the removal or resignation of an executor or testamentary trustee may not be effective without court approval in many states.

It has become increasingly common to include provisions allowing for the removal of fiduciaries. In determining who holds the removal power, the drafter should exercise care, since the power in the grantor or beneficiary to both remove and replace trustees could have undesirable tax consequences, especially in an insurance trust.¹⁵ In situations where an unconstrained removal power may not be suitable, the drafter should consider building in a mechanism that would remove an incapacitated trustee from office, where the trustee will not resign or is physically incapable of resigning. The trust instrument may require incapacity to be established on the basis of the opinion of one or more physicians. In order to provide for the possibility that a trustee may refuse to submit to an examination or decline to have his or her medical records released, the trust agreement can be drafted to provide that a trustee will be deemed to have resigned if an interested party (such as a co-trustee or a beneficiary) has requested the trustee to submit to a medical evaluation and the trustee fails to furnish the opinion of a physician providing that he or she is capable of acting as trustee within a specified period of time.¹⁶

Examples follow:

An executor or trustee shall have the right at any time to resign by acknowledged instrument delivered to any co-executor or trustee, as the case may be, or, if none is then acting, to the successor

acrimonious relationship with the beneficiary, resulting from a cause other than a desire to protect the beneficiary, can be grounds for removal. In *In re Atkins*, the will of the celebrated Dr. Atkins created a marital trust for his wife, Veronica, and included a provision for the voluntary resignation of the instrument's trustees. *In re Atkins*, 2010 N.Y. Misc. LEXIS 3228, N.Y.L.J., Apr. 1, 2010, at 25 (Sur. Ct. N.Y. Cnty. 2010). After a changeover in a number of the trustees, the relationship between Veronica, who was both a beneficiary and a trustee, and the other trustees became acrimonious. The court granted Veronica's request for the removal of the trustees pursuant to SCPA 711, holding that agreements granting the other trustees compensation paid by Veronica beyond that provided in the will and the degeneration of the relationship between Veronica and the trustees justified doing so. The court noted, "In view of the graceful exit open to them under the [will], the trustees' choice to remain in combat with their beneficiary can only be explained by their own financial self interest."

15. See section 5:7, *supra*.

16. See Benjamin H. Pruett, *Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective*, 35 ACTEC J. 331, 347 (2010).

executor or successor trustee, provided, however, that the resignation of any executor or trustee acting alone shall be effective only upon the appointment and qualification of a successor executor or trustee.

The individual independent trustee of any trust under this [will or trust agreement or declaration] is authorized to remove any corporation acting as a trustee of such trust with or without cause.

[A] Situs of Fiduciary

It is becoming increasingly common to use jurisdiction of the fiduciary as a criterion in the selection process. The creator can achieve nexus to the desired jurisdiction by choosing a fiduciary located within the state and locating assets and/or conducting trust activities there. The reasons for choosing a particular jurisdiction vary. A state may be chosen, for example, because it does not have a state law Rule Against Perpetuities, does not treat trusts created by non-residents as a resident trust for state income tax purposes or has minimal or no state filing requirements. Many corporate fiduciaries operate in more than one jurisdiction and recommend that the governing instrument give the fiduciary the power to resign in favor of an affiliate in another jurisdiction. Such a provision, coupled with language permitting change of trust situs, allows maximum flexibility in connection with situs selection. Two 2003 New York decisions denying requests for change of situs illustrate the importance of including express authorization if this flexibility is desired.¹⁷

The drafter must proceed cautiously in connection with planning for possible change of situs since change of governing law could produce tax or dispositive uncertainties. An example of such provisions would read as follows:

Any corporate trustee shall have the right to resign and appoint an affiliated corporation with trust powers as its successor by acknowledged instrument delivered to any co-trustee or if none is acting to such affiliated corporation, provided, however, that any resignation pursuant to this clause shall become effective only upon the acceptance and qualification of such successor corporate trustee and provided, further, that in the event of any such resignation and appointment, all of the references in this instrument to the prior corporate trustee shall be deemed to refer to the successor corporate trustee.

17. Matter of Bush, 2 Misc. 3d 744, 774 N.Y.S.2d 298 (Sur. Ct. N.Y. Cnty. 2003); Matter of William Rockefeller, 2 Misc. 3d 554, 773 N.Y.S.2d 529 (Sur. Ct. N.Y. Cnty. 2003).

My trustees are authorized to remove all or any part of the assets of or the situs of administration of any trust created under this instrument from one jurisdiction to another jurisdiction, either within or without the United States of America, at any time or from time to time and to elect that the laws of such other jurisdiction shall thereafter govern to the extent necessary and appropriate.

§ 6:2 Bond

An executor who has no trust functions is generally not required to give a bond. Nevertheless, the customary clause appointing an executor contains an exemption from any requirement to give bond. This may prove to be of value if the testator dies in a state, other than New York, that may have a contrary requirement with respect to the bond of an executor. If he so desires, however, a testator may provide that his executor shall give a bond.¹⁸ A provision in a will exonerating an executor from bond cannot take effect before the will is admitted to probate, however, and thus is inapplicable to a bond that may be required of a preliminary executor prior to admission of the will.¹⁹

A trustee is generally required to give a bond unless specifically exempted therefrom in the will.²⁰ Such exemption is customary. Some drafters favor requiring a bond, particularly where no corporate fiduciary is named by the testator, because of the protection to the beneficiaries and the supervision that may be given by the bonding company. Most drafters, however, are believed to be of contrary opinion, since the absence of bonds saves some expense and may simplify the formal qualification of the fiduciary, issuance of letters, and administration generally. The decision in any particular case must ultimately be the testator's.

An example of a provision exempting a fiduciary from the requirement to give a bond is provided in Appendix 6B.

18. SCPA § 710.

19. See SCPA § 1412(5) ("Where the will [offered for probate] is silent in respect of the filing of a bond or where it explicitly dispenses with the filing of a bond the court shall nevertheless have full and complete discretion" to require or dispense with a bond. Nevertheless, "where the will explicitly dispenses with the filing of a bond, the court shall grant such letters without bond, unless it determines there are extraordinary circumstances in the particular case to warrant filing of a bond," in which case the court has discretion to require a bond.)

20. SCPA § 806.

§ 6:3 Commissions and Fees

In the absence of any provision to the contrary in the will, the executor and trustee will be entitled to the usual commissions provided by law.²¹ If the testator wishes to limit commissions to an amount less than the statutory amount, or to require that the executor or trustee will serve without commissions, he should clearly provide in the will that such limitation or waiver of commissions is a condition of the appointment. Alternatively, he may provide that

the qualification of my Executor shall constitute his consent to the compensation set forth above and an irrevocable waiver of any right to any other compensation or commissions.

A mere direction limiting or denying compensation may be of doubtful effectiveness.²² To cover the contingency that the appointed fiduciary will decline to serve without commissions, or at less than the statutory rates, an alternative appointment should be made in the will. Many banks will not act as fiduciaries unless their compensation will meet their fee schedules.

A 2004 case is directly on point. In *Othmer*, decedent appointed two of his friends as joint executors of his estate and appointed a

21. SCPA § 2307 (fiduciaries other than trustees); § 2309 (non-corporate trustees); § 2312 (corporate trustees). The first two of those sections contain fee schedules, which have been changed from time to time, while the third refers to “reasonable” compensation. The law in other states varies as to amount of compensation (*e.g.*, whether it is to be “reasonable” or based on schedules) and procedure regarding payment.

22. However, SCPA § 2309(10) reads: “Where the will provides a specific compensation for a trustee he is not entitled to any other allowance for his services.” *Cf.* SCPA § 2312(1): “If the will . . . makes provisions for specific rates or amounts of commissions . . . for a corporate trustee, or, if a corporate trustee has agreed to accept specific rates or amounts of commissions, a corporate trustee shall be entitled to be compensated in accordance with such provisions or agreement, as the case may be.”

SCPA § 2307(5)(b) provides similarly as to other fiduciaries unless specific compensation is renounced within four months after date of letters. A bequest in lieu of executor’s commissions may not be “specific compensation” for services rendered, and thus the SCPA provision for statutory commissions upon renunciation thereof may not apply. Accordingly, a bequest in lieu of commissions should be used only after a careful exploration of the testator’s intent, which should be clearly spelled out.

It is the practice of some probate courts (*e.g.*, Surrogate’s Court, New York Cnty.) to require as a condition of issuing letters testamentary that an executor whose commissions are limited in the will file an affidavit agreeing to the limitation and waiving all rights to statutory commissions.

corporation as an alternative fiduciary.²³ Decedent conditioned those appointments on the executors signing a written statement limiting their commissions to \$800,000 total. As the estate in question was valued at approximately \$250 million, the statutory commissions would have far exceeded the stipulated amount. Only one of the executors signed the statement. However, both individuals applied for and received preliminary letters testamentary. Subsequently, the executor who had not signed the written statement petitioned the court for fees corresponding to the statutory amounts. The court held that even if the decedent's limitation on fees was against public policy, it was valid because he appointed an alternate fiduciary to serve in the event that the initial fiduciaries objected. Further, the court treated the executor's petition for letters of administration as the equivalent of a written agreement to the decedent's terms. The decision in this case highlights the importance of explicitly setting forth any desired limitations on fees and the added importance of providing for an alternate executor should the initial appointee reject those terms.

It is noted, however, that an agreement between the trustee and the beneficiary to alter commissions may be enforceable. In another 2004 case, the court approved an agreement made after the death of the grantor to increase the commissions of the trustee, when the charitable beneficiary later tried to repudiate it.²⁴ In a 2008 case, the court approved payment to the executor of an estate after all the beneficiaries and trustees consented to the payment of the executor's commissions, even though the decedent's will requested that executors and trustees shall not be entitled to receive commissions.²⁵

If the executor or trustee is a partner of the decedent, or a director, officer, or other employee of a corporation in which the decedent is interested, it may be desirable to insert a provision in the will specifically authorizing the executor or trustee to receive commissions as such, as well as to continue to receive compensation from the business.²⁶ Note also the discussion below at section 6:3.3.

SCPA sections 2310 and 2311 provide in certain situations for court proceedings for payment on account of commissions or for their

-
23. Matter of Othmer, 1 Misc. 3d 908(A), 781 N.Y.S.2d 624 (Sur. Ct. Kings Cnty. 2004), *aff'd*, 18 A.D.3d 758, 796 N.Y.S.2d 109 (App. Div. 2d Dep't 2005).
 24. Matter of Rockefeller, 2 Misc. 3d 1004(A), 784 N.Y.S.2d 923 (Sur. Ct. N.Y. Cnty. 2004).
 25. *In re Ostrer*, 23 Misc. 3d 246, 869 N.Y.S.2d 894 (Sur. Ct. Nassau Cnty. 2008).
 26. *Cf.* SCPA §§ 2307, 2309 (authorizing attorney-fiduciary to be compensated both as a fiduciary and as an attorney).

advance payment.²⁷ The order authorizing the payment “shall require the fiduciary to file a bond . . . securing its return” if payment is later disallowed, with certain exceptions. One such exception is “where the will specifically dispenses with such a bond.” If the testator wishes, such a provision can be inserted in the will.

§ 6:3.1 Commissions of More Than Two Fiduciaries

Most of the rules regarding the computations of commissions for executors and trustees of trusts created after 1956 are found in sections 2307 and 2309 of the SCPA. Pursuant to 1993 amendments, both of these sections are now explicitly made subject to the provisions of SCPA section 2313 (as amended in 1995),²⁸ which reads as follows:

Multiple commissions of executors or trustees under wills of persons dying, or lifetime trusts established, after August 31, 1993.

With respect to wills of persons dying, or lifetime trusts established, after August 31, 1993, if there are more than two executors or trustees, no more than two commissions shall be allowed unless the decedent has specifically provided otherwise in a signed writing, and the compensation thus allowable must be apportioned among the fiduciaries according to the services rendered by them respectively unless they shall have agreed in writing among themselves to a different apportionment which, however, shall not provide for more than one full commission for any one of them.

[A] Drafting Under the Multiple Commissions Statute

If the testator wishes to accept the invitation of the statute to provide that three commissions will be available rather than two, for three or more fiduciaries, the statute requires a signed writing. Either the will or a separate writing should suffice, but in order to avoid any argument that the testator did not focus on the impact of such a clause, at least in the case of an attorney-executor, the drafter should consider including a provision *both* in the will and in the statement required under new SCPA section 2307-a.²⁹ Consider the following possibilities:

-
27. As noted in section 6:3.3, *infra*, SCPA § 2111 authorizes an ex parte court application for advance payment of legal fees to an attorney-fiduciary.
 28. SCPA § 2313 (effective Jan. 1, 1994, for decedents dying, or lifetime trusts established, after Aug. 31, 1993). The reference in the section’s heading to the “multiple commissions” is potentially misleading, as the new statute only applies if there are *more than two* fiduciaries (even though two fiduciaries, unaffected by the statute, may be considered “multiple”).
 29. See section 6:3.3[A], *infra*.

For a will:

Notwithstanding section 2313 of the New York Surrogate's Court Procedure Act (SCPA), my executors and trustees shall be entitled to an aggregate compensation equal to the statutory commission of three individual fiduciaries as provided by sections 2307 and 2309 of the SCPA.

For the statement:

If there are two or more executors or trustees, for an estate or trust of more than \$100,000, under the relevant statute only two full commissions are allowed in the aggregate to be collected from the estate or trust. If there are three or more executors or trustees, however, in the case of an estate of more than \$300,000 or a trust of more than \$400,000, the current statute permits me to waive that limitation. (If there are more than three executors or trustees, no matter how large the estate, that governing statute provides for a maximum of three full commissions in any event.) In my (will) (trust), I have elected to waive the statutory limitation and provide for three full commissions to be collected for my estate and the trusts under my will. This statement is also intended to serve as an express provision waiving the statutory limitation, as required by the statute.

One question not expressly addressed by either the old or the new statute is whether the testator has the power to direct that the fiduciaries under the will be compensated more generously than the statute would permit. For example, how will a provision that four executors are each to receive a full commission be treated? What about a clause that awards one and a half, or two or more, statutory commissions to each executor or trustee?

A number of cases have upheld the validity of provisions in wills that permitted compensation in excess of the statutory rates at least where the drafter was not the fiduciary and where full disclosure was made to the testator.³⁰ It is not unlikely, however, that the taxing authorities will take the position that any compensation allowable under the will in excess of the statutory schedules constitutes a legacy, rather than compensation, and is therefore ineligible for an estate tax (or income tax) deduction as an administration expense³¹ (and will not constitute taxable compensation or income for the fiduciary except to

30. See *In re Grant*, 600 N.Y.S.2d 423, 155 Misc. 2d 819 (Sur. Ct. N.Y. Cnty. 1993); *In re Chrestensen*, 573 N.Y.S.2d 797, 175 A.D.2d 641 (App. Div. 4th Dep't 1991).

31. Treas. Reg. § 20.2053-3(b)(2) provides: "A bequest or devise to the executor in lieu of commissions is not deductible. If, however, the terms of the will

the extent that it comes out of distributable net income (DNI) like any other legacy).³² Query whether the IRS will take such a position where the testator has taken advantage of the “provided otherwise” clause of new SCPA section 2313 to permit the full three statutory commissions that have until now been allowable whenever there are more than three fiduciaries (in a large enough estate), by reason of the fact that without the testator’s act new SCPA section 2313 would have limited the executors in the aggregate to two commissions.

§ 6:3.2 Commissions of Corporate Fiduciaries

[A] New York Executors’ Commissions Legislation

Prior to 1984, corporate executors were compensated according to a statutory fee schedule. Legislation enacted in New York in 1984 changed this so that corporate trustees were entitled to “reasonable” compensation.³³ However, the new statute did not define reasonableness, and some trial-level decisions suggested that “reasonable” compensation did not permit the use of published fee schedules but rather required proof by the corporate fiduciary of the value of its services, the efforts provided, the results obtained, the amount at risk, and all of the other factors traditionally associated with fixing attorneys’ fees.³⁴ In response to this, in 1994, the Legislature enacted a new

set forth the compensation payable to the executor for services to be rendered in the administration of the estate, a deduction may be taken to the extent that the amount so fixed does not exceed the compensation allowable by the local law or practice” [emphasis supplied].

32. I.R.C. § 662.

33. See SCPA § 2312(2).

34. See *Matter of McDonald*, 138 Misc. 2d 577, 525 N.Y.S.2d 503 (Sur. Ct. Westchester Cnty. 1988), *recons. denied*, 140 Misc. 2d 49, 530 N.Y.S.2d 453 (Sur. Ct. Westchester Cnty. 1988) (where the court cited various factors that must be considered to determine reasonableness, including “(1) the size of the trust, (2) the responsibility involved, (3) the character of the work involved, . . . (4) the results achieved, (5) the knowledge, skill and judgment required and used, (6) the time and services required, (7) the manner and promptness in performing its duties and responsibilities, . . . (8) any unusual skill or experience of the trustee, (9) the fidelity or disloyalty of the trustee, (10) the amount of risk, (11) the custom in the community for allowances to trustees, and (12) any estimate of the trustee of the value of his services.” The court found that the corporate trustee bore the burden of establishing that the commissions are reasonable and that they did not present sufficient credible evidence to establish such reasonableness. In the absence of such evidence, the court permitted statutory commissions of an individual trustee pursuant to SCPA section 2312(4).).

subsection 2307(1)(f)³⁵ to the SCPA. The amendment, however, primarily addresses those cases where there is reference to the fee schedule in the will. In particular:

(f) If the will makes provisions for specific rates or amounts of commissions for a corporate executor, or, if a corporate executor has agreed to accept specific rates or amounts of commissions, or, if the will provides that a corporate executor shall receive commissions as provided or stipulated in the corporate executor's published schedule of fees in effect at such time or times such commissions become payable, including a stipulated minimum commission and asset base for calculating such commissions, a corporate executor shall be entitled to be compensated in accordance with such provisions, agreement or schedule, as the case may be, even though such provisions, agreement or schedule are not executed in accordance with the provisions required for wills and are not attested as required for the recording of deeds in this state.

It is clear that the statute in effect authorizes incorporation by reference of the published fee schedules where the will so provides. It is not clear, however, what is meant by the reference in the statute to the situation where "a corporate executor has agreed to accept specific rates or amounts of commissions." Perhaps this is intended to refer only to limitations on fees, below the rate that would otherwise be allowable. It is hard to imagine that the Legislature intended for a corporate executor to be able unilaterally to augment its fees merely by "agreeing" (apparently, even after the testator's death) to receive its own published rates, unless of course the agreement is made with the testator—but in that case the statute should have referred to the agreement of the *testator*, not of the corporate executor.

However, compensation of corporate trustees for trust years commencing on or after August 6, 1984 is generally governed by SCPA section 2312, which is discussed below in section 6:3.2[B].

Although clarification is needed, for drafting purposes it is sufficient to note that a clearly identified rate schedule can now be referred to or incorporated into the will³⁶ without fear of violating the technical requirements of the Statute of Wills.³⁷

35. 1994 N.Y. Laws ch. 474 (effective July 20, 1994). The statute does not affect compensation of corporate trustees, which is governed by SCPA § 2312, *see* section 6:3.2[B], *infra*.

36. *See* section 6:3.2[C], *infra*.

37. Codified at EPTL § 3-2.1.

[B] New York SCPA Section 2312: Commissions of Corporate Trustees

SCPA section 2312 became effective August 6, 1984 and governs the commissions of corporate trustees for all trust years commencing on or after August 6, 1984, regardless of when the trust was created. Prior to the enactment of SCPA section 2312, the commissions of corporate trustees had been governed by SCPA section 2308 or 2309, which uses a schedule to calculate commissions and which generally resulted in lower commissions than those resulting from section 2312.³⁸

Section 2312(1) allows the corporate trustee to obtain the specific commissions agreed to by the settlor. If no specific commissions were provided by the will or trust agreement, section 2312(2) allows the corporate trustee to receive “such commissions as may be reasonable” (if the trust has more than \$400,000 of principal).³⁹

Section 2312(3) allows provisions (1) and (2), which are discussed in the above paragraph, to apply to corporate trustees of charitable trusts, subject to a few conditions.

Section 2312(4)(a) establishes a floor for the compensation of corporate trustees. Pursuant to this provision, a corporate trustee is entitled to at least the compensation provided to an individual trustee pursuant to sections 2308 and 2309. If the trust is under the \$400,000 principal limit required by section 2312(2), then the corporate trustee is permitted to receive annual commissions at the rate of not more than \$12.35 per thousand of principal⁴⁰ in lieu of the compensation provided to individual trustees, which is lower.

Generally, unless the trust is a unitrust, a charitable remainder annuity trust, or a charitable remainder unitrust, the compensation provided to corporate trustees shall be paid one-third from income and two-thirds from principal (unless the trust agreement dictates otherwise).⁴¹

[C] Clauses Regarding Compensation of Corporate Fiduciaries

Most corporate fiduciaries require inclusion of compensation provisions that incorporate by reference its published fee schedule in effect from time to time. Such provisions typically include references to the bank’s minimum fees and special fees for handling unusual assets or special services. An example follows:

38. See 6-23 New York Civil Practice: SCPA § 2312.01 (2011).

39. For trusts of less than \$400,000 principal, the corporate trustee is entitled to commissions under SCPA § 2308 (for trusts created on or before August 31, 1956) or § 2309 (for trusts created after August 31, 1956).

40. SCPA § 2312(4)(b).

41. SCPA § 2312(5).

[Corporate fiduciary] shall be entitled to compensation for its services in any fiduciary capacity, including with respect to each fund held for the benefit of a minor, as provided in its regularly published schedule of compensation in effect at the time such compensation is paid, including minimum fees and additional compensation for special investments and services, notwithstanding that such stipulated compensation shall be greater than that now in effect or than that provided from time to time under applicable law, and such compensation may be paid at any time without court approval.

If the estate is unusually large and/or requires special handling, in many cases special fees may be negotiated in advance with the corporate fiduciary. If the agreement is embodied in a separate letter, the will or trust agreement should so state. In states that prohibit incorporation by reference, such side agreements may not be enforceable and should be used cautiously:

In the event that [corporate fiduciary] and the Grantor or [other person] shall have entered into a binding written agreement regarding the compensation to be paid to [corporate fiduciary] as a fiduciary under this instrument, [corporate fiduciary] shall be entitled to compensation for such services as set forth in such written agreement, and such compensation may be changed at any time by mutual agreement in writing between [corporate fiduciary] and the Grantor [or other person], or after his or her death between [corporate fiduciary] and [designated person].

§ 6:3.3 Attorney-Fiduciaries

New York SCPA section 2111 authorizes ex parte applications to the court for advance payment of legal fees of an attorney-fiduciary. It also provides that an attorney who is also a fiduciary may take advances on account of compensation for legal services rendered to the estate, without application to the court, if he has a cofiduciary who is not rendering such legal services and all cofiduciaries consent to such payment on account, or if the will permits him to take such payments on account in advance of the settlement of his account. If, pursuant to this statute, the testator wishes to enable the attorney-fiduciary to pay himself compensation on account of his legal services before his account is settled, appropriate provision therefor should be inserted in the will.

There has been a great deal of litigation, especially in the New York Surrogate's Courts, regarding attorneys functioning as executors, particularly if they or others in their firm drafted the will. A so-called *Putnam* affidavit is frequently required of the attorney to explain the circumstances under which the testator decided to name him executor.

An inference of undue influence originally arose only where the attorney-drafter received a legacy, but the requirement for a *Putnam* affidavit has been informally expanded by the clerks of some Surrogate's Courts to apply as well when the attorney is named merely executor or trustee.

In a thorough opinion, the New York State Bar Association Committee on Professional Ethics has ruled that there are few circumstances to justify an attorney's drafting a will that names the attorney both executor and residuary legatee, a combination that is more likely to lead to abuse than either a legacy or an executorial nomination alone.⁴² The opinion notes that the *Model Rules of Professional Conduct* (which have not been adopted in New York) prohibit an attorney from drafting an instrument for a nonrelative that includes a substantial gift to the attorney or a close relative of the attorney, and it sets forth the New York case law (prior to the Court of Appeals decision referred to above) at some length.

In several counties, the Surrogate's Court has also promulgated local rules on the subject; one county requires the testator's affidavit as to the circumstances that led to the selection of the lawyer as fiduciary, while in another, letters will not issue to the attorney-fiduciary unless the beneficiaries have been served with formal notice that they have the option to challenge the appointment.

In addition to concerns about the propriety of attorney-fiduciaries, fiduciaries who retain counsel with trust funds to protect their individual as opposed to estate or trust interests are cautioned that they may be subject to a surcharge if it is later determined that counsel's services were for the fiduciary's personal benefit. In *Estate of Olga Giuliano*,⁴³ the court held the fiduciary personally responsible for legal fees obtained in an unsuccessful defense against charges of misconduct raised in a contested accounting proceeding. In another case, *Estate of Frederic H. Williams*,⁴⁴ the court did not enjoin the fiduciaries from using trust funds to retain counsel, though it warned them that they could later be forced to pay a surcharge if the services rendered by counsel were for the fiduciaries' personal gain.

[A] Commissions for Attorney-Fiduciary and Employees of Attorney

After several false starts in prior years, the New York legislature in 1995 enacted a special rule dealing with the commissions for executors who are also lawyers.

42. See NYSBA Comm. on Prof'l Ethics, Op. 610 (1990).

43. N.Y.L.J., Jan. 10, 2002, at 30 (Sur. Ct. Nassau Cnty. 2002).

44. N.Y.L.J., Jan. 10, 2002, at 32 (Sur. Ct. Suffolk Cnty. 2002).

The statute was amended in 2004 and again in 2007, each time growing stricter in its approach to curb abuses in this area. Under SCPA § 2307-a as originally enacted, failure to make specific enumerated disclosures to the client limited the drafting attorney, or a lawyer “affiliated with” the drafting attorney, to executor’s commissions of fifty percent of the standard executor’s commissions allowable to anyone else. In general, these disclosures informed the testator that anyone (including a non-lawyer) is ordinarily eligible to serve as an executor, and that an attorney-executor is entitled to receive commissions in addition to fees for legal services. The 2007 amendment: (1) adds new, more detailed elements to the required disclosures, and (2) limits commissions not only of the drafting attorney or affiliated attorney, but also of any *employee of the drafting or affiliated attorney*, absent those disclosures as augmented by the amendment. An affiliated attorney is “[a]n attorney who, by reason of partnership, share holding, association or other relationship, express or implied, could participate directly or indirectly, with the attorney who prepared the will in fees for legal services rendered.”⁴⁵

[A][1] The Current SCPA Section 2307-a and Model Disclosure Agreement

The substance of the required disclosures as expanded by the 2007 amendment is embodied in two statutory models, one for use when executed prior to or concurrently with a will, and one for use when executed after the signing of the will. The disclosure must be acknowledged in writing by the testator in accordance with certain formalities (see below). The acknowledgment itself, in words that conform or substantially conform to the applicable model, is “deemed compliance”⁴⁶ with the statute.

Statutory model for use when the disclosure is set forth in a writing executed prior to or concurrently with a will (SCPA § 2307-a [3][a]):

Prior to signing my will, I was informed that:

- (i) **subject to limited statutory exceptions, any person, including my spouse, my child, a friend or associate, or an attorney, is eligible to serve as my executor;**
- (ii) **absent an agreement to the contrary, any person, including an attorney, who serves as an executor for me is entitled to receive statutory commissions for executorial services rendered to my estate;**

45. SCPA § 2307-a(8).

46. SCPA § 2307-a(4).

- (iii) **absent execution of this disclosure acknowledgment, the attorney who prepared the will, a then affiliated attorney, or an employee of such attorney or a then affiliated attorney, who serves as an executor shall be entitled to one-half the commissions he or she would otherwise be entitled to receive; and**
- (iv) **if such attorney serves as my executor, and he or she or another attorney affiliated with such attorney renders legal services in connection with the executor's official duties, he or she is entitled to receive just and reasonable compensation for those legal services, in addition to the commissions to which an executor is entitled.**

[Witness]

[Testator]

Dated: _____

Dated: _____

Statutory model for use when the disclosure is set forth in a writing executed subsequently to the will (SCPA § 2307-a [3][b]):

I, _____, have designated [my attorney, _____,] [an attorney affiliated with my attorney] [an employee of my attorney or an affiliated attorney] [a] [an] [executor] [alternate executor] [co-executor] (delete what is inapplicable) in my will dated _____.

Prior to signing my will, I was informed that:

- (i) **subject to limited statutory exceptions, any person, including my spouse, my child, a friend or associate, or an attorney, is eligible to serve as my executor;**
- (ii) **absent an agreement to the contrary, any person, including an attorney, who serves as an executor for me is entitled to receive statutory commissions for executorial services rendered to my estate;**
- (iii) **absent execution of this disclosure acknowledgment, the attorney who prepared the will, a then affiliated attorney, or an employee of such attorney or a then affiliated attorney, who serves as an executor shall be entitled to one-half the commissions he or she would otherwise be entitled to receive; and**
- (iv) **if such attorney serves as my executor, and he or she or another attorney affiliated with such attorney renders legal services in connection with the executor's official duties, he**

or she is entitled to receive just and reasonable compensation for those legal services, in addition to the commissions to which an executor is entitled.

[Witness]

[Testator]

Dated: _____

Dated: _____

The courts have strictly construed the disclosure requirements against the drafting or affiliated attorney in a number of cases. Even out-of-state attorneys may be subject to the disclosure requirements if their client is domiciled in New York.⁴⁷ The prudent drafter will therefore inform the testator of the models' contents as expanded under current law, and have the testator sign a form of acknowledgment that follows verbatim the appropriate statutory model.

[A][2] Problems Caused by the 2004 Amendments to SCPA Section 2307-a

In the first (2004) amendment to SCPA section 2307-a, a new subparagraph (iii) was added to the models which sets forth the consequences of failure to make the required disclosure. The amendment failed, however, to add a corresponding additional element of disclosure in the substantive portion of the statute. (This anomaly has been corrected in the 2007 amendment.) Although execution of an acknowledgment "substantially conforming" to the models is not expressly made mandatory and is merely "deemed compliance," a New York County Surrogate in *Matter of Tackley*⁴⁸ held that failure to include the models' new subsection (iii) was fatal to an acknowledgment of disclosure made in 2006. The *Tackley* decision was followed in *In re Will of Gurnee*⁴⁹ and *Matter of Mayer*,⁵⁰ which also involved wills executed after the 2004 amendment. All these cases limited the drafting attorney-fiduciary to one-half the commissions he would otherwise have been entitled to receive. However, the

-
47. See *In re Will of Deener*, 22 Misc. 3d 605, 867 N.Y.S.2d 912 (Sur. Ct. N.Y. Cnty. 2008) (holding that the statute applies to an out-of-state attorney, who prepared the will and was named as a fiduciary, because the client was domiciled in New York).
 48. *Matter of Tackley*, 13 Misc. 3d 818, 821 N.Y.S.2d 750 (Sur. Ct. N.Y. Cnty. 2006).
 49. *In re Will of Gurnee*, 16 Misc. 3d 1113(A), 847 N.Y.S.2d 896 (Sur. Ct. Suffolk Cnty. 2007).
 50. *Matter of Mayer*, 32 Misc. 3d 1229(A), 936 N.Y.S.2d 59 (Sur. Ct. Bronx Cnty. 2011).

Oneida County Surrogate in *Matter of Riley*⁵¹ declined to follow *Tackley* and instead awarded the attorney-executor full commissions despite the attorney's failure to include subsection (iii).

In *In re Will of Griffin*,⁵² the Surrogate held that the 2004 amendment was not retroactive, and therefore was inapplicable to a will executed before its effective date, November 16, 2004. Similarly, for a will executed before the effective date of the 2004 amendment with a codicil executed after the effective date, the court in *In re Moss*⁵³ held that the subsequent codicil did not need to contain a new SCPA 2307-a disclosure statement.

[A][3] Execution Formalities for Disclosure Agreements

Of course, for wills executed after August 31, 2007, the effective date of the 2007 amendment, the appropriate current model (see section 6:3.3[A][1] above) should be used. In order for the disclosure to be effective, that is, to avoid the statutory limitation for lawyers or their employees to a one-half commission, a number of formalities must be observed. Not all of the requirements are evident from a literal reading of the current statute or its earlier versions, and the drafter must take care to avoid pitfalls.

First, the testator must sign the written acknowledgment of the disclosure in the presence of at least one witness other than the executor-designee. In a 2008 case, the Surrogate's Court of Kings County held that the signature of a witness is an essential component of the acknowledgment and, without such a signature, the attorney-executor is not entitled to the full statutory commission.⁵⁴ It may be helpful to set up the form for signature by the same number of witnesses who sign the will as attesting witnesses, certainly two, and possibly three. This will avoid the risk that the one witness who signs happens to be (through error) the very attorney or employee who is named as executor, which would invalidate the acknowledgment disclosure form.

What if the witness is not the person named as executor but is affiliated with that person, as a partner or employee? In *In re Hess*⁵⁵

51. *Matter of Riley*, 29 Misc. 3d 1059, 908 N.Y.S.2d 534 (Sur. Ct. Oneida Cnty. 2010).
 52. *In re Will of Griffin*, 16 Misc. 3d 295, 834 N.Y.S.2d 653 (Sur. Ct. Nassau Cnty. 2007).
 53. *In re Moss*, 21 Misc. 3d 507, 863 N.Y.S.2d 588 (Sur. Ct. N.Y. Cnty. 2008).
 54. *In re Estate of Wroblewski*, 2008 N.Y. Misc. LEXIS 3417, N.Y.L.J., June 4, 2008, at 41 (Sur. Ct. Kings Cnty. 2008).
 55. *In re Hess*, 21 Misc. 3d 507, 863 N.Y.S.2d 588 (Sur. Ct. N.Y. Cnty. 2008).

(a companion case to *In re Moss*), the SCPA 2307-a disclosure statement was witnessed by the lawyer who had drafted the will and who was a partner of the lawyer nominated as co-executor. The court held that the disclosure statement was not duly witnessed because of the affiliation between the witness and the nominated executor. On the other hand, in *Estate of Beybom*,⁵⁶ the form bears the signature and stamp of a notary, who is an attorney affiliated with the draftsperson-executor. The court first determined that “having a notary act as a witness may, in fact, further insure the genuineness of the signature.” The court then went on to examine at what point a witness is no longer disinterested and determined that the statute does not set forth any standard of relationship or affiliation that would disqualify a witness (other than if the nominated executor was the witness) and that it would be impractical for a law firm to have to hire a stranger to sign a SCPA 2307-a disclosure form. The *Beybom* opinion offers a practical view of the witnessing requirements—it would be quite cumbersome to bring in a witness off the street just for the SCPA 2307-a disclosure form when all other documents (including the will itself, trust agreements, powers of attorney, and health care proxies) can be witnessed by those working in the drafter’s office.

A new disclosure acknowledgment should be executed every time the testator executes a will where a named executor (including a co-executor, alternate executor, or successor executor) may be subject to the statute. An acknowledgment of disclosure relating to one will has been held insufficient to satisfy the disclosure requirements with respect to a later will,⁵⁷ despite a provision in the statute authorizing execution of the acknowledgment “*prior to, concurrently with or subsequently to*” such a will.

The acknowledgment must be filed in the Surrogate’s Court “in the proceeding for the issuance of letters testamentary to the executor-designee”⁵⁸ (ordinarily, the probate proceeding).

Additionally, the disclosure acknowledgment must be made in an instrument separate from the will, although it may be annexed to the will, but it may not be in the body of the will. The express requirement for the separate instrument first appeared in the 2004 amendment to the statute. Previously, the courts had been divided on the question of whether a statement of disclosure in the body of the will was

56. *Estate of Beybom*, 33 Misc. 3d 1211(A) (Sur. Ct. Suffolk Cnty. 2011).

57. *Matter of Karlan*, 11 Misc. 3d 1067(A), 816 N.Y.S.2d 696 (Sur. Ct. Nassau Cnty. 2006) and unpublished decisions cited therein.

58. SCPA § 2307-a(2).

necessarily defective.⁵⁹ The Sponsor's memorandum in support of the 2004 amendment states that it was meant to clarify the original version of the statute. By implication, it was not meant to alter prior law. Where possible and practical, even for wills executed prior to November 16, 2004, the effective date of the first amendment, the testator should be asked to sign a new separate disclosure statement if it was previously made in the body of the will.

Lastly, consideration must be given to the applicable date of each amendment. The law enacting the 2007 amendment states, "This act shall take effect on the thirtieth day after it shall have become a law and shall apply to all wills executed on or after such effective date [that is, August 31, 2007]."⁶⁰ This language has been interpreted to preclude retroactivity of the 2007 amendment,⁶¹ despite the fact that the amendment leaves unchanged the original language in the body of the statute providing, "This section shall apply to wills executed on or after January 1, 1996 and, irrespective of the date of any will, to estates of decedents dying after December 31, 1966."⁶² Presumably, the specific language of the enacting statute limiting its application to wills executed after August 31, 2007 will control.⁶³ Nevertheless, as discussed above, for wills executed between November 16, 2004, and August 31, 2007, the disclosure acknowledgment should include the language in subparagraph (iii) of the 2007 models despite its omission from the operative part of the previous version of the statute.

In the case of multiple executors, it would be prudent to add the additional acknowledgment in *supra* section 6:3.1[A]. Even with that acknowledgment it appears that some courts may not allow attorney-drafters (or their affiliates or their employees) to serve as one of multiple fiduciaries without a special showing (at a hearing) as to why the testator made such a designation. Indeed, the 2007 amendment to SCPA section 2307-a includes a new provision that compliance with the required disclosure "creates neither the presumption nor the inference" that the designation of such an individual as executor is proper.⁶⁴ See also the discussion below in section 6:3.3[E].

59. Compare *In re Estate of Pacanofsky*, 186 Misc. 2d 15, 714 N.Y.S.2d 433 (Sur. Ct. N.Y. Cnty. 2000) (suggesting that a separate document is required), with *In re Estate of Winston*, 186 Misc. 2d 332, 717 N.Y.S.2d 879 (Sur. Ct. Bronx Cnty. 2000) (suggesting that the disclosure can be made in the will itself).

60. 2007 N.Y. Laws ch. 488.

61. *In re Will of Winters*, 25 Misc. 3d 631, 632, 883 N.Y.S.2d 703 (Sur. Ct. Broome Cnty. 2009).

62. SCPA § 2307-a(9)(a).

63. See also *In re Will of Griffin*, *supra* note 51.

64. SCPA § 2307-a(4)(b).

[A][4] When a Disclosure Agreement Is Not Required

For wills executed before January 1, 1996, the Surrogate's Court has authority to waive application of the disclosure requirements of SCPA section 2307-a "for good cause shown," which may include the following:⁶⁵

(A) a good-faith effort after the enactment of this statute either to make to the testator the disclosure required by subdivision 1 of this section or obtain from the testator a written acknowledgment substantially conforming to that set forth in paragraph (b) of subdivision 3 of this section, or

(B) otherwise establishing to the satisfaction of the court reasonable grounds to excuse the absence of a written acknowledgment substantially conforming to that set forth in paragraph (b) of subdivision 3 of this section; . . .

In making the requisite showing to the Surrogate's Court, the evidentiary bar known as the Dead Man's Rule,⁶⁶ which ordinarily might prohibit the attorney from testifying on his own behalf regarding communications with the decedent, is explicitly made inapplicable.⁶⁷ In practice, however, many of the courts have been quite skeptical of representations by the attorney, after the client's death, as to attempts to comply with the statutory notification requirements.

There are some instances where a waiver of the 2307-a disclosure requirement has been accepted. In one case,⁶⁸ a woman orally acknowledged the fact that her attorney/fiduciary would be entitled to both commissions and attorneys' fees and reaffirmed her will without signing a disclosure statement. The original will had been drafted in 1981 by the attorney/fiduciary who had since retired. The new attorney reviewed her will with her while she was in the hospital but not apparently critically ill, and he specifically told her that the attorney/fiduciary would be entitled to both commissions and attorneys' fees. The testatrix suddenly died five days later without having signed a disclosure statement. The Surrogate decided that based on those facts the waiver was proper. Two other similar cases in Suffolk County⁶⁹ involved testators who had executed their wills prior to the enactment of SCPA section 2307-a. The attorney/fiduciary in both cases lost contact with testator until the attorney was notified that

65. SCPA § 2307-a(9)(b)(iii).

66. N.Y. C.P.L.R. § 4519.

67. SCPA § 2307-a(9)(b)(iii).

68. *In re Smith*, N.Y.L.J., Nov. 28, 2000, at 29 (Sur. Ct. Nassau Cnty. 2000).

69. *In re Kauffman*, N.Y.L.J., Mar. 15, 1999, at 34, col. 1 (Sur. Ct. Suffolk Cnty. 1999); *In re Roth*, N.Y.L.J., Dec. 4, 1998, at 38, col. 6 (Sur. Ct. Suffolk Cnty. 1998).

testator had been hospitalized or was deceased. Both decisions excused the absence of the disclosure agreement under those circumstances.

In another New York case,⁷⁰ the Surrogate ruled that the waiver was not proper. In this case the will was executed in 1982. When the attorney became eligible to serve as successor co-executor in 1999, the testator was in poor health and became upset when asked about signing documents, including the disclosure statement. However, the attorney testified that the testator was aware that the attorney would receive both a commission and legal fees and would have eventually signed the acknowledgment. The testator then died, and the Surrogate ruled that there was no good cause for waiving the disclosure requirements of section 2307-a when the failure to sign was the result of the attorney's decision. It was the attorney's decision not to review the wills upon the enactment of section 2307-a and it was his decision to wait for a better time for the testator to sign the disclosure.⁷¹ The fact that the testator knew about separate fees and commissions also did not constitute good cause. Therefore, the court limited the attorneys' fees to one-half of the statutory commissions.

In 2002, the disclosure requirements of CPLR section 2307-a were waived by the Surrogate where the will was executed more than twenty years before the decedent's death (and fifteen years before 2037-a was enacted), when the decedent was living in Connecticut. The drafter was not a New York lawyer and practiced in a state that has no counterpart to the 2307-a disclosure requirements. Because the will was not originally intended to be probated in New York, met all the requirements of the state in which it was executed, and the drafter had no reason to be aware of New York law, the statutory disclosure requirement could be waived.⁷²

In *Will of Winters*, the Surrogate established a different standard regarding waiver for employees to whom the act applies. In finding good cause for a legal secretary's failure to make the disclosure, the Surrogate noted that "courts have generally held that for an attorney, good faith means he tried to make the required disclosure," because an attorney, unlike a legal secretary, must be familiar with changes in the law. While "a legal secretary may have some familiarity with the law, [he or she] is not expected or required to have the same knowledge of the law as an attorney."⁷³

70. *In re Katz*, N.Y.L.J., Mar. 26, 2001, at 30 (Sur. Ct. Kings Cnty. 2001).

71. *See In re DeMontagut*, 178 Misc. 2d 521, 679 N.Y.S.2d 273 (Sur. Ct. Bronx Cnty. 1998) (no good cause to waive absence of disclosure statement where failure to make the disclosure was attorney's decision).

72. *Matter of Estate of Newell*, N.Y.L.J., June 6, 2002, at 27 (Sur. Ct. Suffolk Cnty. 2002).

73. *In re Will of Winters*, 25 Misc. 3d 631, 633, 883 N.Y.S.2d 703 (Sur. Ct. Broome Cnty. 2009).

The ability of beneficiaries to waive compliance with the statute has been questioned. However, it has been held that the limitation on commissions may be avoided if the beneficiaries who bear the expense of the commissions give their informed consent to full payment.⁷⁴ Such consent should clearly reflect the beneficiaries' understanding of all the elements of the disclosure required to be made to a testator, including the consequences of failure to disclose.

[B] Executors' Commissions for Attorneys; Multiple Commissions

In a New York Appellate Division case predating SCPA section 2307-a (described in section 6:3.3[A] *et seq.* above) but still highly instructive, the court sustained the determination of the Surrogate that the drafter of the decedent's will failed to inform him of the financial consequences of inserting a clause in the will that granted commissions to the executors in connection with certain property that was not otherwise subject to commissions pursuant to SCPA section 2307.⁷⁵ He also did not inform the testator of the financial impact of this clause as applied to three co-executors, or of his own "duplicate" charges in the form of executor's commissions and legal fees.

As a consequence, the court denied any executor's commissions to the drafter in his capacity as executor. Another of the three executors was a bank "which claims to have had no knowledge of the enhanced commission clause." The court found that it would be "inequitable" to permit this co-executor "to benefit from a co-executor's wrongdoing by retaining commissions of almost twice the statutory amount." Thus, the enhanced-commission clause was given no effect in calculating the bank's commissions. The challenge was brought in this case by the third co-executor, "who was also the testator's husband and primary beneficiary." He was permitted to assert fraud in the preparation of the will long after the probate proceeding had been concluded and, indeed, during the final executorial accounting.

As an additional sanction, the Appellate Division upheld the Surrogate's denial of legal fees to the two law firms of which the drafter was a partner for any services rendered in connection with the administration of the estate. The court characterized the drafter's conduct as a "fraudulent scheme [that] occurred while he was a partner acting in the ordinary course of business of each law firm and, therefore each law firm is liable for the attorney/drafter's misconduct to the same extent as he

74. Matter of Brokken, 12 Misc. 3d 244, 820 N.Y.S.2d 419 (Sur. Ct. N.Y. Cnty. 2006).

75. See Matter of Klenk, 612 N.Y.S.2d 220, 204 A.D.2d 640 (App. Div. 2d Dep't 1994).

is.⁷⁶ The decision determined that the drafter/executor had violated the Code of the Professional Responsibility in connection with the drafting of the will and was therefore not entitled to legal fees for *any* services rendered in connection with his duties as executor. In view of the violation of the disciplinary rule, his law firms were likewise not entitled to any legal fees.

The decision makes it clear that more is at stake when a drafter is named as an executor than even the one-half of a commission jeopardized by incomplete disclosure under new SCPA section 2307-a, described above. The court has the power, in appropriate circumstances, to deny all commissions; to deny all legal fees to the executor; to reduce the commissions of other executors; and to deny the drafter's law firms any fees at all, no matter how much their services might otherwise have justified compensation. In this case, there appeared to be no act of fraud, but merely a failure to disclose to the testator the financial impact of a single clause—enlarging the commission base—on the commissions allowable to the executors.

For further discussion of the ethical duties of drafters asked to name themselves as fiduciaries, see section 8:2 (and especially section 8:2.1[A]) *infra*.

[C] Attorney As Beneficiary

In another case from New York's highest court, a client told her lawyer that she wanted to leave him part of her estate.⁷⁷ He advised her to use another lawyer to prepare the will and he scrupulously refrained from recommending anyone: he sent her instead to the bar association referral service.

The lawyer made what turned out in retrospect to be a crucial mistake, though: he prepared a thorough memo of the client's assets and beneficiaries (including himself), largely on the basis of which the new lawyer drew the will. Critically, the new lawyer did not consult with the client, and even though the first lawyer recommended a substantial legacy to the client's sister, when the final will disinherited the sister she sued to set it aside.

The case turned on the extent to which the lawyer/beneficiary had rebutted the inference of undue influence that arises when a client leaves a bequest to her lawyer. The Court of Appeals remanded to the courts below for further factual findings.

Surely the lawyer/beneficiary regrets the problems caused in part by the failure of the new lawyer to act as independent counsel, which

76. *Id.* at 222.

77. *See In re Henderson*, 80 N.Y.2d 388, 605 N.E.2d 323, 590 N.Y.S.2d 836 (1992).

would have solved his problem. It is hard to fault the first lawyer from trying to help his client and her new lawyer by preparing the memo, yet that, too, contributed to the continuation of the litigation.

For further discussion of the ethical responsibilities of drafters asked to name themselves as beneficiaries, see section 8:2 *infra*.

[D] Calculation of Attorneys' Fees

Several decisions continue the traditional focus on attorneys' fees. When rendering services on behalf of a party that lacks standing to object to probate, such as pets, attorneys should be forewarned that those services may not be compensable from the decedent's estate and may be considered voluntary. In *Will of Doris Duke*,⁷⁸ a New York County Surrogate was requested to fix the legal fees of the attorney for the legatees under the decedent's will for services performed in connection with the administration of her estate, the probate contest related to her will, and the creation of a pet trust for the decedent's dogs. The executor and residuary beneficiary of the estate objected, asserting that the work performed did not benefit the estate and was done voluntarily, excluding the creation of the pet trust. The court held that the attorney's services in connection with the probate contest were undoubtedly beneficial to the estate, but where services are performed on behalf of a party, however necessary, who has no standing to object to probate, those services are voluntary. Thus, those services will not be compensable from the estate except to the extent that such services involve the appointment of the estate fiduciary. The court therefore reduced the attorneys' fees accordingly.

In a much publicized 1995 decision, a New York County Surrogate fixed the fee for the lawyer for Andy Warhol's executor at \$7.2 million.⁷⁹ The court described the circumstances under which a retainer agreement between an executor and his attorney would be upheld. The decision lists numerous factors pertinent both to the fixing of attorneys' fees in general and, in dicta, the enforceability and the validity of retainer agreements in particular.

The fatal flaw with the Warhol retainer agreement is that it provided for a flat percentage fee for the attorney, with no downward adjustment in the percentage if the estate should prove to be significantly more valuable than initially estimated. In fact, at least in part due to the efforts of the lawyer (as described in the decision), the estate proved hundreds of millions of dollars more valuable than originally thought (or feared).

78. *Will of Doris Duke*, N.Y.L.J., Jan. 9, 2002, at 18 (Sur. Ct. N.Y. Cnty. 2002).

79. *See In re Estate of Warhol*, 629 N.Y.S.2d 621, 165 Misc. 2d 726 (Sur. Ct. N.Y. Cnty. 1995).

Although the Surrogate declined to enforce the agreement as written, she did use it as a guideline and in the end awarded a quantum meruit fee in excess of seven million dollars—less than requested, but more than proposed by the residuary legatee, a private foundation.

The Appellate Division reversed.⁸⁰ According to the appellate decision, the Surrogate was correct in considering the time spent, the difficulties encountered, the nature of the services rendered, the amount involved, the professional standing of counsel, and the results obtained, but the Surrogate improperly considered services that were executorial in nature, for which a lawyer may not be paid by the estate (nothing bars the executor from paying fees for these services out of his own pocket).⁸¹ The fee translated to an excessive hourly rate and part of the fee award impermissibly compensated the lawyer for his costs in defending his fee.⁸² The court reduced the fees to \$3.5 million.

[E] Legal Disbursements

Lower courts in New York are inconsistent in their approach to the allowance from estate funds for attorneys' disbursements. The traditional rule, at least in New York, has been to disallow reimbursement of disbursements regarded as normal office overhead. This rule evolved during an era when fees generally were set so as to cover all but extraordinary disbursements such as court filing fees, deposition transcripts, and the like, which were billed separately and typically allowed.

For many years, however, it has been the practice of a number of firms, particularly large urban firms, to "unbundle" their compensation so that fees are set to cover fixed costs. Expenses that are used to a different extent by different clients are charged to the clients who use them. The validity of this unbundling process was accepted in a 1994 New York Surrogate's Court decision, *Matter of Aitken*,⁸³ that allowed reimbursement for items certified by the law firm as not taken into account in computing billing rates. Surrogates in other New York cases have declined to follow *Aitken*, at least insofar as its rationale "shifts the determination of what constitutes non-reimbursable overhead from the court to the attorney seeking reimbursement."⁸⁴ These cases

80. See *In re Estate of Warhol*, 637 N.Y.S.2d 708, 224 A.D.2d 235 (App. Div. 1st Dep't 1996).

81. *Id.* at 709–10.

82. *Id.* at 710.

83. *Matter of Aitken*, 160 Misc. 2d 587, 610 N.Y.S.2d 436 (Sur. Ct. N.Y. Cnty. 1994).

84. *Matter of Herlinger*, N.Y.L.J., Apr. 28, 1994, at 29 (Sur. Ct. N.Y. Cnty. 1994). See also *Estate of Corwith*, N.Y.L.J., May 3, 1995, at 35 (Sur. Ct. Nassau Cnty. 1995).

allow reimbursement for certain out-of-pocket expenses, while others continue to disallow all traditional office overhead costs.⁸⁵

Citing lack of empirical evidence that unbundling compensation results in lower billing rates to clients, Governor George Pataki vetoed a bill in 2002 that would have specifically allowed for reimbursement of certain expenses incurred in connection with the administration of estates.⁸⁶ Thus, the nature of disbursements that may be reimbursed continues to vary from court to court.

§ 6:3.4 Deductibility of Investment Advisory Fees

As of August 2004, there was a split between the Federal Circuits as to whether an estate or trust's investment advisor fees are fully deductible under Code section 67(e). Uncertainty in this area has brought about some interesting possible ramifications for the structuring of trustee commissions and fees.

Under Code section 67(a), investment advisory fees are deductible only to the extent that the sum of those fees, when added to the taxpayer's other miscellaneous itemized deductions, exceeds 2% of the taxpayer's adjusted gross income. Code section 67(e) exempts estates and trusts from this 2% floor to the extent that the costs in question "would not have been incurred if the property were not held in such trust or estate." The circuits were split as to whether investment advisory fees paid in connection with the administration of a trust are subject to the 2% floor or are exempt under section 67(e).

The Sixth Circuit held investment advisory fees fully deductible, as trustees incur them in the course of the performance of their fiduciary duties.⁸⁷ The Federal and Fourth Circuits reached the opposite conclusion, holding that investment advisory fees *are* subject to the 2% floor.⁸⁸ The court's reasoning in the Fourth Circuit case, *Scott*, is of particular significance. The Fourth Circuit noted that the exemption in Code section 67(e) reaches only those expenditures that are *unique* to a trust. As a result, while trustee's commissions are fully deductible, investment advisory fees are not.

The split between the circuits resulted in significant implications for the structuring of trustee commissions and fees. The same individual or corporation often serves as both trustee and investment advisor and renders charges for both of those services. The holdings of

85. *E.g.*, *Matter of Butler*, N.Y.L.J., Nov. 20, 1998, at 35 (Sur. Ct. Westchester Cnty. 1998); *Matter of Muhleemann*, N.Y.L.J., Mar. 13, 1997, at 32 (Sur. Ct. Westchester Cnty. 1997).

86. S. 2938, 225th Sess. (N.Y. 2002).

87. *See O'Neill v. Comm'r*, 994 F.2d 302 (6th Cir. 1993); *nonacq.* 1994-2 C.B. 1.

88. *See Mellon Bank, N.A. v. United States*, 265 F.3d 1275 (Fed. Cir. 2001); *Scott v. United States*, 328 F.3d 132 (4th Cir. 2003).

the Fourth and Federal Circuits therefore suggested that such trustees would be well advised to combine both services under a single charge for trust administration, in order to increase the overall deductible amount (that is, bundle the fees).

The Supreme Court in *Knight v. Comm’r*⁸⁹ ended the circuit split by siding with the Fourth and Federal Circuits in ruling that only costs incurred by trusts that would not “commonly” or “customarily” be incurred by individuals would be exempt from the 2% floor. Although the court declined to rule on exactly what constituted “common” or “customary” expenses, the court did find that “[i]t is not uncommon or unusual for individuals to hire an investment adviser” and that special, additional fees applicable only to fiduciary accounts by an investment advisor would be fully deductible under the section 67(e) exemption. The court also failed to rule on the status of “bundled” fees, which contains some expenses that are fully deductible and some that are subject to the 2% floor.

[A] Proposed Regulations

In 2007, before the *Knight* case, the IRS had published proposed regulations that would have made estate or trust expenses that an individual *could* have incurred subject to the 2% floor.⁹⁰ Following the Supreme Court decision, the IRS and the Treasury Department issued interim guidance on bundled fiduciary fees on March 24, 2008.⁹¹ The guidance allowed taxpayers to fully deduct bundled fiduciary fees. Notices extending that interim guidance had been issued annually until 2011.⁹²

On September 6, 2011, the IRS re-proposed regulations in light of the Supreme Court *Knight* decision.⁹³ The new proposed regulations withdrew the prior regulations proposed in 2007 and provide that the portion of a bundled fee attributable to investment advice will be subject to the 2% floor. However, in keeping with the *Knight* holding, the proposed regulations also provide that any excess investment advisory fee charged above what is generally charged to an individual investor due to an unusual investment objective of the nongrantor trust or estate will not be subject to the 2% floor.

89. *Knight v. Comm’r*, 552 U.S. 181 (2008).

90. Prop. Treas. Reg. 128224-06, 2007-36 IRB 551, 72 FR 41243 (July 27, 2007).

91. Notice 2008-32, 2008-1 C.B. 593.

92. Notice 2011-37, 2011-1 C.B. 785.

93. Prop. Treas. Reg. 128224-06, 76 FR 55322 (Sept. 7, 2011).

§ 6:4 Unanimous or Nonunanimous Decisions and Acts

It is generally thought that one executor can bind the estate even though he is not the sole executor. However, an executor may not make a wholesale delegation of his duties to his co-executor.⁹⁴ Where a testator appoints more than one executor, the normal expectation is that all will consult and decide on action to be taken. If a testator is willing to repose authority to act in less than the whole number, it is advisable to state so specifically.

Where more than one trustee is appointed, the general rule is that the trustees must act unanimously and participate in every decision and join in executing documents relative to the administration of the trust. However, it is permissible to provide in the will that any action may be taken by less than all of them, such as a majority. New York now provides, in effect, that unless the will is expressly contrary, where there are three or more trustees, any action may be taken that a majority of the trustees shall determine. The testator may provide expressly otherwise.⁹⁵ Nevertheless, even in states like New York it would seem advisable to be specific in the will on this subject:

In the event that at any time there are more than two Executors or Trustees acting hereunder, the decision of a majority shall control (excepting only as this will may otherwise specifically provide) and shall be binding and conclusive upon all persons.

Third parties will often examine a will to determine who can act. Moreover, the rule in a particular state may be different from any general rule.

94. See *Matter of Cecile S. Jones*, 1 Misc. 3d 688, 765 N.Y.S.2d 756 (Sur. Ct. Broome Cnty. 2003).

95. New York's EPTL seems not entirely clear, especially as to executors. Section 11-1.1(b)(13) formerly provided that a majority of executors could vote stock registered in the name of three or more executors, and that a majority of the trustees could act in all cases, absent a will provision to the contrary. Paragraph (13) was repealed in 1973 as inconsistent with § 10-10.7, which provides, "Unless contrary to the express provisions of" the will, a "joint power" conferred upon three or more executors or trustees may be exercised by a majority of them. 1973 N.Y. Laws ch. 904, § 2. The section states that it shall not affect the right of any one of two or more executors to exercise a "several power." The section does not, however, define either a "joint power" or a "several power." (It may be that the functions of executors were considered conceptually so different from those of trustees that executorial powers are often "several.") Contrast this with N.Y. GEN. OBLIG. LAW § 5-1508, which provides that if the principal in a statutory short-form power of attorney appoints more than one agent, they must act jointly unless the principal specifically states in the instrument that they are to act severally.

In some cases the testator may wish to provide that certain of the fiduciary powers shall be exercised only by certain specified executors or trustees, for example, that the purchase or sale of investments or that the invasion of principal for the benefit of a beneficiary⁹⁶ shall be determined by a named executor or trustee. The precaution to be observed here is to make it clear that the provision is mandatory and that the other executors and trustees have no authority or responsibility in this regard, and also to provide for the contingency of the death or resignation of the specified executor or trustee.

§ 6:4.1 Directed Trustees

Some testators may wish to give certain powers to “outsiders” or to provide that the executors and trustees may rely upon the advice or recommendation of such third parties, for example, as to investments or as to the needs of certain beneficiaries. If the will or trust requires the executors or trustees to follow the directions of a specified outside adviser with regard to particular trust decisions, some courts have held that the direction is effective, but the adviser is himself a fiduciary.⁹⁷ The executor or trustee who follows the instructions of the adviser as mandated by the will should not be liable (for an improper delegation of discretion) for losses that result therefrom unless the instructions are improper or the executor or trustee violates a fiduciary duty to the beneficiaries. It is well for the will expressly to state this exoneration.⁹⁸

However, a testator may not be able to relieve a directed trustee completely from liability for actions taken under the direction of designated third parties.⁹⁹ The *Restatement (Second) of Trusts*, the *Restatement (Third) of Trusts*, and the Uniform Trust Code all generally provide that a directed trustee is under a duty to follow the directives of the designated third party, except where the directive is contrary to the terms of the trust or where the directive constitutes a breach of fiduciary duty.¹⁰⁰ Colorado, Delaware, Georgia, Idaho, Indiana, Ohio, Oklahoma, South Dakota, and Tennessee have statutes

-
96. EPTL § 10-10.1 provides that a power conferred upon a person in his capacity as trustee to make discretionary distribution of principal or income to himself cannot be exercised by him, unless restricted by an ascertainable standard, and such power may be exercised by the other trustees.
97. See *In re Matter of Rubin*, 540 N.Y.S.2d 944, 143 Misc. 2d 303 (Sur. Ct. Nassau Cnty. 1989). See also EPTL § 11-2.3(c)(3).
98. See section 6:7, *infra*.
99. See generally Richard W. Nenno, *Directed Trusts: Can Directed Trustees Limit Their Liability?*, 21 Prob. & Prop. 45 (2007).
100. UNIF. TRUST CODE (UTC) § 808(b) (providing that the trustee shall act in accordance with the directives of a third party holding such a power to direct, “unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a

that afford greater protection from liability for directed trustees than either the *Restatement* or the UTC.¹⁰¹ Utah and Delaware, for example, provide that a directed trustee may not be liable for investment actions taken under the direction of designated directors except where the trustee has engaged in willful misconduct (or gross negligence, under the Utah statute).¹⁰²

Due to the varying levels of protection provided to directed trustees under different state statutory regimes, consideration should be given to designating which jurisdiction's law will apply in the governance of the trust.¹⁰³

§ 6:5 Business Associates of Testator

If an executor or trustee named in the will or trust is associated in business with the testator, as for example, where an executor or trustee is a partner, member, stockholder, director, officer, or employee of a partnership, limited liability company (LLC) or close corporation in which the testator is a partner, member or stockholder, a conflict of interest should be anticipated and any potential problems ameliorated. This can be done by referring in the will or trust to the fact that notwithstanding the existence of any possible conflict of interest or self-interest of the fiduciary, the testator authorizes him to act in all matters concerning such partnership, LLC, corporation, or other business as fully as if the fiduciary were independent and had no interest in the subject matter. The governing instrument should provide specifically that the fiduciary may act as a director, officer, or other employee of the business and receive compensation as such

serious breach of fiduciary duty that the person holding the power owes to the beneficiaries of the trust"); RESTATEMENT (SECOND) OF TRUSTS § 185 ("[T]he trustee is under a duty to act in accordance with the exercise of such a power [to direct], unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power."); RESTATEMENT (THIRD) OF TRUSTS § 75 (providing that the trustee must act in compliance with an exercise of directive power by a third party "unless the attempted exercise is contrary to the terms of the trust or power or the trustee knows or has reason to believe that the attempted exercise violates a fiduciary duty that the power holder owes to the beneficiaries").

101. Nenno, *supra* note 98.

102. DEL. CODE ANN. tit. 12, § 3313(b); UTAH CODE ANN. § 75-7-906(4).

103. For a discussion of a testator's ability to designate the governing law of his or her trust, as well as a discussion of moving a trust to effectuate a change of governing law, see Nenno, *supra* note 99. See also section 3:2.1, *supra*.

notwithstanding the fact that he is also a fiduciary.¹⁰⁴ An example of a general provision to this effect is the following:

My fiduciaries shall not be disqualified in any respect by reason of the rule of undivided loyalty from participating on behalf of my estate or any trust under this will or personally in any action, inaction or transaction with respect to my estate or any trust under this will or otherwise, it being my intention to waive the rule of undivided loyalty with respect to each of them, provided, however, that any such dealings shall be on terms no less favorable than terms that would be obtained on an arm's-length basis.

Note also the discussion and model language set forth in section 6:6.

The purpose of these provisions is to relieve the executor or trustee from restraint or limitation on his action arising from the strict doctrine of law that a fiduciary may not have divided loyalties or interests adverse to his trust.

Obviously, where the personal interest of the fiduciary conflicts with the interests of the estate or trust to such an extent that it is inevitable that such conflict may result in disadvantage to the estate or make it impracticable for the fiduciary to deal fairly with the estate, then the testator must decide in advance whether it is in the interest of his estate or trust that such person shall be appointed as a fiduciary.

If the testator decides to appoint such person as one of several executors and trustees, he may wish to include a provision that such person shall not act in connection with the particular asset as to which he is personally interested, and that the other fiduciaries shall have sole power and authority to act on behalf of the estate with respect to that asset.

§ 6:6 Special Business or Property Situations of Testator

The drafter may find it advisable to cover special business situations of the testator by appropriate provisions in the will. For example, a testator may be the holder of stock in a close corporation, and have an agreement with his fellow stockholders governing the disposition of his stock on death. It may be anticipated that owing to conditions prevailing at death, some of the provisions in the stockholders' agreement may require modification or renegotiation, especially to effect a more advantageous sale.

104. If a corporate fiduciary is appointed, the testator should direct retention of the stock of such fiduciary and its affiliates. Otherwise, the corporate fiduciary probably would dispose of any stock of itself or a parent or related corporation.

For this reason, it may be advisable to give the executors or trustees specific powers in the will to modify, renegotiate, or even waive any provisions of the agreement, if, in their discretion, it is in the interest of the estate to do so. While the executors or trustees might be considered to have such power under the general rules of law applicable to the discharge of the executorial function, it is preferable that they should find such authority in the explicit provisions of the will. Otherwise, fearing that a departure from the terms of the agreement may expose them to surcharge, the executors or trustees may insist on strict compliance with the terms of the agreement, even though a change in such terms might be more beneficial in the liquidation of the stock.

A similar situation exists when a testator is a member of a partnership or limited liability company (LLC). Partnership and LLC agreements frequently contain provisions concerning the manner in which a deceased partner's or member's interest shall be liquidated. The executors might find that it would be more advantageous to agree on a different method of liquidation, for example, by extending the period during which the surviving partners or members may postpone payment of the deceased partner's or member's interest. For that reason, power to enter into an agreement with the surviving partners or members, thereby modifying the terms of the partnership agreement, should be granted to the executors by express provision in the will.

If, on the other hand, the partnership or LLC agreement is silent as to the disposition of a deceased partner's or member's interest, the testator may wish to set forth specific provisions as to its disposition. He may also wish to authorize his executors and trustees to retain the partnership or LLC interest, or to change a general partnership interest into a limited partnership interest, as well as to make advances to the partnership or LLC.

Likewise, if the testator is sole proprietor of a business and desires his executors and trustees to be able to continue the business, he should give them specific authority to do so. See model language below for an example of such a provision. A general power to retain investments should not be relied upon, for the continuance of a business involves risks not inherent in the mere retention of securities and not customary in the administration of estates.¹⁰⁵

Whenever a testator owns, apart from a business, property whose liquidation may involve problems peculiar to the nature of the property it may similarly be well to include a broad grant of discretion to the executors and trustees, in the management and liquidation of

105. SCPA § 2108 sets forth the procedure for obtaining a court decree authorizing continuance of a business, particularly useful when the will is silent on the point.

the specific property, in order to afford the executors and trustees the widest scope within which to function for the purpose of achieving the most advantageous realization of the value of the property. Depending on circumstances, the testator may also, or alternatively, wish to give rather specific directions or nonmandatory expressions of objectives concerning the property. An example of a general provision on business interests follows:

Without in any way limiting the authority elsewhere granted to my Executors and Trustees, such authority shall include the following: The authority to retain and continue (whether or not income-producing or resulting in lack of diversification) my interests in any business enterprises in which I am engaged or interested at the time of my death, whatever the nature of such business may then be and whatever the nature of my interest may then be, and to carry on and continue the business, and to expand, contract, and discontinue the business and to change the form in which it may be conducted (whether corporation, partnership, limited liability company, sole proprietorship, joint venture, trust, syndication, or otherwise without limitation) to any form and in connection with such a change to organize and dissolve partnerships, corporations, limited liability companies, and other business forms, and to consent to and take part in any such transaction, and to transfer and consent to the transfer of and to receive and hold any asset of such business; and to do all things with respect to such business with the same force and effect as if they were acting on their own behalf as individuals and not as fiduciaries; and to use the general assets of my residuary estate for such purposes, all as they may deem advisable in their discretion.

The fact that any one or more of my Executors or Trustees may be beneficiaries under this will or may be associated or connected with such businesses in any way, whether as partner, member, director, officer, stockholder, employee, consultant, attorney, or otherwise, shall not disqualify them from receiving fees, commissions, and compensation under this will, and salaries, fees, commissions, and other compensation and profits from such businesses, and they shall be as free to act on behalf of such businesses and to enter into transactions with them as if they were not Executors or Trustees under this will.¹⁰⁶

Some drafters also include (and some corporate fiduciaries require) clauses expressly authorizing the fiduciaries to dissolve, liquidate, or sell the business; to incorporate, merge, recapitalize, or otherwise change the form of the business; to use the other assets of the trust

106. Certain forms of property, *e.g.*, oil and gas and intellectual property, may call for special provisions.

to promote the business; to borrow money for the business (including borrowing from a corporate fiduciary as lender) and to pledge the assets of the business, and possibly other trust assets, as security for such borrowing; and to hire managers and corporate officers for the business, and to elect directors including employees of the fiduciary. Finally, some corporate fiduciaries will insist upon provisions limiting liability arising out of the business first to business assets and then to trust assets (with an exculpation or indemnity of the fiduciary) and providing special compensation to the fiduciary for its time, effort, and responsibility involved in running the business.

§ 6:7 Exculpatory Clause

None of my Executors or Trustees shall be liable for any act or omission in connection with the administration of my estate or any of the trusts or powers under this will or for any loss or injury to any property held in or under my estate or any of said trusts or powers, except only for his or her own actual fraud [, willful misconduct or gross negligence]; and none of my Executors or Trustees shall be responsible for any act or omission of any other Executor or Trustee.

The wording of such clauses will vary greatly, depending upon the situations that the testator wishes to cover. They may be of a general nature, like the clause above, or they may apply to particular situations or items. An exculpatory clause may be of particular value in connection with a specific grant of authority or a direction in a will or trust, for example, where the testator desires that a speculative asset shall be held as an investment or a close business shall be operated by the fiduciaries (see section 6:9.3[D][3] below for detailed discussion regarding the effect of attempts to override the duty to diversity with respect to a specific investment). Similarly, if the testator directs that one trustee shall determine whether to retain or sell certain investments, it may well be advisable to couple this with a provision exempting the other trustees from any liability in the matter. Likewise, the grant of some special discretion to trustees, as in connection with invasion clauses, may be followed by a provision that the exercise of the discretion shall be final and conclusive upon all persons.

It must be recognized, however, that the protection afforded by an exculpatory clause may be open to considerable question. It may be argued on the one hand that since, subject to certain limitations, a testator can give all his property outright to his executors and trustees, he should be able to exculpate them. On the other hand, an executor or trustee is a fiduciary and must act as such; once appointed, the fiduciary relationship exists with its necessary incidents. Executors

and trustees should not assume that exculpatory or similar clauses will be given literal effect, or that action taken in reliance upon such a clause will thereby be free from question.¹⁰⁷

This is a matter of great importance to executors and trustees, and it is important for the testator to realize this in planning the detailed provisions of his will. In jurisdictions in which such a clause may be partially invalid, the drafter may wish to insert “insofar as permitted by law,” or the equivalent, at an appropriate place in the clause.

107. New York specifically provides that the “exoneration of . . . [an executor or testamentary trustee] from liability for failure to exercise reasonable care, diligence and prudence” is contrary to public policy; the attempted grant of such immunity will be void, although it will not render the will invalid as a whole. EPTL § 11-1.7. Courts have split over whether the public policy reflected in this statute should apply to inter vivos trusts as well. Irene S. Cooper and Robert M. Harper, *Incomplete Protection: Exoneration Clauses in New York Trusts and Power of Attorney*, 28 *TOURO L. REV.* 379 (2012) (advocating for the amendment of EPTL § 11-1.7 to declare that broad exculpatory clauses in inter vivos trusts are void as against public policy). *See, e.g.*, *Matter of HSBC Bank USA*, 2012 N.Y. Slip Op 4954, 2012 N.Y. App. Div. LEXIS 4880 (App. Div. 4th Dep’t June 19, 2012) (declining to extend the statute to inter vivos trusts and finding that the statute did not preclude a trust from exonerating a trustee “in respect of any action under [the trust] taken, suffered or omitted in good faith by [the trustee] in accordance with the opinion of counsel”); *Matter of Malasky*, 736 N.Y.S.2d 151, 290 A.D.2d 631 (App. Div. 3d Dep’t 2002) (stating that “[a]lthough an inter vivos trust may limit the right of beneficiaries to compel an accounting . . . , any attempt to completely excuse the obligation of a trustee to account is void as against public policy”); *Matter of the Accounting of Tydings*, 32 Misc. 3d 1204(A) (Sur. Ct. Bronx Cnty. 2011) (exoneration clause in inter vivos trust did not bar grantor from recovering lost income and profits due to the trustee’s use of the trust funds to make interest-free loans and to benefit an entity in which she was personally interested); *Matter of Francis*, 853 N.Y.S.2d 245, 19 Misc. 3d 536 (Sur. Ct. Westchester Cnty. 2008) (voiding as against public policy an exoneration clause in a power of attorney which sought to exonerate an attorney-in-fact from any and all liability); *In re Kornrich*, 854 N.Y.S.2d 293, 19 Misc. 3d 663 (Sur. Ct. N.Y. Cnty. 2008) (holding unenforceable trust provision in an inter vivos trust relieving trustee from duty to account until trust terminates); *Estate of Mede*, 177 Misc. 2d 974, 677 N.Y.S.2d 707 (Sur. Ct. Kings Cnty. 1998) (finding that an exoneration clause that absolves the trustee for failure to use reasonable care or even “best efforts” in choosing an appropriate bond for investment clearly violated public policy); *Daiger v. Bank of N.Y.*, 2001 WL 579741 (S.D.N.Y. 2001) (exoneration clause in an inter vivos trust is fully enforceable under New York law); *Stark v. U. S. Trust Co.*, 445 F. Supp. 670 (S.D.N.Y. 1978) (enforcing using New York law exoneration clause in an inter vivos trust); *In re Trusteeship of Williams*, 591 N.W.2d 743 (Minn. Ct. App. 1999), *aff’d*, 631 N.W.2d 398 (Minn. Ct. App. 2001) (corporate trustee was surcharged for negligence, which was not protected by an exculpation clause which referred only to “any mistake or error of judgment made by [the trustee] in good faith”).

§ 6:8 Appointment of Guardians

I appoint my wife, Mary Jones, Guardian of the person and property of each of our infant children, and if she predeceases me or for any reason fails or ceases to act as such Guardian before all our children attain their majority, I appoint my brother, Thomas Jones, substitute Guardian. I direct that no bond or other security shall be required of my wife or brother in any jurisdiction for the faithful performance of her or his duties as such Guardian.

In New York, either parent may appoint, by will, the surviving parent as the guardian of the person and the property of their infant, unmarried children. Such appointee is known as a testamentary guardian. If the appointment is made without bond, this dispenses with a bond as to property received by the infant under this will, but not as to property derived from other sources.¹⁰⁸ In the absence of such an appointment, the surviving parent is known as the natural guardian and may have more limited authority over the child's property (although her authority over the child's person will be the same with or without the appointment). For this reason it is customary for the will not to bother appointing the other parent a guardian, but rather to appoint a guardian only if the other parent does not survive or is unavailable (due to illness, incarceration, or the like).

If a surviving parent appoints a stranger as testamentary guardian, the court may refuse to issue letters of guardianship to such appointee if the appointee is shown to be unfit. The standard is the best interests of the child. Such an appointment is a matter requiring the most careful consideration, because the appointment by a surviving parent of a stranger may invite opposition of relatives who consider themselves more capable of acting as guardians of the infant children. Advance discussions with family members may be helpful in avoiding conflict.

In this respect it may be well to note that a surviving parent may appoint one person as guardian of the person and another person as guardian of the property of the infant. One or more guardians in either capacity may be appointed.¹⁰⁹ A person may be an excellent choice in one capacity, but not in the other.¹¹⁰

Some drafters insert provisions appointing a stranger as guardian, even though the other parent (often in this context no longer married

108. SCPA § 1711(3).

109. N.Y. DOM. REL. LAW § 81, which has detailed provisions for various situations.

110. SCPA § 1723 authorizes a will appointing a guardian of the property to limit the guardian's power to sell personal property, including investing it or the proceeds and changing and disposing of investments.

to or living with the testator) survives. In such event the appointment will probably fail as an appointment of a guardian unless the other parent is disqualified. (Although the probate court may have the power to give effect to such an appointment, the surviving parent will rarely be displaced as guardian without good cause.) The appointment may operate, however, to give the so-called guardian a power to manage during minority any property passing to the infant under the will of the testator.¹¹¹ Whether or not the testamentary appointment of a guardian has any legal effect, it should be helpful to the court as an expression of the testator's preferences.

However, as discussed earlier, as to testamentary property intended for an infant that requires management and investment, it is preferable that such property be administered under a testamentary trust, a power in trust, or a custodianship, and that will avoid the need for a guardian of the property altogether.¹¹²

§ 6:8.1 Standby Guardians in New York

In 1992, New York adopted legislation that permits a parent, during his life, to petition the court for the appointment of a "standby" guardian of the person or of the property.¹¹³ The statute was enacted at least partly in response to the large numbers of children orphaned at an early age by the AIDS-related death of one or both parents, often in circumstances that led to postmortem disputes over custody and guardianship. For example, the statute as initially enacted required that the petition "state that there is a significant risk that the petitioner will become incapacitated or die, as applicable, within two years of the filing of the petition and the basis for such statement."

There are detailed requirements for the petition stated in the statute. The guardianship becomes effective either upon the death or incapacity of the parent or upon execution by the parent of a consent to commencement of the guardian's authority in the presence of two adult witnesses plus the guardian, all of whom must also sign the consent. The standby guardianship may be revoked under certain circumstances by the petitioner-parent or the court.

The statute also permits appointment of a standby guardian without recourse to the courts. For drafting purposes, the most important

111. New York now provides in SCPA § 1714 that the donee of a power to manage, during minority, property vested in an infant, resulting from an ineffectual attempt to appoint the donee as guardian, shall be subject to the provisions of the SCPA article on guardians, and in respect of such property shall have all the rights and duties of a guardian and shall be entitled to receive the commissions allowed to a guardian. See SCPA § 2307 as to such commissions.

112. See generally sections 1:23, 3:1.1[A] and 3:6, *supra*.

113. SCPA § 1726.

point is that a parent may designate the standby guardian and an alternative standby guardian. The statute provides an approved but nonexclusive form, reproduced at Appendix 6A. A designated standby guardian's authority commences upon receipt of either (a) a determination of incapacity by the parent's attending physician or (b) both (1) a determination of debilitation (chronic and substantial inability to care for the child by reason of physical disability, illness, disease, or injury) and (2) a written, witnessed consent by the parent to the commencement of such authority.

Within sixty days after the authority of the designated standby guardian commences, he must petition the court for judicial appointment as a guardian. Until he does so, his authority with respect to the minor is concurrent with the parent's. There is a procedure for filing designations of standby guardians in court without commencing a proceeding for judicial appointment.

Conceptually, the innovation of a standby guardian is similar to that of a "springing" power of attorney.¹¹⁴ Many jurisdictions other than New York also have standby guardianship legislation, with Indiana enacting its legislation most recently in 2011.¹¹⁵ However, approximately half the states still lack any sort of standby guardianship laws.¹¹⁶ It would be prudent to check the law of each state as the laws do differ slightly from state to state.

§ 6:9 Administrative Powers of Executors and Trustees

Executors and trustees are given various investment and other administrative powers by statute and by decision. In many states, these topics are now encompassed in statutes, including Uniform Acts, covering a wide range of topics relating to the administration of estates and trusts. In the absence of contrary or limiting provisions in

114. Discussed in section 7:3.1, *infra*.

115. States that have enacted standby guardian provisions include: ARK. CODE ANN. § 28-65-22; CAL. PROB. CODE §§ 2105, 1502; COLO. REV. STAT. ANN. § 15-14-202; CONN. GEN. STAT. § 45a-624; D.C. CODE ANN. §§ 16-4801-16-4810; DEL. CODE ANN. tit. 13, § 2365; FLA. STAT. § 744.304; HAW. REV. STAT. ANN. § 560:5-202; GA. CODE ANN. § 29-2-9; 755 ILL. COMP. STAT. ANN. 5/1-2.23; IND. CODE § 29-3-3-7; IOWA CODE §§ 633.560, 633.591A; MD. CODE ANN. §§ 13-901-13-908; MASS. GEN. LAWS ANN. ch. 201, §§ 2A-2H; MINN. STAT. ANN. § 524.5-202; MO. ANN. STAT. § 475.024; NEB. REV. STAT. 30-2608; NEV. REV. STAT. § 159.205; N.J. STAT. ANN. §§ 3B:12-72-3B:12-78; N.Y. SCPA § 1726; N.C. GEN. STAT. §§ 35A-1370-1382; N.D. CENT. CODE § 30.1-26-04; OHIO REV. CODE ANN. §§ 1337.09(b), 2111.02, 2111.12, 2111.121; 23 PA. CONS. STAT. ANN. §§ 5602-5616; TEX. PROB. CODE ANN. § 676; VA. CODE ANN. §§ 16.1-349-16.1-355; W. VA. CODE §§ 44A-5-1-44A-5-9; WIS. STAT. § 48-978.

116. Joshua S. Rubenstein, *Standby Guardianship Legislation: At the Midway Point*, 33 AM. C. OF TR. & EST. COUNS. J. 1, 2 (2007).

a will, the statutory powers would automatically apply without being repeated or referred to in the will.

In New York, article 11 of the EPTL contains detailed provisions in Part 1 on “Fiduciaries: Powers, Duties and Limitations” and in Part 2 on “Investments by Fiduciaries: Powers and Duties Relating Thereto.” Part 2 includes extensive provisions respecting principal and income, in a modified form of the Uniform Act on that topic.¹¹⁷ These provisions are often updated by the legislature.

In other states, such as Connecticut and Virginia, the administrative powers statutes expressly provide that the statutory powers may be incorporated in the governing instrument by specific reference.

Nevertheless, it is desirable, even at the expense of increasing the length of the will, that the testator specify certain permissive powers and discretions for the executors and trustees. It must be emphasized at the outset that all such powers should be drawn in language that is permissive rather than mandatory, and that the drafter should carefully avoid employing the word “direct” in connection with any power unless the testator intends it to be mandatory. The word “shall” should be cautiously used, since it connotes a mandate rather than a discretion.

Although theoretically it should be sufficient to “give to my executors and trustees complete power and authority with respect to all matters and questions,” it is preferable, in practice, to provide an extensive grant of specific powers, to avoid question as to what the executors or trustees may do in a particular case. Even where the statutes or decisions of a particular state may specifically authorize an executor or trustee to perform some act, it may be desirable to set forth the authority in the will, to avoid question, for the will is considered the charter of the executor and the trustee and specification of their powers facilitates the discharge of their function. Furthermore, the testator may move to another state, or own realty located in, or other property subject to the laws of, another state, whose statutes and decisions do not provide the desired authority.

Drafters differ as to the precise powers to be set forth, but the following are believed to be more or less customary. They do not cover all topics covered by the statutes, and they differ from statutory provisions in various respects, nor do they cover various other topics that might be provided for. There is a very great variety of clauses both as to topics and as to the wording. The clauses below are intended to give the executors and trustees a broad area of authority. If the drafter encounters the average testator’s natural resistance to lengthy provisions in his will, it should be emphasized that if an additional page or two enables the estate to save the expense, trouble, and delay of a

117. See Uniform Principal and Income Act (last amended 2008).

single construction proceeding, the extra effort is more than recompensed.¹¹⁸ Moreover, most wills are generated by word processors based on models, precedents or other software, so that the inclusion of “boilerplate” powers does not itself cause any notable incremental cost to the client (unless the client insists on a detailed explanation of each phrase from a lawyer who charges by the hour!). Not unlikely, many drafters will have a standard set of what they regard as fairly full powers, which they will use without review, or with little review, to save their time in preparing drafts. See, for example, Article Twenty-Sixth of Appendix 1A.

Unfortunately, time so saved may be offset by time involved in going over drafts with clients, explaining the meaning and significance of the various clauses and perhaps removing or rewriting clauses that clients insist are unnecessary or unwanted. Moreover, such a set of power clauses may be out of place in a will disposing of a modest estate, where there is no prospect of a large estate. Thus only a short paragraph appears in Appendices 1B, 1C, and 6C, which contain in abbreviated form a half-dozen powers that may be particularly useful.¹¹⁹

Further, there may be occasions when there is only enough time to prepare in longhand an extremely short will, with no powers clause, for example, at an airport just before the final boarding call. It hardly need be added that a stopgap will should be replaced by one in more traditional form when it becomes practicable to do so. It will probably be up to the drafter to remind the testator.

In short, the subject of power clauses is not one that should be dismissed lightly as “boiler-plate.”

§ 6:9.1 **Introductory Clause**

I give to my Executors and Trustees, [and the survivors or survivor and the successor or successors of them,] in addition to and not in limitation of the power and authority granted by law, the following power and authority, which may be exercised by them in either or both capacities, at any time and from time to time, as they shall in their absolute discretion deem advisable, without court order or other approval:

The purpose of referring to the “survivors” and “successors” is to make clear that the exercise of the powers is not limited to the period when all the initial executors or trustees are acting. Otherwise, if the

118. The relation of administrative powers to a trust intended to qualify for the marital deduction should be considered. See section 4:3.9, *supra*, and section 6:9.4, *infra*.

119. See section 6:9.18, Administrative Provisions in Absence of Trusts, *infra*.

fiduciaries named in the will or trust die, or for some other reason cease to act, and the court appoints successors, a question might be raised concerning their right to exercise all the powers specified in the will or trust, particularly those that involve discretion. In New York, the statute now provides that the surviving fiduciary may continue to act without the appointment of a successor, unless contrary to the express provision of the will.¹²⁰ New York also provides that a successor fiduciary succeeds to all powers and discretion of the original fiduciary, unless expressly prohibited by the will to any successor fiduciary.¹²¹

Some drafters prefer to set up each administrative power as a separate sentence or paragraph commencing with the words, "I give my executors and trustees full power and authority to" Others prefer the introductory language written above followed by provisions, separately lettered, as subdivisions of a general grant of power and authority. This second possibility will be used in the discussions that follow.

In the discussion of administrative powers that follows, reference is frequently made to "trustees" alone, but the discussion is intended, in general, to apply to "executors" as well. Similarly, the references, in the discussion, to "estates" and "trusts" are frequently interchangeable. Some drafters insert a definition of "fiduciaries" to include executors, trustees and their successors (and perhaps substitutes), and of "estate" to include trusts and property held under a power in trust for minority. Drafting of the actual powers clauses is then simpler and more inclusive.

For example, a definition of "Fiduciaries" such as the following may be included in the Will:

My "Fiduciaries" shall be deemed to mean and refer to (a) my Executor with respect to any and all property, whether real or personal, which I may own at the time of my death or which shall at any time constitute part of my estate, and (b) my Trustees with respect to any and all property, whether real or personal, which shall at any time constitute part of any trust hereunder.

120. EPTL § 11-1.1(b)(11).

121. EPTL § 11-1.1(b)(12), which also applies to a substitute fiduciary, a term to whom this book generally does not refer. If the drafter wishes to refer specifically to substitute fiduciaries he should do so consistently throughout. The terms "substitute" and "successor" at least at times appear to be used interchangeably, even in statutes. Perhaps the difference is that "substitute" may imply a fiduciary appointed other than by the testator or pursuant to a mechanism he established, whom the testator may not know (and who may have been appointed by a court rather than through a procedure set forth in the will) and therefore to whom the testator may not be willing to give the same broad authority. That would justify the omission of "substitutes" from the form above. *See also* section 6:1.3, *supra*.

§ 6:9.2 Retention

I give to my Executors and Trustees, [and the survivors or survivor and the successor or successors of them,] in addition to and not in limitation of the power and authority granted by law, the following power and authority, which may be exercised by them in either or both capacities, at any time and from time to time, as they shall in their absolute discretion deem advisable, without court order or other approval:

A. To hold and retain all or any part of the property comprising my estate at the time of my death, or received by my Trustees from my Executors, as long as they deem advisable.

The purpose of clause A is to authorize the retention of testator's investments as long as deemed advisable. Otherwise, failure to dispose of the investments within a reasonable time may lead to surcharge. The clause is particularly desirable where the will does not contain broad investment authority. In such a case it may be advisable to add to the end of clause A above, the words "notwithstanding that the same may not be permitted by law for the investment of trust funds." Despite the existence of such a provision, the trustee may not negligently or imprudently continue to hold investments of the testator for an excessive and unsafe length of time, resulting in loss to the estate.¹²²

If the testator has a large block of stock in any corporation, whether it is a public corporation or a close corporation, he may wish to insert specific instructions or authority with respect thereto. He should at least consider whether to add "without regard to diversification" or similar language at the end of clause A.¹²³ See also the discussion at section 6:6 above on Special Business or Property Situations of Testator.

Some drafters prefer to insert the phrase, "whether or not income producing," in the authority to retain property, particularly if the testator owns property that is or may become unproductive. Under the old Uniform Principal and Income Act (UPAIA) (repealed effective Jan. 1, 2002) this used to have unintended consequences with regard to the allocation between income and principal of the proceeds of sale of underproductive property. If such a phrase is used, it may well result in loss of the estate tax marital deduction if it is applicable to

122. EPTL § 11-2.2(a)(7) (effective for investments made and held through Dec. 31, 1994); § 11-2.3(b)(3)(D) (effective for investments made and held after Jan. 1, 1995). See section 6:9.3[D][4], *infra*.

123. Diversification is generally required under the Prudent Investment Act in the absence of a contrary direction in the instrument. EPTL § 11-2.3(b)(3)(C); see section 6:9.3[D][3], *infra*.

a trust for which the deduction is sought.¹²⁴ Accordingly, if the phrase is used, it should be coupled with a savings clause applicable to marital deduction trusts such as those set forth in sections 4:3.9 and 6:9.4.

Language along the lines suggested above may be very important in preventing forced sales of property for which there is no ready market or no definite market value, such as a large block of stock in a corporation for which the market is thin,¹²⁵ or a collection of art.

Of increasing importance as an asset to be disposed of is a structured settlement to a tort litigation, which is in the nature of an annuity and, as such, has been considered to be a wasting asset subject to depletion. Annual payments under the structured settlement will then need to be apportioned between principal and income in accordance with what is reasonable and equitable, and, unless the will directs otherwise, the income beneficiary should receive only as much of any particular payment as represents a fair return on the capital value of the settlement. However, there appears to be no statutory or other legal requirement for the fiduciary to provide for a reserve for depreciation out of income. If a structured settlement is likely to be a significant asset, and if the will includes any trusts, the trustees should be authorized to make the appropriate allocations, and perhaps the will should spell out guidelines or even provide mandatory directions in that regard.

§ 6:9.3 Investment

B. To invest and reinvest any funds in my estate or any trust created by this will in any property, real or personal, of any kind or nature, including, without limitation, stocks, whether common, preferred, or otherwise, bonds, secured or unsecured, obligations, mortgages, securities of investment companies, interests in investment trusts, common trust funds, and all other securities, and interests in any of the foregoing, without being limited or restricted to investments prescribed or authorized by law for executors or trustees; it being my intention to give my Executors and Trustees the same power of investment and reinvestment that I myself possess with respect to my own funds.

For less complex situations, a shorter form may be employed, reading as follows:

To invest and reinvest any funds in my estate or any trust created by this will, in any property, real or personal, including, without

124. See Treas. Reg. § 20.2056(b)-5(f)(4), 20.2056(b)-7(d)(2).

125. But see cases cited in footnotes for section 6:9.3[D][3].

limitation, stocks and other securities of any nature, without being limited to investments authorized by law for trust funds.

[A] Evolution of Trustee Investment Standard Through 1970

New York was, for a considerable period of time, a “legal list” state, with frequent amendments. In such states the basic principle of law governing the investment of trust funds is that unless the will provides otherwise a trustee is limited to investing trust funds in certain classes of investments specified by statute and sometimes referred to as “legal investments” or “legals.”

In line with evolving investment theory and experience, New York in 1950 amended EPTL section 11-2.2, which specifies various categories for legal investments, to permit a fiduciary to invest also in stocks and other investments, not so specified, up to 35% of the aggregate market value at that time of all the property of the fund held by such fiduciary, subject to the restrictions therein set forth. In effect, this gave New York fiduciaries, to a limited extent, the investment authorization granted to fiduciaries in states where the prudent person rule governs fiduciary investments.

In 1965, the 35% was increased to 50% and in 1970 the limitation to sixteen enumerated classes was removed, making New York entirely a prudent person rule state. However, it continued to have a number of investments in which, by statute, fiduciaries are authorized to invest. Some of these enactments authorize investing in obligations of a single specified issuer, for example, certain “public” authorities.

[B] Prudent Person Rule (1970 Through 1995)

As formulated in New York through 1995, the prudent person rule permitted investment in “such securities as would be acquired by prudent men of discretion and intelligence in such matters who are seeking a reasonable income and preservation of their capital,” but without limiting the effect of any will creating or defining the investment powers or the authority of a court to instruct the fiduciary in the interpretation or administration of the express terms of the will, or in the administration of the property.

Effective January 1, 1986 (as amended on July 30, 1987), the statute was amended to elevate the standard of care for investments by a fiduciary that is a bank, trust company, or paid professional investment adviser, or any other fiduciary “representing that it has special investment skills.” These fiduciaries are to exercise such diligence in investing the trust “as would customarily be exercised by prudent men of discretion and intelligence having special investment skills.”

Even though the prudent person rule gave trustees authority to invest in other than “legal” investments, it did not authorize them to

abandon the standards of care and prudence that are imposed on trustees in general. Nor did it sanction a program of speculation, as distinguished from investment. Basically, regardless of whether the trustees were limited to legal investments or were permitted to purchase other investments, the trustees were required to adhere to the duty to obtain an income from the investments of the trust and at the same time to conserve the principal.

**[C] Unwise Drafting Restrictions on Investment
(Beware of Bad Precedents)**

The contents of an investment clause can be of crucial importance. A clause that attempts to set up mandatory categories of investments for the trustee invites serious consequences to the trust. For example, years ago it was not unusual for a will to direct the trustee to limit his investments to "guaranteed first mortgages," or to "first mortgage railroad bonds which have not defaulted in the payment of interest for a period of five years." To impose on any trustee a limitation to such a narrow group or class of securities is to expose the trust to the risk that such securities will either be nonexistent, or will neither be as safe, nor produce as generous an income, as the testator imagined.

Similarly, some wills endeavored to set up the proportions of permissible investments, such as "one-fourth of the trust shall be invested in Government bonds; one-fourth of the trust shall be invested in first mortgages; one-fourth of the trust shall be invested in first mortgage railroad bonds; and one-fourth of the trust shall be invested in such other securities as the trustees may determine." Here, too, the rigidity of the plan may produce unlooked-for consequences. A mechanical problem arises in attempting to determine when the one-fourth limit has been exceeded. Is the one-fourth based on the original value of the principal of the trust, or must the relative ratio be maintained throughout the life of the trust? Furthermore, the specification of categories often leads to the question whether a particular security is included within the category.

Another unwise practice had been to specify that the securities in which the trustees may invest shall be those that are allowed for investment by savings banks and insurance companies. This type of provision overlooked the fact that investments permitted for savings banks and insurance companies differ, and questions will arise as to the scope of the trustee's authority. Further, there have been special provisions for such institutions that are not applicable to trustees.

While the decision as to the investment policy of the trust must be made by each individual testator, it is advisable that the drafter explain to the testator the problems that lurk in an investment clause that is too narrow and would constrict the latitude that a trustee may wish to exercise in an effort to administer the trust soundly. A most

important factor to be stressed where fixed-income, highly rated bonds are required is that such bonds often produce lower rates of income. (This principal value is also subject to considerable fluctuation as market rates of interest change.) Hence, by a limitation to such investments the principal may be conserved (unadjusted for inflation) at the cost of a lower income return to the beneficiaries of the income who, in all probability, are the immediate members of the testator's family and the objects of his deepest concern. There is also the risk of loss of nominal principal value if they must be sold to raise cash at a time when higher interest rates have depressed the principal value; and of course there is the risk of seriously under-performing inflation.

On the other hand, unlimited power to invest in stocks, which could include so-called growth stocks, might likewise result in low income (at least until the overall portfolio has grown significantly), as well as loss of principal (in a "bear" market), a contingency, needless to say, that unfortunately is not confined to stocks and of which recent history provides far too many examples. While the risks for the current beneficiaries may be ameliorated by an appropriate provision for the invasion of principal, they nevertheless merit the testator's and his legal adviser's very careful consideration.

Some testators may wish to provide for investments "without regard to diversification." New York now generally requires diversification,¹²⁶ but even before that was the case it was a factor in assessing the prudence of a particular investment. Some testators may wish to omit certain of the categories set forth in clause B in section 6:9.3 above, but there may remain a question whether the categories are nevertheless implicitly included in the grant of general authority. Skillful drafting may be required.

[D] Prudent Investor Act—1992 to Date

The 1992 *American Law Institute Restatement of the Law of Trusts* (the "*Restatement*") led to approval of the Uniform Prudent Investor Act (UPIA) by the National Conference of Commissioners on Uniform State Laws in 1994. Versions were promptly enacted in several states with more states adopting the Act each year. By now, almost all of the states (plus the District of Columbia) have adopted the UPIA, in whole or in part, with or without modifications.¹²⁷

126. EPTL § 11-2.3(b)(3)(C); see section 6:9.3[D][3], *infra*.

127. Delaware, Georgia, Kentucky and Louisiana require a total portfolio approach to investment management, but do not otherwise have provisions resembling the UPIA. All other states have adopted the UPIA or substantial portions thereof.

As states modify existing rules in response to the Uniform Act or otherwise, the drafter, and of course anyone responsible for the administration of a trust or estate, will need to check the pertinent state statutes currently in effect. There are several important components of the Prudent Investor Act. The Act requires a trustee to diversify so that if a testator wants his fiduciaries to hold on to or invest in a large interest in a particular investment, he should spell out his intentions and preferably recite that the fiduciaries are not required to diversify and may invest regardless of the result that there is little or no income. See section 6:9.3[D][3] below.

In addition, the *Restatement* expressly permits delegation of investment decisions (as well as various other powers). See section 6:9.3[D][6] below. Language in wills permitting the fiduciaries to delegate such decisions, which was of questionable validity before, will now be effective in jurisdictions that follow the *Restatement*. (Indeed, delegation is permitted even in the absence of such a clause.)

The fiduciary must act with prudence in deciding whether or not to delegate and how to delegate, in selecting the persons to whom investment authority is delegated, in setting investment goals and guidelines, and in regularly reviewing the performance of the portfolio managers. The effect of the *Restatement* and an appropriate will clause is to avoid the older rule in many states of strict liability for any investment losses (even for an investment that was prudent when made) under a theory of improper delegation of investment discretion.

The other major changes of the *Restatement* and the UPIA apply the standard of prudence to the investment of the portfolio as a whole, rather than to each individual investment; identify the fiduciary's central consideration as the trade-off in all investing between risk and return; and abrogate any categorical restrictions on types of investments.

[D][1] *New York's Version of the Prudent Investor Act (1994)*

With some variations, in 1994, after years of debate, New York passed the Prudent Investor Act. Examination of the statute will be fruitful both for provisions applicable in several states and for drafting and planning suggestions to deal with the changes.

A new section 11-2.3 to the EPTL was enacted, effective for all investments made *or held* after January 1, 1995. The former rules, which were based on the "Prudent Person" approach, are codified at EPTL section 11-2.2 and will continue to apply only to investments made and held prior to that date.

[D][1][a] Current Standard of Conduct

The Prudent Investor Act sets forth standards and rules for fiduciary investments but, by its own terms, does not apply to the extent “otherwise provided by the express terms and provisions of a governing instrument,” except to the extent that the provision may attempt to exonerate a fiduciary “from liability for failure to exercise reasonable care, diligence and prudence.”¹²⁸ The statute begins by making it clear that investments are to be judged by “a standard of conduct, not outcome or performance.”¹²⁹ Compliance with the rule is “determined in light of facts and circumstances prevailing at the time of the decision or action of a trustee.”¹³⁰ If a trustee acts in reasonable compliance with the new standard “or in reasonable reliance on the express terms and provisions of the governing instrument” he or she will not be liable to a beneficiary.¹³¹

Thus, the first two subsections of the new statute reflect the critical role of the language of the will. So long as the will does not impermissibly exonerate the fiduciary from the exercise of prudence, it may vary the standards created by the new statute, and reasonable reliance on the language of the will provides a statutory defense to a disgruntled beneficiary’s surcharge action.

The rule is expressed as a general statement and as a series of specific duties. The general expression of the rule is:¹³²

A trustee shall exercise reasonable care, skill and caution to make and implement investment and management decisions as a prudent investor would for the entire portfolio, taking into account the purposes and terms and provisions of the governing instrument.

Of interest, the statute also defines “portfolio” as referring to “all property of every kind and character held by a trustee,” so as to avoid the implication that the statute refers only to a portfolio of publicly traded marketable securities. In fact, the statute applies to all assets and investments held by the trust. Despite frequent references to “trust” and “trustee,” the statute makes it clear that those terms include executors, administrators and similar fiduciaries who are administering the estate of a decedent.¹³³

128. EPTL § 11-2.3(a), *incorporating by reference* EPTL § 11-1.7 (which by its terms declares void as against public policy such an attempted exoneration of an executor or testamentary trustee, but which does *not* [unlike the Prudent Investor Act, which *does*] apply to an inter vivos trustee).

129. EPTL § 11-2.3(b)(1).

130. *Id.*

131. *Id.*

132. EPTL § 11-2.3(b)(2).

133. EPTL §§ 11-2.1(e)(1), 1-2.13.

Note once again the importance of the governing instrument. Here, the “purposes and terms and provisions” of the will are to be a factor in the fiduciary’s investment decisions. For example, if it is clear from the context or language of the will that the testator’s primary concern is long-term growth of the trust, with only secondary interest in the current income beneficiaries, the investment portfolio should reflect that concentration, while if the decedent’s primary concern was the current cash flow provided to the income beneficiaries, a different portfolio should be assembled.

The general standard under the old “prudent person” rule, as codified in EPTL section 11-2.2(a)(1), was different: investments were permitted “in such securities as would be acquired by prudent men of discretion and intelligence in such matters who are seeking a reasonable income and preservation of their capital.” While the old statute expressly recognized that the governing instrument could vary the investment standard, the purposes, terms and provisions of the will were not incorporated within the statute as a factor affecting the investment portfolio’s composition.

Moreover, the traditional investment standard was applied to each investment. If it was imprudent to make or retain the investment at any particular time, considered in isolation from all other investments held by the fiduciary for the same trust or estate, a surcharge would result. By contrast, under the new statute, the prudence of the investment in view of the anticipated performance of the entire portfolio is to be considered.

[D][1][b] Specific Duties Under the New Statute

The new statute goes on with specific duties:

- (3) The prudent investor standard requires a trustee:
 - (a) to pursue an overall investment strategy to enable the trustee to make appropriate present and future distributions to or for the benefit of the beneficiaries under the governing instrument, in accordance with risk and return objectives reasonably suited to the entire portfolio;

Here the statute makes explicit the relationship between the distributions required for present and future beneficiaries and the “overall investment strategy,” including “risk and return objectives” for the trust as a whole. In view of the focus of the new Prudent Investor standard on overall portfolio performance and on matching investments to distribution requirements, the EPTL has been amended to authorize adjustments between principal and income¹³⁴ or an optional

134. See section 6:9.3[D][2][a], *infra*.

unitrust approach.¹³⁵ This will avoid the need for fiduciaries to pay attention to the highly technical rules of allocation of receipts and disbursements between income and principal in order to measure the anticipated impact of contemplated investments on the distributions to be made to the beneficiaries.

As an example, consider an investment in a widely traded, well-regarded public company with a practice of paying extremely small cash dividends but reinvesting earnings and as a result regularly growing in value and occasionally splitting or paying stock dividends. As part of an overall balanced portfolio, the investment may (after consideration of additional factors) be determined by the trustee to be prudent. Yet, in a trust where payment of income to the current beneficiary is an important objective, the trustee may feel inhibited from making the investment either because of the anticipated low rate of return of ordinary income or, perhaps even worse, because of the daunting need to investigate the technical rules regarding the principal and income allocations of stock dividends, stock splits and the rules then in effect regarding the proceeds of sale of “underproductive property” (that is, property that historically paid less than one percent of its inventory value as regular income, in which case a percentage of the proceeds of sale, corresponding to a 5% annual income return, was artificially allocated to income).¹³⁶

One of the goals of the legislation was to permit fiduciaries, and their investment advisers, to select investments based upon careful economic analysis using modern financial tools. Because of the focus on distributions required to present or future beneficiaries coupled with the unchanged rules regarding allocation between principal and income, investments still could not be made considering economic factors alone unless the will was carefully conformed to the legislation (as to which see below). This problem was addressed in 1997 when the Uniform Commissioners promulgated a revised UPAIA that allows fiduciaries to adjust between income and principal to ameliorate this problem. This Act was later amended in 2000 to include a section on judicial control for abuse of discretion.¹³⁷ After much study, in 2002,

135. See section 6:9.3[D][2][b], *infra*.

136. EPTL § 11-2.1(k) (repealed effective Jan. 1, 2002 when it was replaced by EPTL art. 11-A).

137. The UPAIA was further amended in 2008 to clarify section 409 (relating to trusts that are the beneficiaries of retirement plans) and section 505 (relating to mandatory income trusts that own an entity such as an LLC). Although over half of the states have already enacted the 2008 amendments, New York has not. The discussion in the text relates to provisions in the UPAIA unaffected by the 2008 Amendment.

New York adopted legislation that combines the adjustment power with an optional statutory unitrust¹³⁸ for similar reasons.

The UPAIA lists factors that are to be considered in making or retaining investments, “to the extent relevant to the decision or action”:

The size of the portfolio, the nature and estimated duration of the fiduciary relationship, the liquidity and distribution requirements of the governing instrument, general economic conditions, the possible effect of inflation or deflation, the expected tax consequences of investment decisions or strategies and of distributions of income and principal, the roles that each investment or course of action plays within the overall portfolio, the expected total return of the portfolio (including both income and appreciation of capital), and the needs of beneficiaries (to the extent reasonably known to the trustees) for present and future distributions authorized or required by the governing instrument; . . .¹³⁹

Now the potential conflict with the old, rigid Principal and Income Act becomes even clearer, because among the factors that a fiduciary is now *required* to consider are both the “expected total return of the portfolio (including *both income and appreciation of capital*)” and, at the same time, “the needs of beneficiaries . . . *for present and future distributions* authorized or required by the governing instrument.” [emphasis added.] Obviously, the fiduciary cannot simply invest in assets that are likely to produce the greatest total return if, as a consequence, one class or another of beneficiaries is likely to be adversely or unfairly affected by the operation of the technical principal and income rules (unless there is an appropriate provision in the will for reallocations or adjustments).

[D][2] Drafting Approaches Under the New Statute

[D][2][a] Invasions; Income and Principal

In most states, the Principal and Income Act has now been amended in view of the conflict with the Prudent Investor Act noted above.¹⁴⁰ In New York, this has taken two alternative forms. First,

138. See EPTL § 11-2.4 (optional unitrust provision) and § 11-2.3(b)(5) (trustee’s power to adjust), both sections effective January 1, 2002. See also section 6:9.3[D][2][a] and [b], *infra*.

139. EPTL § 11-2.3(b)(3)(B).

140. The revised UPAIA was approved in 1997 by the National Conference of Commissioners on Uniform State Laws. It has been adopted in whole and in part, including either a power to adjust or a statutory unitrust provision, or both, in all but a few states.

based on the provisions of the UPAIA, under the New York statute¹⁴¹ the Trustee is authorized:

To adjust between principal and income to the extent the trustee considers it advisable to enable the trustee to make appropriate present and future distributions in accordance with clause (b)(3)(A) if the trustee determines after applying the rules in article 11-A (the Principal and Income Act) that such an adjustment would be fair and reasonable to all of the beneficiaries, so that current beneficiaries may be given such use of the trust property as is consistent with preservation of its value.

Second, the statute sets forth several factors that the trustee is to consider in determining whether and to what extent to exercise this power of adjustment, including the intent of the settler as expressed in the governing instrument, the type of assets held in the trust, whether any beneficiary is using a trust asset, whether the asset was purchased by the trustee or received from the settler, the amount of income as compared to capital or principal gain, and the trustee's other powers under the trust instrument.¹⁴² There are limitations which prohibit the trustee from exercising the adjustment power in a variety of situations where an adverse tax consequence might result.¹⁴³ There are special procedures set forth with regard to judicial control of the adjustment power and notice to the beneficiaries.¹⁴⁴

In states that have not adopted changes to the Principal and Income Act, or even in states that have made such changes but where the testator does not want to rely on the uncertain future state of the law, but nevertheless wishes to have his fiduciaries obtain the greatest benefit from the new Prudent Investor Rule, the testator can provide some help in the will or trust. One obvious approach is to grant the trustee liberal discretion to invade principal, so that if the "income" yield is too low but total return high, a portion of the principal gains can be distributed to the current income beneficiary.¹⁴⁵ An alternate but potentially awkward strategy is to tinker with the principal and income rules themselves (or to permit the trustees to do so), which is explicitly authorized in EPTL sections 11-2.1(a)(1)(A) (through De-

141. EPTL § 11-2.3(b)(5) (effective Jan. 1, 2002). Note that this provision appears in New York in the Prudent Investor Act, even though it was promulgated as part of the revised UPAIA.

142. EPTL § 11-2.3(b)(5)(B).

143. EPTL § 11-2.3(5)(C).

144. EPTL § 11-2.3-A.

145. It may also be possible to specify in the trust agreement that there is no need to diversify investments where the settler's intent is clearly to maximize the trust for the income beneficiary's benefit. *See Carter v. Carter*, 965 N.E.2d 1146, 358 Ill. Dec. 667 (Ill. App. Ct. 2012).

ember 31, 2001) and 11-A-1.3(a) (starting January 1, 2002). While few drafters or testators will want to create a different set of principal and income rules, it may be helpful to add a clause along the following lines:

I authorize and empower my fiduciaries, at any time or times, in their discretion, to determine that a portion or all of any receipt of realized gain, net of the costs incurred in the production of such gain, shall be treated as income for distribution and all other purposes in the administration of my estate and the trust(s) under this Will; provided, however, that the calculation of the commissions payable to my fiduciaries shall not be affected by any such determination. This provision is not intended to compel my fiduciaries to realize gain in any particular circumstance.

[D][2][b] Annuities and Unitrusts

Another approach to the tension between the emphases on total return of all character under the Prudent Investor Rule and the effect of different types of investment yield on “income” beneficiaries is to unlink the connection between classic income and principal questions, on the one hand, and the theoretically distinct question of which beneficiary is to receive which amounts. In short, the Prudent Investor Act provides an incentive for increased use of trusts in which the current beneficiary’s entitlements are measured not by “income” but rather by (i) a fixed dollar annuity amount, (ii) an annuity fixed as a percentage of the initial trust value, or (iii) a “unitrust amount” that is a fixed percentage of the trust’s value from year to year. Variations are possible as well, so that the amount or percentage itself can increase or decrease over time.

In some states, the unitrust approach has been embodied in legislation. For example, New York has adopted an opt-in statutory unitrust.¹⁴⁶

The provisions of the statute apply to a trust if the governing instrument so provides, or if an appropriate election is made by the trustee (with the consent of the beneficiaries or in the trustee’s discretion) before the end of the second full year of trust administration (or, for older trusts, prior to December 31, 2005).¹⁴⁷ The election may be retroactive to any prior trust year as long as it follows the effective date of the legislation.¹⁴⁸ An election to have the unitrust provision apply to a trust is not revocable, but a court may at any time

146. EPTL § 11-2.4 (effective Jan. 1, 2002).

147. *Id.* § 11-2.4(e)(1).

148. *Matter of Heller*, 6 N.Y.3d 649, 849 N.E.2d 262, 816 N.Y.S.2d 403 (2006) (finding that “the Legislature structured EPTL 11-2.4 so that it could be applied retroactively”).

determine that the trust shall no longer be governed by the unitrust provisions or, alternatively, that a trust which is governed by the standard Principal and Income Act should instead be governed by the unitrust provisions.¹⁴⁹ In any such proceeding there is a rebuttable presumption that the unitrust provisions apply.¹⁵⁰ A trustee who is also a remainder beneficiary may make the election even though it is to his or her personal benefit, at least as long as there are other remainder beneficiaries whose interests are enhanced by the election, but where the election benefits the trustee it will be scrutinized with special care to assure its fairness.¹⁵¹ The statute provides a list of factors relevant to the trust and its beneficiaries that are pertinent in determining whether the classic Principal and Income Act (EPTL Article 11-A) or the unitrust provision should apply.¹⁵²

The unitrust amount is, to summarize, 4% of the net fair market value of the assets held in the trust at the beginning of the current year, but once the unitrust rules have applied to a trust for at least three years, the base to which the 4% is applied each year will be the average of the value of the trust assets for the prior three years. The unitrust amount is to be proportionately reduced for distributions to beneficiaries required under the trust, and proportionately increased for additional contributions to the trust within a current valuation year. The unitrust provisions will not apply to estates, and there are extensive definitions and details provided in the statute.

The client and drafter do not need to limit themselves to the provisions of such a statute. As an alternative, the will or trust itself can set forth whatever unitrust or annuity provisions are appropriate or desirable, and in states without unitrust legislation this will be the only alternative. (The IRS has even authorized the use of unitrusts in lieu of the income requirements, for example, of marital deduction trusts.)¹⁵³ Following are some drafting considerations for those who wish to provide a customized unitrust. See also Appendices 3C and 3D above.

For example, in a trust for a child, there is no tax requirement that the child be entitled to all of the trust's income. The testator may decide, for example, that the child should receive an amount equal to 5% of the trust's value each year, so that any total return in excess of that amount would continue to be held by the trustee and the growth compounded. Conversely, if the ordinary income in a given year

149. *Id.* § 11-2.4(e)(2).

150. *Id.* § 11-2.4(e)(5)(B).

151. Matter of Heller, *supra* note 148 (determining that the election is subject to review where the trustees have a personal financial interest in the election).

152. EPTL § 11-2.4(e)(5)(A).

153. See section 6:9.3[E], *infra*.

happens to be less than 5%, the child would nevertheless be entitled to that amount.

Drafters have some experience with charitable lead and remainder annuity trusts and unitrusts. The concept under discussion is similar, without any of the technical rules required to qualify for income, gift, estate, and GST tax deductions because charity is not a beneficiary. A possible clause is as follows:

My Trustees shall pay to such child each year, in quarterly installments, an amount equal to 5% of [the initial value of the trust] [or the value of the trust at the end of the preceding fiscal year], first out of the income of the trust (accumulating any excess income and adding it to principal) and, to the extent that such income is insufficient for the payment of this annuity, out of the principal of the trust, including capital gains.

There are some drawbacks to this approach, of course. First, what would otherwise be taxed, for fiduciary income tax purposes, as a “simple trust”—that is, all of the ordinary income is taxed to the beneficiary who is entitled to receive it, whether or not he in fact receives it¹⁵⁴—now becomes a “complex trust,” in which the taxable income of the trust and the beneficiary depend to a large extent upon the amounts actually distributed to the beneficiary during the tax year and immediately thereafter.¹⁵⁵ Moreover, distribution of appreciated trust assets in kind to satisfy the annuity or unitrust distribution requirements will likely trigger recognition of capital gain,¹⁵⁶ unless the annuity or unitrust amount is expressed as a fixed or floating *percentage* of the value of the trust (rather than an *amount* calculated under a formula which in turn depends upon a percentage of value).

A trust of this sort also requires attention to a greater number of drafting details than a more traditional income trust: Should the annuity be fixed from year to year or should it float with the value of the trust? Should the annuity be expressed in terms of absolute dollars or as a fraction of the value of the trust? Should the amount or fraction change from year to year even if the value of the trust does not?

Nevertheless, an annuity trust or unitrust offers a certain level of predictability to the beneficiary. It also offers to the fiduciary the freedom to invest for a total portfolio return, as invited by the new prudent investor rule, without the distraction of trying to predict the effect of the principal and income rules, as applied to the projected investment results of each asset, on distributions to the beneficiaries.

154. I.R.C. §§ 651–52.

155. *Id.* §§ 661–63.

156. *Id.* § 663(a)(1); Treas. Reg. §§ 1.661(a)-2(f)(1), 1.663(a)-1(b)(1), 1.664-1(e)(2).

Consider the following clause for a guaranteed unitrust amount payable to the beneficiary after having attained a particular age, where the trustees are also given the discretion (or required) to pay to the beneficiary any additional income that is received and to invade principal subject to an ascertainable standard (the age and percentage in this model clause are merely an example and may be varied as the client wishes):

At the end of each trust year after the Beneficiary has attained the age of 25 years, the Trustees shall pay to the Beneficiary a unitrust amount equal to five percent (5%) of the average of the net fair market value of the assets of the trust on the first business day of such year and of the immediately preceding trust year. The unitrust amount shall be paid from income and, to the extent that income is insufficient, from principal. The unitrust amount shall be prorated for any short year.

The Trustees [alt. 1: are authorized and empowered, at any time and from time to time, to pay to the Beneficiary any part or all of the net income in excess of the unitrust amount for any year as the Trustees, in their discretion, determine. Any net income not so paid to the Beneficiary shall be accumulated and added to principal.] [alt. 2: shall pay to the beneficiary at least annually all net income in excess of the unitrust amount.]

The Trustees are authorized and empowered, at any time and from time to time, to pay to the Beneficiary such part or parts of the principal of the trust as they, in their discretion, determine, for the health, education, support, or maintenance of the Beneficiary taking into account the other resources of the Beneficiary, and the interests in the trust of all other persons. This power includes the power to distribute all of the principal to the Beneficiary, effecting a termination of the trust.

Another possibility is to describe the entitlement of the beneficiary as a percentage of the trust's assets each year (rather than as an amount calculated by reference to such a percentage). The purpose of such a difference is primarily to attempt to avoid the recognition of capital gain if appreciated assets are distributed to the beneficiary, unless the trustee elects to the contrary under section 643(e) of the Code. The language should be the same as in the foregoing example, except that reference to "a unitrust amount equal to 5 percent" is replaced by "5 percent of the trust" or "a fractional share of the trust equal to 5 percent."

The "modern portfolio theory" of investing reflected in the Prudent Investor Act has been required by the investment standards governing retirement and pension plans under ERISA and a number of states are

headed in the same direction as the Act spreads. As that happens, drafters should give serious consideration to recommending increased use of annuity trusts and unitrusts in place of traditional income trusts.

See Appendices 3C and 3D for further models.

One important caveat must be stressed: in order to qualify for the marital deduction for estate and gift tax purposes, a trust for a spouse must provide that she is to receive all of the income as determined for local law trust accounting purposes. If the testator wishes to guarantee his surviving spouse an annuity or unitrust amount, it *must* be expressed as “the greater of” the ordinary trust income or the desired annuity or unitrust amount in order to guarantee that the income requirement will be satisfied, except in a state whose law qualifies under Treasury regulation section 20.2056(b)-7(d)(1).¹⁵⁷ Alternative two in the specimen above should be acceptable in this regard.

[D][3] The Trustee’s Duty to Diversify Assets

With the advent of the Prudent Investor Act [see section 6:9.3[D]], the portfolio theory of investment became the legally mandated principle for the investment of trust assets. The underlying investment theory is that the diversification of assets decreases the overall investment risk of the portfolio because “not all eggs are put into one basket.” Thus, one bad investment will not catastrophically decrease the trust’s capital, and as a result, aggregate net investment returns are expected to be higher. If the various investments are of different and potentially counter-cyclical types (stocks [perhaps further diversified using large-cap, mid-cap, small-cap, domestic, emerging markets, Euro, Asian], bonds (similarly further diversified), money markets, private equity, real estate, commodities, hedge funds, etc.) and in different holdings within each class or subclass, then exposure to a massive loss in the event of a market downturn in one section is greatly reduced.

The duty to diversify trust assets is codified in one form or another in many states and became subsumed into the many duties of a trust fiduciary. For example, the New York Prudent Investor Act now requires the trustee:

to diversify assets unless the trustee reasonably determines that it is in the interest of the beneficiaries not to diversify, taking into account the purposes and terms and provisions of the governing instrument; . . .

157. Discussed in section 6:9.3[E], *infra*.

[D][3][a] The Balance Between the Duty to Diversify and the Testator's Wishes

There are times when the testator or settlor has accumulated substantial wealth in the form of stock of a single public company. Perhaps the client was a founder or key employee. Often this individual, together with his or her family, will feel that they owe their material and social success to the company and are averse to the thought of ever selling the stock in order to diversify. Perhaps they think that over the long term no basket of other investments can outperform this stock, based on their experience to date. In such situations the will or trust may address retention of the stock, or the family may do so after the death of the progenitor. An illuminating series of cases demonstrates the frightening risks to which a trustee may be exposed if it succumbs to the blandishments urging retention, after the stock falls out of favor and the beneficiaries seek damages. After summarizing these cases we address some solutions.

In a case relating to the period prior to the Prudent Investor Act, but decided after enactment of the statute that first explicitly required diversification, New York's highest court held a trust company liable even under the prior standard for failing to sell a large block of Kodak stock as it lost value.¹⁵⁸ The decision revisits the old rule and finds a limited duty to diversify even without the new statute, in a case where concentration of the trust portfolio in a single investment itself creates or increases risk.

If a trust with a concentrated portfolio has been in existence for several decades, its trustee may be subject to each of the prudent investor, prudent person and common law diversification standards for different time periods. However, differing applicable standards do not necessarily produce different results in court. For instance, in *Matter of HSBC Bank USA*,¹⁵⁹ a grantor formed a trust in 1957 and funded it in part with shares of the F.W. Woolworth Company, a family controlled business. The trust gave the trustee power to invest "without regard to diversification" and the trustee held the shares of Woolworth until 1997. When the trustee requested judicial acceptance of its resignation and an accounting for the period from 1957 through 2005, four of the trust's income beneficiaries filed objections, arguing that the trustee failed to diversify the trust's holdings and should not have retained 23,000 shares of Woolworth stock. The Surrogate's Court agreed and awarded the beneficiaries nearly \$30 million.

158. *In re Estate of Janes*, 659 N.Y.S.2d 165, 169–70, 90 N.Y.2d 41, 49–52, 681 N.E.2d 332, 335–38 (1997).

159. 2012 N.Y. Slip Op 4954, 2012 N.Y. App. Div. LEXIS 4880 (App. Div. 4th Dep't June 19, 2012).

The Appellate Court reversed the Surrogate in significant part. The court explained that the most recent prudent investor standard required the trustee to diversify the trust's holdings while the earlier prudent person and common law standards "dictated against any absolute rule that a fiduciary's failure to diversify . . . constituted imprudence." The court held that under all three standards the trust's holdings were diversified, with securities from different industries, cash, and bonds. Although the trust had held an overweight position in Woolworth and four other securities, these assets actually increased in value. As such, the beneficiaries could not establish that the trust sustained a financial loss by retaining these positions, and the trustee was not liable for a surcharge. The court concluded that the trustee's only failure was to retain Woolworth stock after it stopped paying dividends in 1995, reasoning that the trust was established "to generate income" and that there was "no logical reason," other than family connection, to retain the stock after its dividends ended.

In a similar case, the remainder beneficiaries of a residuary testamentary trust sought to surcharge the trustee for failure to diversify the trust's holdings. The sole asset of the trust was IBM stock received from the decedent's estate. In 1960, the beneficiaries (a life tenant and two remainder beneficiaries) signed an agreement authorizing the trustee to hold the IBM stock instead of diversifying. Since 1984, the two remainder beneficiaries had urged the trustee to diversify, although the trustee insisted that IBM stock should be kept as long as it was on their parent corporation's buy list and that they were unable to diversify because there was not unanimous written revocation of the previous agreement. However, the bank's own internal policy directed careful annual review of accounts holding large concentrations of IBM stock, which was not carried out. The market decline in 1987 caused a \$4 million loss to the trust. The Surrogate¹⁶⁰ found that the direction to retain the stock was no longer effective once some of the beneficiaries repudiated it. Furthermore, IBM's underperformance, the failure of the bank to contact the family pursuant to its own internal policies and a failure to sell before an increase in the capital gains rate when the stock was declining contributed to a finding of a breach of fiduciary duty. The court then used a 1987 letter from a daughter urging diversification as a benchmark for the date from which to calculate the surcharge.

The Appellate Division affirmed,¹⁶¹ emphasizing the bank's failure to keep the beneficiaries informed and the fact that the agreement of

160. *In re Saxton*, 179 Misc. 2d 681, 686 N.Y.S.2d 573 (Sur. Ct. Broome Cnty. 1998).

161. *In re Saxton*, 274 A.D.2d 110, 712 N.Y.S.2d 255 (App. Div. 3d Dep't 2000).

the beneficiaries could not authorize the trustee to act imprudently. The appeals court directed a recomputation of damages in a manner designed to augment the surcharge.

In another New York case,¹⁶² the court considered the standard of investment prudence used to judge the trustees' conduct of a thirty-year-old inter vivos trust. Part of the trust was funded with stock of a public company to which the grantor had sold a portion of his family business. The grantor's brother and a bank were the trustees. The trust agreement expressly prohibited sale of the stock unless agreed by the brother as co-trustee. The trust also expressly authorized retention of the stock and lack of diversification. Several years after creation, the trust accepted an offer from the company to redeem the stock at a price less than half its initial value. In an accounting, the grantor's children sought a surcharge for failure to sell the stock at the time to the trust's creation and for losses attributable for the failure to retain equities that were subsequently sold by the bank at the grantor's request. The court did not grant summary judgment to either side because there was a factual question based on the prudent person standard then in effect. The court distinguished the *Janes* case¹⁶³ where the trustee bank was liable for failure to sell 95% of the Kodak stock held in the trust at the trust's inception. The court stated that *Janes* involved an estate that was the sole support of a widow, and not an inter vivos trust holding stock of a company that was continuing grantor's business and which included an agreement that the trustees had the right not to sell the stock.

New York dealt with another similar case involving Kodak stock in 2004. In that case, the Appellate Court reversed the Surrogate's finding that the trustee should have sold the trust's near exclusive holdings of Kodak stock. The Surrogate¹⁶⁴ had considered the effect of a clause that directed the executors and testamentary trustee not to dispose of decedent's Kodak stock for purposes of diversification. The will purported to exonerate the fiduciaries from liability for loss in value of the stock. These provisions were subject, however, to a clause authorizing the trustee to sell the stock "in case there shall be some compelling reason other than diversification of investment for doing so." The Surrogate concluded that the corporate trustee failed to manage the trust prudently, and failed to recognize what the court found were compelling reasons, other than diversification, to sell:

162. *In re Bank of N.Y. (Li)*, N.Y.L.J., Apr. 26, 2000, at 27 (Sur. Ct. N.Y. Cnty. 2000), *aff'd*, 276 A.D.2d 407, 717 N.Y.S.2d 512 (App. Div. 1st Dep't 2000).

163. *See supra*, note 158.

164. *In re Dumont*, 4 Misc. 3d 1003(A), 791 N.Y.S.2d 868 (Sur. Ct. Monroe Cnty. 2004).

ongoing, significant losses that jeopardized the value of the trust corpus, and the low income yield of the stock. The trustee was surcharged almost \$21 million, including damages to the trust for loss of value and forfeiture of commissions.

The ruling, however, was reversed on procedural grounds. The Appellate Court¹⁶⁵ unanimously held that the Surrogate's Court erred in finding, *sua sponte*, that the trustees should have sold the Kodak stock as of a specific date in the absence of pleadings or proof of that date. This finding was impermissible and based on "nothing more than hindsight" and the Surrogate may not "look beyond the objections" brought by the trust beneficiaries to determine that a compelling reason existed to sell the Kodak stock as of a different, later date. The reversal relieved the trustee from the large damage award, but it does not carve out new law on the issue of diversification.

[D][3][b] Diversification and Market Pressures

Sometimes the trustee will make a decision regarding diversification of assets based on the condition of the market. In a New York case,¹⁶⁶ the failure to diversify resulted in the fiduciary's removal and a surcharge to the trustee. The remainderman of a testamentary charitable lead trust created in decedent's will claimed that the bank, in failing to diversify its portfolio of (once again) IBM stock, had acted imprudently. The trust was created in 1989 and funded with 30,000 shares of IBM stock. The trust had a fifteen-year term. A few months after the trust was funded the bank reviewed the trust and determined that since the value of the stock had declined it would be imprudent to diversify immediately. Rather, the bank suggested that the trust wait until the stock picked up in value to diversify. This is not an uncommon reaction to realization that an investment has lost value; but that does not make it a wise one. After all, sometimes (more often than investors would like) stocks that have lost value do not regain it! Strictly speaking, there is little if any logical relationship between the fact that a stock has already lost value and the prudence of diversification.

Eventually the bank sold 8,000 shares, but there were still 19,398 shares left in the trust in 1996 (at time of trial) at a value of \$74, compared to the initial value of \$117. The Surrogate found the bank negligent for not diversifying in 1989. Consequently, the court revoked the bank's letters of trusteeship, appointed successors to the trustee and ordered the bank to refund its commissions and pay damages. The bank appealed and the appellate court affirmed. The Appellate

165. *In re Dumont*, 26 A.D.3d 824, 809 N.Y.S.2d 360 (App. Div. 4th Dep't 2006).

166. *In re Rowe*, 274 A.D.2d 87, 712 N.Y.S.2d 662 (App. Div. 3d Dep't 2000).

Division used the following factors as ground to affirm: testimony of the objectant's expert; the failure of the bank to adhere to its internal protocols and to review the trust more often in light of the trust's needs; and the fact that the trust had no restrictions on diversifying nor were there any adverse tax consequences to restrict the bank from diversifying.

In 2007, the New York Appellate Division took a more subjective approach to reviewing the decision of the trustees not to diversify.¹⁶⁷ A large portion of the trust assets were held in Finch Pruyn, a closely held family corporation whose stock was not publicly traded. Class A shareholders of Finch Pruyn stock held all of the voting rights and controlled any decision as to liquidation. However, it was the Class B shareholders who would receive the proceeds from the liquidation. This unique capital structure created a deadlock in that the stockholders who had voting rights on liquidation would not receive the benefit of liquidation. Because of these factors, there was essentially no market for the Finch Pruyn stock. After meeting with numerous investment bankers and brokerage houses, the trustees concluded that a fair price for the shares could only be obtained through a sale of the entire company. The court found that because of these specific facts, the trustees were justified in their decision not to diversify.

[D][3][c] Diversification and Hindsight Liability

The courts have explicitly held that trustees cannot be held liable for making investment decisions merely because in hindsight they were not beneficial to the trust. Similarly, trustees cannot avoid liability for imprudent investments even if the trust experienced a net gain.

In a 1974 New York case,¹⁶⁸ the Court of Appeals affirmed the Appellate Division's decision not to surcharge the trustee with respect to its investment of the shares of three companies but disagreed with the basis of that decision. Instead, the Court of Appeals stated that "[t]he fact that this portfolio showed substantial overall increase in total value during the accounting period does not insulate the trustee from responsibility for imprudence with respect to individual investments for which it would otherwise be surcharged." The court ultimately found that the actions of the corporate trustee did not warrant surcharging as they acted in good faith and not imprudently. The court further cautioned that "it is not sufficient that hindsight might suggest that another course would have been more beneficial; nor does a mere error of investment judgment mandate a surcharge."

167. *Matter of Hyde*, 44 A.D. 1195, 845 N.Y.S.2d 833 (App. Div. 3d Dep't 2007).

168. *In re Bank of N.Y.* (Spitzer), 35 N.Y.2d 512, 323 N.E.2d 700 (1974).

In a 2010 case, the Surrogate's Court reiterated the principle that trustee liability (or lack thereof) cannot be based on hindsight.¹⁶⁹ Like the 1974 case discussed in the previous paragraph, the court rejected the argument that because the trust experienced a net gain, the trustees should not be liable for failing to diversify. Instead, the court found that the trustee's actions violated its own internal policies and failed to meet the prudent investor rule. The court awarded damages in the amount of the trust capital lost by failing to diversify (by selling 95% of the Kodak shares) on the date by which the trustee should have sold the shares (which date was determined by the court).

[D][3][d] Drafting Guidelines

A common thread in many of these cases is that the failure to diversify was a violation of internal bank policy, policies of the Comptroller of the Currency and regulations of the Federal Reserve Bank. Generally, those policies prohibit holding more than 10% of a trust's portfolio in a single asset, and in many cases once diversification is required damages are computed based on the theory that 90% of the stock should have been sold within thirty (30) days. This is not a strict rule but rather a guideline of convenience.

Notwithstanding, if a testator is set on retaining a large block of stock, drafting a generalized retention clause is not sufficient to override the duty to diversify. In an Ohio case, the question arose whether the duty to diversify remained when the testator empowered the corporate trustee to retain its own stock.¹⁷⁰ This generally poses a conflict of interest, which the testator can remedy by using a retention clause that circumvents the duty of loyalty imposed on trustees. The retained stock in this case made up over 80% of the trust assets. The trust underperformed and one of the beneficiaries sued the corporate trustee for failure to diversify the trust assets. While the corporate trustee pointed to the testator's retention clause, the court held that even where a trust allows the retention of assets that would not normally be suitable or prudent, the duty to diversify remained and attached to all investments, even those already held in trust, absent explicit authorization not to diversify or special circumstances. Trust holdings that are important to the family, such as a piece of farmland or a family business, for example, fall into the category of special circumstances.

169. *In re JPMorgan Chase Bank (Hunter)*, 27 Misc. 3d 1205(A), 910 N.Y.S.2d 405 (Sur. Ct. Westchester Cnty. 2010).

170. *Wood v. U.S. Bank*, 160 Ohio App. 3d 831, 828 N.E.2d 1072 (2005), *appeal denied*, 835 N.E.2d 727, 106 Ohio St. 3d 1545 (Ohio 2005).

The *Wood* case was followed a year later¹⁷¹ by a case involving Procter & Gamble stock that was contributed to a charitable remainder unitrust by a descendent of the founding family of that company. The court held that the state attorney general had properly participated in the trial, that the trust agreement did not authorize retention of undiversified stock with sufficient specificity, and that even if the agreement were construed to include such specific authorization the bank would still be liable for losses because its investment officer failed “to verify facts relevant to the investments and management” of the CRUT as required by state statute. The court upheld a judgment against the bank of just over \$1 million.

In a recent Indiana case,¹⁷² the trustees were entitled to rely on an express clause which authorized them “to retain indefinitely any property received by the trustees . . . and any investment made or retained by the trustees in good faith shall be proper despite any resulting risk or lack of diversification” Part of the reason this was effective, however, was the extensive participation of sophisticated counsel for the charitable beneficiaries in the trust plan and in particular in the use of the retention language as well as the plan to gradually dispose of the concentrated stock position. Moreover, diversification cannot become a goal in and of itself, but instead is a tool to be used as part of an overall prudent investment approach.¹⁷³

It is imperative for drafters to be explicit about the testator’s intent since the trust instrument governs and, if sufficiently specific, can abrogate the duty to diversify or circumvent a rule that prohibits a trustee from owning its own stock. This point is driven home in another Ohio case, which the court distinguished from *Wood* because the testator’s intent was stated incontrovertibly.

In this case, the plaintiffs alleged, among other grievances, a breach of fiduciary duty for failure to properly diversify a trust that was created by the Smucker heir. In 1980, common shares of the Smucker Company made up 87% of the trust’s value, but by 2001, this had decreased to 25%. The court’s analysis begins with an excerpt from the trust instrument:

The Trustees are empowered to retain as an investment, without liability for depreciation in value . . . securities acquired by the Trustees . . . from the Grantor or any other person, even though such property be of a kind not ordinarily deemed suitable for trust

171. Fifth Third Bank v. Firststar Bank N.A., 2006-Ohio-4506, 2006 Ohio App. LEXIS 4456 (Ohio Ct. App. 2006), *appeal denied*, 860 N.E.2d 768, 112 Ohio St. 1445 (Ohio 2007).

172. Americans for the Arts v. Ruth Lilly Charitable Remainder Annuity Trust #1, 855 N.E.2d 592 (Ind. Ct. App. 2006).

173. See *In re Sky Trust*, 868 A.2d 464, 2005 Pa. Super. 6 (Pa. Super. 2005).

investment and even though its retention may result in a large part or all of the trust property's being invested in assets of the same character or securities of a single corporation. . . . Without limitation upon the generality of the foregoing, the Trustees are expressly empowered to retain as an investment, without liability for depreciation in value, any and all securities issued by The J.M. Smucker Company, however and whenever acquired, irrespective of the proportion of the trust properly invested therein.¹⁷⁴

Although the decision in *Wood* suggested that a duty to diversity remains where the trust document allows the trustee to retain certain assets, the *Noble* court stressed that this was the case only if the trust instrument clearly indicated an intention to abrogate the duty to diversify. The court absolved the trustees from wrongdoing because the agreement on its face shielded them from liability in case of depreciation of a non-diversified trust portfolio. The decedent's instruction, succinctly drafted in the trust agreement, and expressly authorizing retention of this particular stock, therefore settled the question. Though special circumstances may have applied as a trump card against diversification because Smucker's is a family business, the court did not broach the topic because the trust instrument was dispositive.

Thus, the key to circumventing diversification is to (i) empower the trustee to retain investments that might otherwise be deemed unsuitable (that is, a large block of a single asset, specifically identified) and (ii) exonerate the trustee from any liability should there be depreciation in the trust value on account of this investment.

A 1980 New York Surrogate's Court case offers a second solution.¹⁷⁵ In that case, the court was faced with several trusts that had decreased in value. The trustees had acquired Real Estate Investments Trusts (REITS) on behalf of the estate and retained them through a period of economic decline. The trustees defended by arguing that the beneficiary had consented to the investment because she had expressed dissatisfaction with the size of the trust and the expected return. The court stated that although the trustee can insulate himself from liability for failing to diversify by obtaining informed consent from each beneficiary, that consent must be given "with full knowledge of all material facts relating to the transaction," including knowledge of the act's failings and the right to accept or reject the act. Here, although the beneficiary expressed a need for substantial income, she

174. *Nat'l City Bank v. Noble*, 2005-Ohio-6484, 2005 WL 3315034 (Ohio Ct. App. 2005).

175. *Matter of Newhoff's Will*, 107 Misc. 2d 589, 435 N.Y.S.2d 632 (Sur. Ct. Nassau Cnty. 1980), *aff'd*, 107 A.D.2d 417, 486 N.Y.S.2d 956 (App. Div. 2d Dep't 1985).

did not authorize the initial or subsequent investments in REITS nor ratified them as she did not know the precise nature of the investments.

Of course, having the power to override the duty to diversify does not mean the power should be used indiscriminately. When a testator would like to retain a plot of land or a family business interest, there is arguably an ascertainable benefit to the beneficiaries (though maybe not an economic one), which justifies the testator's intent not to diversify.

Such sentimental value, coupled with a general retention clause, was found to be sufficient to overcome the duty to diversify in *In re Trust Created by Harold Inman*.¹⁷⁶ In *Inman*, the trust assets consisted solely of 189 acres of farmland. The trustee, who was also a beneficiary of the trust, sought court approval authorizing him to sell a portion of the farmland to himself, arguing that he had a duty to diversify the trust's assets. The Nebraska court held that the trustee would not be violating any duty by retaining the land, because the trust instrument authorized the retention of assets if such retention was in the best interests of the beneficiaries, and a majority of the beneficiaries were opposed to the sale based on their sentimental attachment to the land.

Moreover, diversification in cases where assets are illiquid is often impractical. However, in the case where a testator directs that a large block of stock of a publicly held company not be diversified when diversification is easy and economically sensible, it seems unjustifiable and needlessly risky for the health of the trust fund not to do so.

[D][4] Retention of Initial Portfolio

There has also been considerable litigation regarding the ability of a fiduciary to retain assets received upon inception (for example, the decedent's assets in the case of an executor, and the assets distributed from the estate, or delivered by a previous trustee, in the case of a testamentary trust). The statute now imposes an express duty:

(D) within a reasonable time after the creation of the fiduciary relationship, to determine whether to retain or dispose of initial assets.¹⁷⁷

Especially in the case of closely held business, under appropriate circumstances the client and drafter should consider abrogating this requirement by express language in the will. Consider some of the

176. *In re Trust Created by Harold Inman*, 269 Neb. 376, 693 N.W.2d 514 (Neb. 2005).

177. EPTL § 11-2.3(b)(3)(D).

language and approaches set forth in the cases addressed in subsection [D][3], above.

The protection afforded by retention clauses is far from absolute. In the *Saxton*, *Janes*, *Rowe*, and *Dumont* cases mentioned above (section 6:9.3[D][3]), the undiversified portfolio in each instance was comprised of stock that was part of the original trust corpus. That circumstance, however, did not absolve the fiduciary from liability for loss even though the testator expressed a desire that the stock be retained. Query whether the Surrogate in the *Dumont* case would have surcharged the trustee even in the absence of the clause authorizing it to sell for compelling reasons. Possibly so, in view of the court's statement, "Where prudence dictates sale, a retention clause is superseded [citing *In re Hubbell*, 302 N.Y. 246, 97 N.E.2d 888 (1951)]."

[D][5] Additional Powers Under the New Statute

After listing the general standard and the four requirements quoted in the above sections,¹⁷⁸ the statute lists four acts that "the prudent investor standard authorizes a trustee" to do,¹⁷⁹ which will be discussed in this section and in section 6:9.3[D][6] below. The first act that the trustee is authorized to do is:

(A) to invest in any type of investment consistent with the requirements of this paragraph, since no particular investment is inherently prudent or imprudent for purposes of the prudent investor standard; . . .¹⁸⁰

This language, as proposed in the original bill and the Uniform Act, would simply have provided that "no particular investment is inherently imprudent"; as enacted in New York, the bill was modified to make it clear that the trustee cannot assume that any particular investment is inherently prudent, either. The trustee is also authorized (the second item listed in the statute):

(B) to consider related trusts, the income and resources of beneficiaries to the extent reasonably known to the trustee, and also an asset's special relationship or value to some or all of the beneficiaries if consistent with the trustee's duty of impartiality; . . .¹⁸¹

Here, the trustee is invited to focus on the beneficiaries' needs and desires, including not only the beneficiaries' own resources but also other trusts that are available for the beneficiary. Presumably, the

178. EPTL § 11-2.3(b)(3)(A)-(D).

179. EPTL § 11-2.3(b)(4)(A)-(D).

180. EPTL § 11-2.3(b)(4)(A).

181. EPTL § 11-2.3(b)(4)(B).

“special relationship or value” of an asset to a beneficiary may relate to fractional interests in the same asset that are shared between the beneficiary and trust, or other economic synergies. Query whether the emotional attachment to an asset, such as shares of the company founded by the beneficiary’s parent, are to be considered here.¹⁸²

[D][6] Delegation of Investment and Management Functions

In a long-anticipated development, the new statute expressly authorizes a trustee (this is the third item in the Prudent Investor statute):

(C) to delegate investment and management functions if consistent with the duty to exercise skill, including special investment skills; . . .¹⁸³

The last clause of this subsection suggests that trustees with special investment skills will have less justification to delegate investment authority except perhaps in areas beyond their own expertise (such as foreign investments, commodities or other nontraditional investments).

In a separate subsection dealing exclusively with delegation of investment or management functions, the statute spells out the duties and responsibilities of the trustee and delegee as follows:¹⁸⁴

- (c) Delegation of investment or management functions
 - (1) Delegation of an investment or management function requires trustee to exercise care, skill and caution in:
 - (A) selecting a delegee suitable to exercise the delegated function, taking into account the nature and value of the assets subject to such delegation and the expertise of the delegee;
 - (B) establishing the scope and terms of the delegation consistent with the purposes of the governing instrument;
 - (C) periodically reviewing the delegee’s exercise of the delegated function and compliance with the scope and terms of the delegation; and
 - (D) controlling the overall cost by reason of the delegation.

182. The cases noted in section 6:9.3[D][4], *supra*, suggest a negative answer.

183. EPTL § 11-2.3(b)(4)(C).

184. EPTL § 11-2.3(c).

- (2) The delegee has a duty to the trustee and to the trust to comply with the scope and terms of the delegation and to exercise the delegated function with reasonable care, skill and caution. An attempted exoneration of the delegee from liability for failure to meet such duty is contrary to public policy and void.
- (3) By accepting the delegation of a trustee's function from the trustee of a trust that is subject to the law of New York, the delegee submits to the jurisdiction of the courts of New York even if the delegation agreement provides otherwise, and the delegee may be made a party to any proceeding in such courts that places in issue the decisions or actions of the delegee.

These provisions are the results of extensive negotiations and compromise. Originally, the bill as proposed (like the Uniform Act) would have entirely exonerated fiduciaries who exercised the appropriate level of prudence in selecting and supervising the delegee. Thus, if a trustee prudently selects and supervises an investment manager, the trustee would not have been liable for poor investment performance even if the investment manager was negligent. That protection does not appear in the final New York statute, while it does in the Uniform Act as passed in several states.

On the other hand, the statute only requires the trustee to exercise care, skill, and caution in the selection of the delegee, the establishment of the scope and terms of the delegation, periodic review of the delegee's performance, and control of the cost resulting from the delegation. Thus, the statute does not expressly make the fiduciary liable for the delegee's negligence. In fact, the question of vicarious liability of that sort seems to remain governed by the general law of agency and is simply not addressed by the statute.

In a sense, this gap is unfortunate because it may still be possible for a trustee to be liable, under the doctrine of respondeat superior or otherwise, for the negligent performance of the agent, even if all due care was exercised in the selection, engagement and supervision of the agent. One of the goals advocated by those who proposed this particular amendment in the statute was to permit trustees to engage professional portfolio managers without fear of vicarious liability. The statute does not achieve that goal. Careful drafting, however, can, because it does not appear that exoneration of the *fiduciary* from vicarious liability for the negligence of the *delegee* violates the public policy restrictions of EPTL section 11-1.7, and as a result, such an exoneration is probably permitted under new section 11-2.3.

The New York statute imposes a duty of reasonable care, skill, and caution on the delegee; imposes on the delegee duties of reasonable care, skill and caution notwithstanding any agreement to the contrary

(such as a standard clause in an investment management or brokerage agreement); and mandates that the mere acceptance of employment as investment manager for a trust that is subject to New York law constitutes submission to the jurisdiction of the New York courts even if the “delegation agreement” provides otherwise, as again many investment management or brokerage agreements do via an arbitration clause. Query whether the will can obviate this requirement; typically, the language of the governing instrument has no effect on jurisdictional provisions of the statute.

Some investment managers have informally opined that those jurisdictional provisions of the state are void (that is, preempted to the extent that they conflict with the federal statutes and regulations governing broker-dealers and investment managers). For that reason, an executor or trustee who signs an investment management or brokerage agreement would be well advised to strike out the standard exclusive arbitration clause and other provisions inconsistent with the statute if he wishes to preserve recourse to the court in case of a dispute (and this may be essential if the fiduciary is later attacked for investment decisions made by the delegee), to avoid being inadvertently drawn into a “test case” of this preemption theory and to avoid a surcharge claim based on the very signing of the agreement.

In addition to the requirement to control the costs of delegation, there is the last of the four general requirements, which authorizes the trustee:

(D) to incur costs only to the extent they are appropriate and reasonable in relation to the purposes of the governing instrument, the assets held by the trustee and the skills of the trustee.¹⁸⁵

This suggests not only that overall costs should be minimized, but that if a bank is the trustee it will be unable to justify the cost of an outside investment manager or investment adviser absent special circumstances. The statute continues the provisions of the prior law that banks, professional investment advisers, and persons representing that they have special investment skills are to be judged by a higher standard, namely, that of a prudent investor “of discretion and intelligence having special investment skills.”

[E] The Final “Income” Tax Regulations and Total Return Legislation

In an attempt to reconcile the tax laws governing trusts with state laws regarding trustee investments and distributions, the Treasury Department issued final regulations (the “Final Regulations”),

185. EPTL § 11-2.3(b)(4)(D).

effective January 2, 2004, revising the definition of “income” under section 643(b) of the Internal Revenue Code and cognate tax laws. These regulations were issued in response to the new range of opportunities given to trustees by the UPIA and the Revised UPAIA in determining how to manage trusts that pay “income” to their beneficiaries. These state law legislative changes are sometimes referred to as “Total Return Legislation” and are discussed extensively in section [D] above.

[E][1] The Tax Questions the Final Regulations Were Intended to Address

The power to adjust between trust principal and income, as well as the unitrust regime, raises issues regarding possible adverse federal tax consequences. Among the concerns the UPAIA and related changes raised were its effect on the gift and estate tax marital deduction (the spouse’s income might be reduced), whether the grandfathered status of old GST trusts would be eliminated, and whether the exercise of the adjustment power would be considered a gift. These concerns arose because many provisions in tax law are based on state law definitions of “income” and “principal,”¹⁸⁶ and the power to adjust and the unitrust option allow the trustee to make adjustments or conversions without regard to what used to be considered accounting income in a trust. Thus, when it was brought to the attention of the Treasury Department that many states had enacted total return legislation containing the power to adjust and/or the unitrust option, the Treasury responded by issuing proposed regulations on February 15, 2001.

The preamble to the proposed regulations observed that without the power to adjust or unitrust approach, the shift in investments from bonds to equities (as preferred at the time by the investment community and encouraged by the Prudent Investor Act) might adversely affect the income beneficiary in that the amount of traditional “income” would be reduced.¹⁸⁷ The proposed regulations in the income, gift, estate and GST tax areas were designed to reflect the changes made in state laws regarding definitions of income and principal to ameliorate this potential harm. *Id.* After written comments were received and public hearings were held, the Final Regulations were subsequently issued on January 2, 2004.¹⁸⁸

[E][2] The Effective Dates for the Final Regulations

The Final Regulations generally apply to trusts and estates for taxable years ending after January 2, 2004, except for regulations that apply

186. See I.R.C. § 643(b).

187. 66 Fed. Reg. 10,396 (Feb. 15, 2001).

188. T.D. 9102 (Jan. 2, 2004).

to pooled income funds¹⁸⁹ and charitable remainder unitrusts.¹⁹⁰ In addition, the preamble states that taxpayers may rely on the provisions of the Final Regulations for any taxable years in which a trust or estate is governed by a state statute authorizing a unitrust payment or a power to adjust in accordance with the Final Regulations. This is a liberalization from the proposed effective date rule promulgated with the proposed regulations.

[E][3] How the Final Regulations Address the Tax Issues

To briefly summarize some of the results under the Final Regulations, it is clear that if the transaction falls within the guidelines described by the Final Regulations, converting a trust into a unitrust or exercising the power to adjust will *not*:

- Cause loss of the federal estate tax marital deduction,
- Result in eliminating the grandfathered status of a GST trust,
- Cause recognition of capital gains, or
- Generate a taxable transfer for gift tax purposes.

[E][3][a] Definition of “Income”

The Final Regulations revise the definition of income. They state: “an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation.”¹⁹¹ Nevertheless, even the Final Regulations, like their predecessor, will generally not recognize trust provisions departing fundamentally from “traditional principles of income and principal.”¹⁹²

Consequently, for example, interest, dividends and rents should still be allocated in the first instance to income, while the proceeds from a sale or exchange of a trust asset should still be allocated to principal. Thus, the issue is what is a “reasonable apportionment of the total return of the trust” that can override the initial, classic allocation of trust receipts between income and principal? The Final Regulations on this point now take into account the two changes in total return legislation that states have made in adopting or modifying the UPAIA.

189. Treas. Reg. § 1.642(c)-2 and (c)-5.

190. Treas. Reg. § 1.664-3.

191. Treas. Reg. § 1.643(b)-1.

192. *Id.*

First, the Final Regulations provide that a “state statute that permits the trustee to make adjustments between income and principal to fulfill the trustee’s duty of impartiality between the income and remainder beneficiaries is generally a reasonable apportionment of the total return of the trust.” (The word “generally” was added to include states that may grant trustees the power to adjust “without enacting a prudent investor standard.”)

In addition, a “state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust.” (Because this exception applies only to statutory unitrusts, a non-statutory unitrust for a surviving spouse, for example, in a state that has not enacted unitrust legislation, will not qualify for the marital deduction unless the trust explicitly states that the spouse will receive the unitrust amount or the trust accounting income, whichever is greater.) As a result, it is clear from the Final Regulations that the benefits of the new regulations apply only to those states that have statutes giving trustees the power to adjust and the power to convert to a unitrust in accordance with the Final Regulations.

[E][3][b] Mandatory versus Permissive Statutes

Note that when authorized by a state statute, the power to adjust and the power to convert to a unitrust are respected whether the distribution is mandatory or discretionary, whether there is more than one beneficiary, and “regardless of which alternate permitted method is actually used.”¹⁹³ Moreover, where there are alternative methods of distributing income under applicable state law, one can switch between methods without the switch constituting “a recognition event for purposes of section 1001 and [it] will not result in a taxable gift from the trust’s grantor or any of the trust’s beneficiaries,” nor will it result in the loss of grandfathered status. This addresses three separate tax concerns raised by the total return legislation.

However, if the methods of determining income are not explicitly authorized by state statute, yet are valid under state law, a switch to or between the new methods may constitute a recognition event for purposes of section 1001 and may result in taxable gifts, “based on the relevant facts and circumstances.”¹⁹⁴ Thus, the favorable treatment of the Final Regulations may not apply to a unitrust that results from a permitted judicial modification or reformation if the state does not have a statute with a specific provision authorizing conversion to a unitrust.

193. *Id.*

194. *Id.*

[E][3][c] Capital Gains and Distributable Net Income

The Final Regulations make it easier to include capital gains in distributable net income (DNI) passed through to the current beneficiary who receives the unitrust amount or the adjustment to “income.” Section 1.643(a)-3(b) is now amended to provide that capital gains from the sale or exchange of capital assets are included in DNI to the extent that:

1. The gains are allocated to income; or
2. The gains are allocated to principal, and they are:
 - a. treated consistently by the fiduciary on all records, trust’s books, and tax returns as part of a distribution to a beneficiary, or
 - b. actually distributed to the beneficiary, or
 - c. utilized by the fiduciary in determining the amount to be distributed to the beneficiary.

In each case that the gains are included in the DNI, the treatment must be made pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of discretion by the fiduciary in accordance with the power granted to the fiduciary by applicable local law or by the governing instrument—if not prohibited by applicable local law. In addition, if income under applicable local law is defined as, or consists of, a unitrust amount and there are no ordering rules either in the state statute or in the governing instrument, the trustee’s discretionary power must be exercised consistently, and the amount distributed may not be greater than the excess of the unitrust amount over the amount of DNI determined, irrespective of the rules in Regulation section 1.643(a)-3(d) that apply to capital gains. Otherwise, capital gains are excluded from the DNI.

[E][3][d] Marital Deduction Trusts

The Final Regulations amend the marital deduction treatment for transfers to trust in both the estate and gift tax contexts. The new rule provides that the income requirement¹⁹⁵ will be satisfied if the spouse is entitled to income under a state statute with a “reasonable apportionment” provision that meets the requirements of section 1.643(b)-1 (that is, a statute providing for either a power to adjust or a unitrust amount of no less than 3% and no more than 5%). As a result, a spouse

195. See I.R.C. §§ 2056(b)(5), 2056(b)(7)(B)(ii)(I), 2523(e), and 2523(f)(2)(B), reflected in Treas. Regs. §§ 20.2056(b)-5(a)(1), 20.2056(b)-5(f)(1), 20.2056(b)-7(d), 25.2523(e)-1(f)(1), and 25.2523(f)-1(c)(i).

who, as the income beneficiary, is entitled to a unitrust amount between 3% and 5% is entitled to all the income for purposes of qualifying the trust for the gift and estate tax marital deduction. In addition, these marital deduction rules apply to qualified domestic trusts under section 20.2056A-5(c)(2).

[E][3][e] Grandfathered GST Tax Exempt Trusts

In general, the Generation-Skipping Transfer (GST) Tax does not apply to any distribution from a trust that was irrevocable on September 25, 1985.¹⁹⁶ Such trusts are called “grandfathered” trusts, and they are allowed to make distributions to people two generations or more below the original transferor without the imposition of the GST tax. The Final Regulations clarify that administering a trust in conformance with local law that allows a unitrust amount or a power to adjust, and that meets the requirements of section 1.643(b)-1, will not cause a shift of beneficial interest.¹⁹⁷ Such a trust will not lose its grandfathered status. Furthermore, changing the situs of the trust to allow for a unitrust conversion or income adjustments also will not affect the grandfathered status of a trust.¹⁹⁸

[E][3][f] Charitable Remainder Trusts

Certain charitable remainder trusts are excluded from the full scope of the liberalization of tax rules. This aspect of the Final Regulations affects only charitable remainder unitrusts that make distributions by reference to “income,” such as Net Income Charitable Remainder Unitrusts (NICRUTs) and Net-Income-With-Makeup Unitrusts (NIMCRUTs). They do not affect charitable remainder annuity trusts (CRATs) or standard charitable remainder unitrusts (STANCRUTs) that pay only a unitrust interest. The IRS’s concern was that, if NICRUTs or NIMCRUTs could elect a unitrust definition of income, under state law, with a payout of less than 5%, the taxpayer could, in effect, indirectly create a charitable remainder unitrust with a fixed percentage payout of less than 5%—which is expressly prohibited, under Code section 664(d)(2)(A).

The new rules provide that, although trust income generally means income as defined under section 1.643(b), for NICRUTs and NIMCRUTs “trust income may not be determined by reference to a fixed percentage of the annual fair market value of the trust property, notwithstanding any contrary provision in applicable state law.”¹⁹⁹ In addition, gains from the sale of assets contributed to the trust by the

196. Pub. L. No. 101-508, §§ 1433(b)–(d); Treas. Reg. § 26.2601-1(b).

197. Treas. Reg. § 26.2601-1(b)(4)(i)(D)(2).

198. Treas. Reg. § 26.2601-1(b)(4)(i)(E), Exs. 11 and 12.

199. Treas. Reg. § 1.664-3(a)(1)(i)(b)(3).

donor must be allocated to principal and not to trust income “at least to the extent of the fair market value of those assets on the date of their contribution to the trust.”²⁰⁰ Further, capital gains may not be distributed to trust income “at least to the extent of the trust’s purchase price of those assets.”²⁰¹

Notwithstanding the two above exceptions, capital gains from assets contributed to the trust by the donor or purchased by the trust may be allocated to income pursuant to the terms of the governing instrument, if not prohibited by local law. Moreover, the trustee’s discretionary power to make this distribution is acceptable, but “only to the extent that the state statute permits the trustee to make adjustments between income and principal to treat beneficiaries impartially.”²⁰²

[E][3][g] Pooled Income Funds

The Final Regulations amend the definition of income for pooled income funds, by making the charitable deduction for a contribution of long-term capital gain unavailable if the income beneficiary’s right to income could be met either as a unitrust amount or by adjusting between income and principal. Therefore, if state law permits a unitrust definition of income for pooled income funds that would disqualify a contribution to a pooled income fund from receiving the charitable deduction, the fund may reform the fund’s governing instrument until October 2, 2004.

[E][4] Distinctions Between the Final Regulations and the Proposed Regulations

The Final Regulations deviate from the proposed regulations in two significant ways. First, the Final Regulations clarify that distributions apportioning the total return of the trust pursuant to state statute will be respected “regardless of whether the trust has one or more income beneficiaries and irrespective of whether income must or may be paid out each year.” The proposed regulations were unclear as to what types of trusts would apply.

Second, the Final Regulations allow for changing between alternative methods as described above, but only those methods that are specifically authorized by state statute.

[E][5] Open Issues

The Final Regulations complete the chain of modernization of prudent investing law that commenced with the *Restatement (Third)*

200. *Id.*

201. *Id.*

202. *Id.*

of Trusts and the Prudent Investor Act, and now reflect and clarify the tax impact of the changes that were brought about with total return legislation. Nevertheless, the Final Regulations do leave open the question regarding what constitutes a “fundamental departure” from the “traditional principles of income and principal.”²⁰³

Because of this open point, trusts should whenever possible be drafted and administered pursuant to statutes that fall within the ambit of the tax rules. For example, if a state statute does not expressly provide for a unitrust approach, then a trust which is drafted as a unitrust, and which is valid in that state under general principles of freedom of testation or donation, may still run afoul of these tax problems.

A more remediable problem can arise if a trust is drafted as a unitrust in a state that expressly authorizes trusts to opt into a statutory unitrust scheme. It is possible, under the Final Regulations, that such a trust will not have the benefit of the relaxed tax rules because it is not a unitrust pursuant to the statute! Presumably the trustee can opt into the state unitrust statute to cure this concern, but possibly at the cost of overriding any specific provisions that the settlor or testator added as to how the unitrust is to be administered, if they conflict with the state default rules.

§ 6:9.4 Other Provisions Relating to Investments

If unconventional investments are contemplated, they should be specifically authorized. Otherwise, the fiduciary may question the authority to make the investment, as will the counterparty. Thus, the investment authorization would specify investments in:

puts, calls, warrants, futures, forwards or other derivative investments, in each case whether foreign or domestic and with respect to financial instruments and any group or index of securities, whether or not such derivative investments relates to any other property held as a trust investment and in connection with any such investment to deposit any property as collateral with any agent, and to grant security interests in such collateral; interests in commodities, foreign currencies, gold, silver or other precious metals, jewels, rare books, antiques, stamps, coins, or other works of art.

If investments may include non-income producing assets and if there is a trust for the surviving spouse intended to qualify for the marital deduction, the investment clause should permit the spouse to

203. See E. James Gamble, *Trust Accounting and Income Taxes* (AICPA June 2005) (suggesting that a provision that defines ordinary dividends and interest as principal would constitute a fundamental departure).

compel the trustee to convert the investment to one that produces income. The absence of such a savings clause could jeopardize the marital deduction, since the deduction is available only if the trust entitles the spouse to all of the income.²⁰⁴ An example of such a clause is:

Notwithstanding the investment authorization in this instrument, my fiduciaries are not authorized to hold in a trust for my wife that is intended to qualify for the federal estate tax marital deduction, any property that is not productive of income for longer than a reasonable time without her consent.

Or, more simply:

My wife, [NAME], shall have the right to compel my Trustees to convert any non-productive property at any time held in the trust under this Clause into income-producing property.

If the creator desires for one or certain of several fiduciaries to make investment decisions broadly or over a particular investment (for example, the decision to sell a contributed asset), it is wise so to specify and to exonerate the remaining fiduciaries from the consequences of such decisions. Consider, however, the effect of statutes like EPTL section 11-1.7 on the validity or scope of such exoneration. See section 6:7 above.

If a corporate fiduciary is contemplated, the investment clause should include an express authorization to invest in common trust funds and/or mutual funds offered by the corporate fiduciary. In some states, including New York, the authorization to invest in mutual funds should allow the bank to receive compensation for serving as a fiduciary in addition to fees in connection with services rendered to its mutual fund. Otherwise, the fiduciary may be required to elect to take either a trustee fee or fees payable by the mutual fund.²⁰⁵ An example follows:

[The Trustees are authorized to invest in] shares or interests in investment trusts, mutual funds (including without limitation trusts or funds for which any corporate fiduciary under this instrument or any affiliate of it acts as investment advisor or performs custody or any other services, in which case such corporate fiduciary or affiliate may be compensated for such services in addition to

204. See section 4:3.5, *supra*.

205. EPTL § 11-2.2(b)(1) (effective for investments made and held through Dec. 31, 1994), § 11-2.3(d) (effective for investments made and held after Jan. 1, 1995).

the compensation of such corporate fiduciary as a fiduciary under this instrument, or common trust funds . . .

§ 6:9.5 Lending

C. To make any loans, either secured or unsecured, in such amounts, upon such terms, at such rates of interest, and to such individuals, firms, or corporations, as they deem advisable.

Although this power might be deemed to be included in the general power to invest, separate mention of it is preferable. Ordinarily, trustees may not make any loans as such, because lending may not constitute the making of an investment. This power should be sparingly used, but its inclusion may serve to meet some emergency situation, especially if the loan is to a beneficiary or to a close corporation or partnership in which the beneficiaries have an interest. Such a loan will be especially appropriate where the trustees have the power to distribute principal outright to the beneficiary; some would argue that the power to lend is a lesser-included power of the power to invade principal.

The power to lend may also prove to be essential to permit certain leveraged or derivative investment strategies.

§ 6:9.6 Sale

D. To sell, exchange, partition, or otherwise dispose of any property, real or personal, which may at any time form part of my estate or any trust created by this will, at public or private sale, for such purposes and upon such terms, including sales on credit, with or without security, in such manner and at such prices, as they deem advisable.

This clause creates a power of sale of real and personal property and authorizes private sales on credit with or without security. It also remedies any lack of inherent power in the executor and trustee to sell real estate without leave of the court.²⁰⁶

§ 6:9.7 Mortgage, Lease, Repairs

E. To mortgage any real property, which may at any time form part of my estate or any trust created by this will, in such amount and on

206. EPTL § 11-1.1(b) provides that unless the will provides to the contrary, every fiduciary is authorized to sell any property not specifically disposed of, at public or private sale, and on such terms as the fiduciary considers most advantageous. In EPTL § 1-2.15, "property" is defined as real or personal property.

such terms as they deem advisable; to lease any such property, for such term or terms, and upon such conditions and rentals, and in such manner, as they deem advisable, irrespective of whether the term of any such lease shall exceed the period permitted by law or the probable period of any trust created under this will, and to renew or modify any such leases; to make repairs, replacements, and improvements, structural or otherwise, of any such property, and to charge the expense to principal or income, as they deem proper; to demolish buildings; to abandon any such property.

In general, fiduciaries have been seriously restricted with respect to the administration of real property.²⁰⁷ To release these restrictions and save the expense of proceedings that may be otherwise necessary to obtain leave of court, the above-quoted clause has been designed to vest the executors and trustees with wide authority in the administration of real property. These powers are unlikely to be intended to apply to property that has been specifically devised outright (that is, free of trust), which is deemed to pass by operation of law to the devisee at the moment of death. If they are intended to do so, the clause should so state explicitly.

The language of the above clause also covers other related matters likely to arise in the administration of real estate held in trust, which call for no specific comment.

Generally, the limitations applicable to the administration of real property do not apply to real property representing the proceeds of personal property originally comprised in the trust. An example is real property bought on foreclosure of a mortgage held by the trust. Because the mortgage originally was personal property, the real property held in substitution therefor, after the foreclosure, should retain the quality of personal property and hence may be sold by the trustees, even in the absence of a power of sale in the will. Similar logic applies to real property of a corporation whose stock is owned by a testator at his death and that was liquidated into his estate. Nevertheless, as stated above, it may be preferable to spell out in the will the authority of the executors and trustees.

In preparing a will or trust the drafter should also consider any special contingencies that may arise in regard to particular parcels of real estate that the testator may own and that may require special

207. EPTL § 11-1.1(b)(5)–(8) permits an executor to lease property for a term up to three years and a trustee for a term up to ten years. This section also authorizes, among other things, collecting rents, mortgaging the property, making ordinary repairs, and granting options for the sale of property for a period up to six months. Several of these powers apply only to property not specifically disposed of in the will.

language, appropriate to the peculiarities of the property under consideration.

§ 6:9.8 Borrowing

F. To borrow money for any purpose in connection with the administration of my estate or any trust created under this will from any person or corporation (including any fiduciary under this will and any affiliate of it); to execute promissory notes or other obligations for amounts so borrowed, and to secure the payment of any amounts so borrowed by mortgage or pledge of any real or personal property which may at any time form part of my estate or any trust created under this will.

The purpose of this clause is to confer clearly the power to borrow money and mortgage or pledge estate or trust assets as security, if necessary. It is sometimes advisable to borrow money to meet obligations, such as estate taxes, in order not to sacrifice valuable assets of the estate by a forced or premature sale. Although extensions of the time to pay the estate tax for appropriate reasons may be available under Code section 6161 or 6166, not all estates will qualify for the extensions. Borrowing is also an integral part of leveraged investment transactions as well as a number of estate planning techniques (for example, an installment sale of assets from the grantor to a grantor trust).

If it is contemplated that the fiduciaries may need to borrow from a related party such as one of themselves (or a corporation or firm in which one of them is interested), the surviving spouse, an executor of a surviving spouse, or a trust created during the testator's life (such as an insurance trust that may hold much of the liquidity available at the decedent's death), the will or trust should specifically authorize borrowing from such related persons, as in the model above. Likewise, if sales of estate assets to interested persons are anticipated (for reasons similar to borrowing), the will should expressly permit such sales to them.

§ 6:9.9 Renewing Obligations; Settling and Arbitrating Claims

G. To renew or extend the time of payment of any obligation, secured or unsecured, payable to or by my estate or any trust created under this will, for as long a period or periods of time, and on such terms, as they determine.

H. To adjust, settle, compromise, and arbitrate claims or demands in favor of or against my estate or any trust created under this will, upon such terms as they deem advisable.

Although certain of these powers are granted to executors and trustees by statute²⁰⁸ or by case law, here again it is advisable to set forth the powers specifically in the will to avoid any possibility of question. Here, too, the general comment applies that any such grant of powers, as set forth above, will not relieve the executor or trustee from exercising the proper measure of prudence and care.

Note that there is little difference in substance among the phrases “as they determine,” “as they deem advisable,” and “as they see fit.” Some drafters prefer, as elsewhere in this book, to insert “may” or “shall” before the verb in these phrases, although the auxiliary verb seems not to add any substance to the phrase. Another embellishment in this context is use of the additional phrase “in their discretion,” which may be useful in at least alerting the fiduciaries and beneficiaries that the power is to be exercised in the discretion of the trustee.

A similar-sounding phrase, “in their sole and unreviewable discretion,” is sometimes used in connection with beneficial powers of invasion or discretionary powers to pay, apply, or accumulate income. In that special context the phrase probably inhibits challenges to the exercise or nonexercise of the power, as courts give some effect to the notion of “sole and unreviewable” discretion. In an egregious case of self-dealing or bad faith, however, the phrase will be of little use; the court may typically decide that no discretion at all was exercised, so that the unreviewability of discretion is of no help to the errant fiduciary. Moreover, the effectiveness of exculpatory language may be limited by statute. See the discussion of exculpation clauses at section 6:7 above.

§ 6:9.10 Voting Rights, Reorganizations

I. In respect of any securities forming part of my estate or any trust created under this will, to vote upon any proposition or election at any meeting, and to grant proxies, discretionary or otherwise, to vote at any such meeting; to join in or become a party to any reorganization, readjustment, merger, voting trust, consolidation, or exchange, and to deposit any such securities with any committee, depository, trustee, or otherwise, and to pay out of my estate or any trust created under this will any fees, expenses, and assessments incurred, and to charge such expenses to principal or income as they see fit; to exercise conversion, subscription, or other rights, or to sell or abandon such rights, and to receive and hold any new securities issued as a result of any such reorganization, readjustment, merger, voting trust, consolidation, exchange, or exercise of conversion, subscription, or other rights; and, gen-

208. See, e.g., EPTL § 11-1.1(b)(8), (13).

erally, to take all action in respect of any such securities as they might or could do as absolute owners of such property.²⁰⁹

The purpose of this clause is to confer upon the executor or trustee the power to take such steps as the testator himself would have taken in connection with voting, reorganizations, mergers, or other corporate matters. It may well be urged that a general power to invest in nonlegal investments includes most of the powers set forth above, but the specification of such powers may facilitate the administration of the estate or trust. This is especially true in the case of a close corporation.²¹⁰

If the will limits the fiduciary to legal investments, which in a legal list state may not include stocks, unsecured obligations, and the like, it would be well to add to this clause a provision that any securities received in connection with any such reorganization, merger, and the like can be continued to be held by the fiduciary, notwithstanding that they are not legal investments.

§ 6:9.11 *Distribution in Kind*

J. Whenever they are required or permitted to pay any legacy or to divide or distribute my estate or any trust created under this will, to make such payment, division, or distribution in kind or in money, or in part kind and in part money, and to make any such payment, division, or distribution in kind in shares that may be composed differently, and to allocate to such shares or legacies equal or unequal and disproportionate undivided interests in specific property, all without regard to the tax basis of any such property.

This clause is intended to authorize an executor or trustee to make distribution “in kind,” that is, a distribution of property instead of money. In the exercise of this power the executor or trustee must, of course, determine the value of the property being distributed in lieu of money.

Such determination must be equitable and fair in the light of all the circumstances and is subject to review by the court if questioned by any interested party.²¹¹

209. EPTL § 11-1.1(b)(14)–(16) gives a fiduciary various powers regarding securities held by the fiduciary.

210. See the discussion on Special Business or Property Situations of Testator at section 6:6, *supra*.

211. In New York, the fiduciary is authorized to distribute in kind any property at its fair market value at the date of distribution. EPTL § 11-1.1(b)(20). There is a statutory prohibition against giving an executor or testamentary trustee the “power to make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation or otherwise.” EPTL § 11-1.7(a)(2).

In addition, it may be advisable for the will expressly to permit the fiduciary to take into account, or to ignore, the different income tax bases of various assets, or other tax consequences of distribution, in determining which assets to distribute to which beneficiary.

§ 6:9.12 Dividends

K. To apportion stock, extraordinary, and liquidating dividends, received by them, between income and principal, in such manner as they may see fit; and to determine what constitutes such dividends.

A clause of this kind is intended to avoid some of the problems that may arise as to what constitutes a stock, liquidating, or extraordinary dividend, and the manner in which such dividends shall be allocated.²¹² Some drafters prefer detailed provisions as to the allocation of different types of dividends, for example, all cash dividends to income, all stock and other dividends to principal, with authority to the trustees to determine what constitutes each category. Such a mandatory allocation may prove to be troublesome, at least in the case of cash liquidating dividends upon dissolution of a corporation.

§ 6:9.13 Amortization

L. In connection with investments, to determine whether or not to amortize premiums in whole or part.

212. Many states have legislation setting forth detailed rules, which can be varied in a will, for apportioning receipts and disbursements between income and principal, including the various types of dividends mentioned in the text. The statutory provisions change from time to time. They often follow the UPAIA. In New York, the rules applicable through Dec. 31, 2001, are found in EPTL § 11-2.1. For subsequent periods, the rules are embodied in a new EPTL Article 11-A, which is modeled on the 1997 version of the Uniform Act. The reader is directed to the new statute for its detailed rules regarding income and principal allocations for estates and trusts, allocation between successive beneficial interests and similar matters, as well as fiduciary authority to make adjustments between principal and income in regard to the results of certain tax elections, for example (EPTL § 11-A-5.6). The same legislation added a new § 11-2.3(b)(5) to the EPTL, which authorizes a trustee to adjust between principal and income in light of the nature of investment returns, in order to make appropriate present and future distributions, as well as a new § 11-2.4, which provides an alternate scheme pursuant to which "income" is redefined as a unitrust amount, if the unitrust treatment is elected by the settlor, or by the trustee with the consent of all persons interested in the trust or in the discretion of the trustee. (See section 6:9.3[D], *supra*.) In the case of a trust that is governed by the unitrust provisions, none of the fine distinctions between income and principal will be applicable.

For example, when an executor or trustee purchases a bond having a face value of \$1,000 at a market price of more than \$1,000, the excess is termed a premium. If the estate holds the bond until maturity, the entire amount collected on the bond will consist of the stipulated interest and the \$1,000 of principal. The purpose of this clause is to avoid any controversy as to whether in any particular case the fiduciary is under a duty to distribute all of the interest as income to the life beneficiaries, or whether he must use a part of each interest payment to restore the amount of the premium to principal (known as “amortizing the premium”). The above provision specifies that the matter shall be discretionary. This is considered more advisable than a hard-and-fast rule either way as developed in the various jurisdictions.²¹³

§ 6:9.14 Consolidated Investments

M. To hold and administer any property in the trusts created under this will in one or more consolidated funds, in whole or in part, in which the separate trusts shall have undivided interests.

The purpose of this clause is to facilitate the administration of several trusts by the same trustee.²¹⁴ It is especially useful where the trusts are small and advantages are to be gained from consolidating the investments of the various trusts. Sometimes, a more favorable price can be obtained, or brokerage or other administrative costs reduced, by purchasing larger blocks of stock. However, if a trustee avails himself of this privilege, he must, nevertheless, keep the book-keeping records of the trusts so as to indicate clearly each fund’s interest in the consolidated investment.

213. In New York, at one time, the fiduciary was obliged to amortize the premium in the absence of any contrary direction in the will. To avoid this rule, a clause was customarily inserted in the will to make amortization discretionary rather than compulsory. Subsequently, amortization was forbidden unless specifically authorized in the will. EPTL § 11-2.1(f). Many drafters still included such authorization as a discretionary matter. Now, under EPTL Article 11-A, there is no specific provision regarding amortization of premiums, so that the authority contained in the suggested clause of text remains advisable. Of course, the testator may, if he desires, provide for amortization to be compulsory or to prohibit it. EPTL Article 11-A does contain detailed rules regarding financial instruments described as derivatives and options as well as asset-backed securities. EPTL § 11-A-4.14, -4.15. There are also special provisions for a marital deduction trust which holds assets that are not otherwise sufficiently productive of income. *Id.* § 11-A-4.13. There is also general broad discretion to reallocate receipts as between income and principal, in order to avoid distortion that might otherwise be caused by the Prudent Investor Act. *Id.* § 11-2.3(b)(5).

214. EPTL § 11-1.1(b)(18) contains a similar authorization. This is sometimes referred to as holding *in solido*.

In some circumstances it may be helpful for the will to authorize consolidated holdings with other trusts, not created under the will, with the same trustee and beneficiaries. This may be particularly useful where wills of a husband and a wife create parallel sets of trusts or where inter vivos trusts, for example, insurance trusts, are involved.

§ 6:9.15 **Services of Others**

N. To engage attorneys, accountants, agents, custodians, clerks, brokers, investment counsel, and such other persons as they may deem advisable in the administration of my estate and any trust created under this will, and to make such payments therefor as they may deem reasonable (and to charge the expense to income or principal as they may determine), and to delegate any investment discretion they may deem advisable without liability for investment losses resulting from investment decisions made pursuant to such delegation.²¹⁵

The purpose of this clause is to recite the authority of the executor or trustee to employ such assistance as he may require to administer the estate or trust efficiently, and which an individual owner of the property might normally engage. Such a clause is also intended to resolve any doubt as to whether these persons may be engaged at the additional expense of the estate or trust, or whether the functions that they perform should be deemed to be included in the executor's or trustee's duties for which he receives commissions.²¹⁶ The executor or trustee is, of course, entitled to employ legal counsel.

The last clause is intended to defeat the possible rule of per se liability for any losses resulting from a delegation of investment discretion (in the absence of the Prudent Investor Rule), even if the investment was prudent when made and the delegation itself was prudent. (The clause may have no effect if either the investment or the delegation was imprudent.) In some states the clause may be vital in the case of a family member acting as trustee of a large trust that would benefit from the efforts of a professional investment adviser or portfolio manager.

215. See discussion in section 6:9.3[D][6], *supra*, regarding the possibility of vicarious liability of a fiduciary for acts of a delegee.

216. EPTL § 11.1.1(b)(9) and (10) have provisions regarding employment of a bank as a custodian of securities and registration of securities in the name of the nominee of a bank. EPTL § 11-A-5.1–5.6 contains provisions regarding allocating expenses between principal and income, including transfers between the two types of interests, reimbursements and adjustments. As to marital deduction aspects, see discussion in chapter 4, especially sections 4:3.6 and 4:3.9, *supra*.

If there is any possibility that the fiduciary may also serve as attorney, accountant, investment counsel, etc., it may be appropriate to add language like the following:

and I direct that any of my fiduciaries, or a partnership or corporation in which any of my fiduciaries may be interested or by which any of my fiduciaries may be employed, may be retained in any such capacity and, in such event, the fees and charges payable to such fiduciary, partnership or corporation shall be in addition to commissions or compensation otherwise allowable to such fiduciary.

In any event, the following language may be helpful as well:

I direct that none of my fiduciaries shall be liable for any loss or damage to my estate arising out of or resulting from any act or omission to act on the part of my fiduciaries taken or based on the opinion or recommendation of, or arising out of or resulting from the act or omission to act of, any such attorney, accountant, agent, custodian, clerk, broker, or investment counsel engaged by my fiduciaries in good faith.

§ 6:9.16 *Accumulations, Powers in Trust*

O. To exercise all of their power and authority, including any discretion, conferred in this will, with respect to all accumulations of income and with respect to all property held under a power during minority to manage property vested in an infant.

This clause makes it clear that all of the powers that the trustee may exercise concerning the principal and income of the trust may likewise be exercised with respect to accumulations of income and powers in trust.

§ 6:9.17 *Authority After Trusts Terminate*

R. To exercise all power and authority, including any discretion, conferred in this will, after the termination of any trust created under this will and until it is fully distributed.

The purpose of this clause is to leave no room for doubt that the trustees' powers do not end abruptly with the termination of the trust, but may continue during the period necessarily consumed in the distribution of the trust, which period may be lengthy, depending upon the problems of liquidation and distribution of the trust fund and accounting therefor.

§ 6:9.18 Administrative Provisions in Absence of Trusts

If the will does not create any trusts, the administrative provisions set forth above may be materially shortened. See Appendix 6C for an example of a shortened provision. Obviously no reference to trusts and trustees is necessary. Likewise unnecessary, as a general rule, is any mention of powers relating to principal and income and the allocation of receipts and expenses between them; this alone will result in substantial shortening.

In general, however, the composition and character of the testator's property will, in large part, determine the extent to which administrative powers of the executors should be specified in the will. The disposition of the property will have a similar bearing.

For example, if the entire estate is left outright to one person who is an adult, that person can authorize any action that the executor thinks advisable, without the necessity of mentioning appropriate powers specifically in the will. Moreover, such person is often the executor.

Some drafters believe that it is beyond the ordinary function of an executor to make investments. Accordingly, they omit from a will that has no trust any authority to make investments or to take part in corporate reorganizations, or the like. However, in view of the length of time that the administration of an estate may require, it may be advisable to include these provisions, at least in abbreviated form. A prudent executor usually does not leave substantial funds idle. In states with the Prudent Investor Rule, executors are responsible for investments.

§ 6:9.19 Pourover or Decanting Powers

An important power that is often given to trustees either by statute or by the trust agreement itself is the pourover or decanting power. This power allows the trustee to transfer part or all of the trust property into a completely different trust, which may have terms different from and distinct to the original trust. This power may be very useful in modifying irrevocable trusts especially after the death of the settlor.²¹⁷

Some practitioners believe that a common law of decanting exists so that trustees with unlimited distribution powers also possess a decanting power even where the trust agreement does not specifically provide for the power and no decanting statute has been enacted in the

217. Some states allow reformation of a trust upon consent of the settlor and all the beneficiaries of the trust. *See, e.g.*, N.Y. EPTL § 7-1.9; Uniform Trust Code § 411 (2010). However, in New York this option of modifying the trust agreement is only available if the settlor is alive and all the beneficiaries agree, which may not be possible. *See* sections 1:22.2, 3:1.2[A], 3:7.2, and 3:7.3, *supra*.

state. Although there is some case law supporting this belief,²¹⁸ drafters should exercise caution before using the common law to decant.

Various states have enacted decanting statutes empowering trustees to pour the assets of one trust into another under given circumstances. New York was the first decanting statute to be enacted (in 1992). Since then several other states have enacted their own statutes. In 2011, New York updated its decanting statute after considering the statutes enacted by the other states. Although the New York statute and its 2011 amendment is discussed in detail below in sections 6:9.19[A] and [B], other state statutes should also be considered. Additionally, although the decanting power is expressly provided by statute in various states, to ensure flexibility in administration of a trust, the drafter should seriously consider the addition of a pourover/decanting power in the trust agreement itself. This is especially crucial when the situs of the trust is in a jurisdiction that has not enacted a decanting statute. Model pourover/decanting language is provided in section 6:9.19[C] below.

In 2011, the Internal Revenue Service published I.R.S. Notice 2011-101,²¹⁹ seeking comments for a study on the tax implications of decanting trusts that include changes in beneficial interests. The Service does not plan to issue private letter rulings on such decanting trusts until it completes this study. However, it will generally continue to issue private letter rulings for decanting trusts without a change in beneficial interests (or the applicable rule against perpetuities period). Drafters should exercise particular caution with respect to decanting trusts with changes in beneficial interests until the Service issues published guidance on their use.

[A] New York Decanting Statute

New York enacted its decanting statute (EPTL section 10-6.6(b)) in 1992 in an effort to counter pending generation-skipping transfer tax legislation.²²⁰ The statute rests upon the premise that “a trustee with an absolute power to invade principal is analogous to a donee of a special power of appointment.”²²¹ Pursuant to the laws surrounding powers of appointment, a donee of a special power of appointment may exercise the power by appointing the property in further trust. The statute analogizes this to a trustee and determines that a trustee

218. *See, e.g.,* Phipps v. Palm Beach Trust Co., 142 Fla. 782, 196 So. 299 (1940) (allowing the trustee to exercise his power to appoint to pour the old trust property into a new trust for the same beneficiaries).

219. 2011-52 I.R.B. 932.

220. Alan Halperin et al., *Decanting Discretionary Trusts: State Law and Tax Considerations*, TAX MGM'T EST. GIFTS TR. J. (Sept. 9, 2004).

221. *In re Estate of Mayer*, 176 Misc. 2d 562, 564, 672 N.Y.S.2d 998, 1000 (Sur. Ct. N.Y. Cnty. 1998).

with an absolute power to invade should be able to appoint the property in further trust as well.

The original New York decanting statute allowed the trustee to decant into a new trust when three main requirements are met: (1) the trustee must have the absolute discretion to invade trust principal for at least one beneficiary, (2) the new trust must not reduce the fixed income of any beneficiary, and (3) the exercise of the power must be in favor of the proper objects of the exercise of the power.²²² These requirements were amended in 2011 (see section 6:9.19[B]).

The first requirement of absolute discretion to invade principal²²³ has been strictly enforced.²²⁴ One New York Surrogate's Court explained that this bars a trustee limited to an ascertainable standard from exercising the decanting power.²²⁵ Instead, to satisfy the requirement, the discretion must be "unconstrained except by the implicit requirements of reasonableness and good faith."²²⁶

The next requirement listed by the statute is that the exercise of the decanting power may not be used to reduce the fixed income interest of any income beneficiary.²²⁷ By its terms the statute implies that the trustee may decant the old trust assets into a new trust that reduces or even eliminates the discretionary or future interests of a beneficiary.²²⁸ Although this is a harsh result, a trustee with absolute discretion to invade trust principal already had the power to exclude these beneficiaries through that discretion.

The last requirement is that the decanting power must be exercised in favor of the proper objects of that power.²²⁹ This provision is best understood through an analogy to the exercise of a limited power of appointment. A donee of a limited power of appointment may only exercise that power in favor of a member of the specified class. Similarly, the trustee should be able to decant a trust into a new trust benefiting the beneficiaries of the original trust. However, the question of just how many of those beneficiaries the new trust must benefit is

222. EPTL § 10-6.6(b). The statute further mentions two other conditions: (1) that in the case of a testamentary trust, the new trust does not violate the public policy limitations of EPTL § 11-1.7, and (2) that certain filing requirements be met.

223. EPTL § 10-6.6(b)(1).

224. Note that the 2011 amendments relaxed this requirement. See section 6:9.19[B].

225. See, e.g., *In re Mayer*, 176 Misc. 2d 562, 672 N.Y.S.2d 998 (Sur. Ct. N.Y. Cnty. 1998) (holding that the ascertainable standard of invading principal for health, support, maintenance and education did not constitute the "absolute discretion" required by the statute).

226. *Id.* at 565.

227. EPTL § 10-6.6(b)(1)(A).

228. See Halperin, *Decanting Discretionary Trusts*, note 219, *supra*.

229. EPTL § 10-6.6(b)(1)(B).

not clear from the original statute,²³⁰ although some commentators had suggested that only one of the original beneficiaries would need to be included as a beneficiary of the new trust. This view is consistent with the limited power of appointment analogy, because the donee of such a power can exercise his or her limited power of appointment to just one person out of the specified class.

With so few limitations and such breadth of possible uses, the decanting statute is a common feature in the estate planner's repertoire. It can be used to change administrative provisions in a trust,²³¹ take out current or remainder beneficiaries, or even reduce administrative expenses²³² or state taxes.²³³

[B] 2011 Amendments to the New York Decanting Statute

In June 2011, the New York State legislature passed a bill liberalizing and expanding the decanting statute (to be effective August 17, 2011).²³⁴ The measure introduced a number of substantive changes to the law, relaxed certain filing requirements, clarified the operation of the statute in certain circumstances, protected certain tax results and prescribed a fiduciary duty and standard of care.

The amendment significantly modified the decanting statute by removing the requirement that a trustee have "unlimited discretion" to invade the principal of a trust. Under the revised law, a trustee can pay over the principal of a trust into a new trust even absent absolute discretion to invade.²³⁵ If the trustee does have unlimited discretion to invade principal, the new trust can exclude current beneficiaries.²³⁶ If the trustee does not have unlimited discretion, the new trust must include all current beneficiaries and the trust must contain language

230. The 2011 amendments clarified this issue.

231. *See In re Alfred Hazan*, N.Y.L.J., Apr., 11, 2000 (Sur. Ct. Nassau Cnty. 2000) (allowing decanting to extend trust for the lifetime of a beneficiary); *Matter of Rockefeller*, N.Y.L.J., Aug. 24, 1999, p. 28, col. 2 (Sur. Ct. Nassau Cnty. 1999) (allowing decanting into new trusts with spendthrift provisions).

232. *See In re Vetlesen*, N.Y.L.J., June 29, 1999 (Sur. Ct. N.Y. Cnty. 1999) (court permitted the principal of an inter vivos trust to be decanted into an existing testamentary trust with identical provisions in order to reduce administrative expenses).

233. *See In re Dornbush*, 164 Misc. 2d 1028, 627 N.Y.S.2d 232 (Sur. Ct. N.Y. Cnty. 1995) (court allowing decanting of a New York trust into a new Florida trust with identical provisions except that the new trust would be governed by Florida law instead of New York law to shield trust property from New York real property transfer gains tax).

234. Act to Amend the Estates, Powers and Trusts Law; S 5801, A08297A-2011 (NY 2011).

235. EPTL § 10-6.6(c).

236. EPTL § 10-6.6(b).

limiting the trustee's ability to invade principal in a manner similar to the restriction in the original trust.²³⁷

The amendment also provides that a trustee with unlimited discretion may decant into a new trust that grants a power of appointment to one or more of the beneficiaries of the invaded trust.²³⁸ The beneficiary receiving the power of appointment must have been eligible to receive the principal outright under the terms of the invaded trust.²³⁹ The power of appointment can be exercised with respect to either all or part of the assets of the old trust.²⁴⁰

The new appointed trust can also have a term longer than that provided for in the invaded trust,²⁴¹ and trustees may continue to receive compensation on the same terms throughout the extended terms of the trust.²⁴²

The trustee may only exercise the decanting power in accordance with a prudent person standard and when it would be in the best interests of one of the objects of the exercise of power to do so.²⁴³ The trustee cannot exercise the decanting power when there is substantial evidence of contrary intent by the creator of the trust.²⁴⁴ The decanting may also not reduce or limit any vested trust interests, except that a change affecting mandatory rights when a trust pays over to a supplementary needs trust is permissible.²⁴⁵

The revised law clarifies that the trustee's exercise of the power to appoint under the statute does not relieve the trustee from liability under the invaded trust or the liability to account for the exercise of the power to invade the trust.²⁴⁶ The trustee has no duty to exercise the power to appoint, and no inference of impropriety shall arise as a result of non-exercise.²⁴⁷

The amended decanting statute provides certain definitions and clarifications formerly absent. The original law did not specify the effective date of the exercise of the power to appoint, but the revised law established that the effective date is thirty days after the service of notice.²⁴⁸ The statute also now clarifies that the law applies to inter vivos and testamentary trusts initially subject to New York law and to

237. EPTL § 10-6.6(c).

238. EPTL § 10-6.6(b)(1).

239. *Id.*

240. EPTL § 10-6.6(j)(3).

241. EPTL § 10-6.6(e) (but still subject to the rule against perpetuities, *see* § 10-6.6(p)).

242. EPTL § 10-6.6(q)(1).

243. EPTL § 10-6.6(h).

244. *Id.*

245. EPTL § 10-6.6(n)(1).

246. EPTL § 10-6.6(j)(5).

247. EPTL § 10-6.6(l).

248. EPTL § 10-6.6(j).

trusts whose primary administration is transferred to the state of New York.²⁴⁹ The statute also now defines many terms that were previously incorporated by reference to other statutes.²⁵⁰

The revisions to EPTL section 10-6.6 align the New York law more closely with the Delaware decanting statute.²⁵¹ For example, the Delaware decanting statute does not require trustees to have absolute discretion and specifically permits the new trust to contain a grant of a power of appointment to beneficiaries of the original trust.²⁵² The Delaware decanting statute historically offered greater flexibility than the New York provisions, and this provided an incentive (perhaps among others) for New Yorkers to set up trusts in Delaware instead of in their home state.

[C] Model Pourover/Decanting Language

Although the amended New York decanting statute offers a great deal more flexibility now, it is still worthwhile to include a specific pourover/decanting power in the trust agreement itself. This will allow the settlor to clearly spell out when he wants the trustee to be allowed to decant the trust. An example of such a provision follows:

Notwithstanding any other provision of this Agreement, the Trustee (other than any Beneficiary or a Donor's spouse) is authorized and empowered to pay over to the trustees of any other trust for the primary benefit of any one or more of the beneficiaries hereunder, any or all principal (and income on hand or accrued) out of the trust hereunder or out of property otherwise directed to be held in the trust hereunder, for the primary benefit of such beneficiary or beneficiaries, whether such other trust was created by the Settlor or by any other individual, inter vivos or by Will, regardless of when such other trust was created (whether before or after the creation of the trust hereunder), and whether or not such other trust was created for the express purpose of being the repository of such principal and/or income. The determination by such Trustee as to whether any such other trust or any such trust hereunder is for the primary benefit of such beneficiary or beneficiaries shall be binding on such beneficiary or beneficiaries and on all other persons having or acquiring an interest in any such other trust or the trust hereunder. Any such payment shall not be treated as a distribution of principal of the trust hereunder for trustee commission purposes.

249. EPTL § 10-6.6(r).

250. EPTL § 10-6.6(e).

251. 12 DEL. CODE § 3528.

252. 12 DEL. CODE § 3528(a).

§ 6:10 Duties of Executors and Trustees

As the selection of executors and trustees requires much thoughtful consideration, likewise the decision to accept an appointment to serve as executor or trustee must be carefully weighed. The positions of executor and trustee include many time-consuming responsibilities and should be accepted only after a knowledge of what the undertaking requires is acquired.

A special word of caution regarding successor trustees is in order. Because a successor trustee who fails “to inquire into the account of his predecessors” or to “take proper steps to redress a breach of trust committed by the predecessors” is liable to the trust beneficiary for wrongdoing committed by the predecessors,²⁵³ a successor trustee should investigate especially thoroughly before assuming the responsibility.²⁵⁴

§ 6:10.1 The New York Model

The executor has a general duty of diligence and loyalty to creditors and devisees, and is required to disclose pertinent information to any interested parties, such as beneficiaries or next of kin who are not beneficiaries. The executor must probate the will and file tax forms for the estate and final income tax returns for the decedent. Finally, the executor will have to pay any creditors with claims against the estate, and then will have to distribute the decedent’s remaining assets under the will to the devisees.

A trustee’s first and foremost duty, as a fiduciary, is a duty of loyalty to the beneficiaries of the trust, meaning that the trustee must administer the trust under the duty of loyalty and must act in the best interests of the beneficiaries. In acting in the best interests of the beneficiaries, a trustee should avoid potential conflicts of interest and

253. *E.g., In re Alpert*, 2010 N.Y. Misc. LEXIS 3262, N.Y.L.J., Jan. 27, 2010, at 34 (Sur. Ct. N.Y. Cnty. 2010) (citing *Bank of N.Y. v. N.J. Title Guar. & Trust Co.*, 256 A.D. 609, 11 N.Y.S.2d 181 (App. Div. 1st Dep’t 1939)). *See also* RESTATEMENT (SECOND) OF TRUSTS § 223(2), holding a trustee liable for breach of trust if he “(a) knows or should know of a situation constituting a breach of trust committed by his predecessor and he improperly permits it to continue; or (b) neglects to take proper steps to compel the predecessor to deliver the trust property to him; or (c) neglects to take proper steps to redress a breach of trust committed by the predecessor.”

254. *See* Peter C. Valente & Herbert Bockstein, *The Plight of the Successor Trustee; Wills, Estates and Surrogate’s Practice*, N.Y.L.J., Mar. 31, 2010, at 3 (noting that a successor trustee who waits until after accepting the appointment to complete an investigation has little bargaining power to ensure compliance with his inspection and also runs the risk of being found dilatory in his investigation).

should maintain impartiality among the beneficiaries' potentially differing interests. The trustee also must maintain accurate records and provide accurate information to the beneficiaries when requested. A trustee also has a duty to exercise reasonable skill and reasonable care and to incur only reasonable costs in the administration of the trust.

§ 6:10.2 *The Uniform Codes*

Both the Uniform Probate Code (UPC) and the Uniform Trust Code (UTC) contain provisions regarding the duties of executors and trustees. Other provisions of the UPC and UTC are covered extensively in sections 2:19 and 3:7, respectively.

The executor must notify the devisees of the will by mail of his or her appointment.²⁵⁵ The executor must also inventory the decedent's property and either appraise it²⁵⁶ or hire a "qualified and disinterested" appraiser to do so.²⁵⁷ The inventory and appraisal must be completed within three months of the executor's appointment, and the executor must mail it to any interested party who requests it.²⁵⁸ Additionally, the executor must file tax forms for the estate and final income tax returns for the decedent.

An executor "is under a duty to settle and distribute the estate of the decedent in accordance with the terms of any probated and effective will and this Code"²⁵⁹ Accordingly, the executor will have to file the will in probate court and notify the devisees of the filing. The executor will have to pay any creditors with claims against the estate and then will have to distribute the decedent's remaining assets under the will to the devisees. Until the probate process is complete, the executor must keep the decedent's finances separate by opening a separate bank account for the decedent's estate. In addition, as a fiduciary, the executor must abide by a fiduciary's obligations of diligence and loyalty to creditors and devisees.

A trustee's first and foremost duty, as a fiduciary, is a duty of loyalty to the beneficiaries of the trust.²⁶⁰ The trustee must administer the trust under the duty of loyalty. Because a trustee must act in the best interests of the beneficiaries, this duty of loyalty includes a duty to avoid conflicts of interest and a duty to not engage in self-dealing transactions. Even when the trustee is afforded sole discretion, the trustee must exercise that discretion "in good faith and in accordance

255. UNIF. PROBATE CODE (UPC) § 3-705.

256. UPC § 3-706.

257. UPC § 3-707.

258. UPC § 3-706.

259. UPC § 3-703(a).

260. UNIF. TRUST CODE (UTC) § 802.

with the terms and purposes of the trust and the interests of the beneficiaries."²⁶¹

"Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries. . . ." ²⁶² In administering the estate, a trustee must "exercise reasonable care, skill, and caution."²⁶³ A trustee may only cause the trust to incur "costs that are reasonable in relation to the trust property, the purposes of the trust, and the skills of the trustee."²⁶⁴ If the trustee has any particular skill or expertise that is relevant to the duties and powers of a trustee, the trustee should use that skill or expertise in carrying out his or her duties and powers as trustee.²⁶⁵ A trustee may delegate duties and powers under the trust, so long as the trustee acts reasonably in the selection of an agent and in ensuring the agent's performance is adequate.²⁶⁶

In acting for the benefit of the trust beneficiaries, the trustee also has a duty to remain impartial to beneficiaries' respective interests.²⁶⁷ This duty to maintain impartiality extends to investing trust assets, and distributing and maintaining trust property. The trustee must inform beneficiaries "about the administration of the trust and of the material facts necessary for them to protect their interests."²⁶⁸ If a beneficiary requests information about the trust, the trustee has a duty to respond promptly. In order to report accurate information to the beneficiaries, the trustee must "keep the trust property separate from the trustee's own property," and must keep accurate records of the trust and its administration.²⁶⁹

A trustee has a duty to take and maintain control of the trust property, as well as to protect the trust property while it remains in trust.²⁷⁰ In taking control of trust property, a trustee must sometimes collect the trust property by taking "reasonable steps to compel a former trustee or other person to deliver trust property to the trustee."²⁷¹ Once the trust property is in the trustee's control, the trustee must enforce any claims of the trust and defend any claims against the trust.²⁷²

261. UTC § 814(a).
 262. UTC § 801.
 263. UTC § 804.
 264. UTC § 805.
 265. UTC § 806.
 266. UTC § 807.
 267. UTC § 803.
 268. UTC § 813(a).
 269. UTC § 810.
 270. UTC § 809.
 271. UTC § 812.
 272. UTC § 811.

If the trustee breaches one of these numerous duties, the trustee may be subject to certain liabilities. For a breach of trust, the trustee can be liable to the beneficiaries for either the extent of the trustee's profit from the breach or the amount required to return the trust to what its value would have been had the breach not occurred.²⁷³ In the absence of a breach of trust, the trustee is not liable to the beneficiaries for a decline in the trust's value, but the trustee can be liable to the extent of the trustee's profit even if there has been no breach.²⁷⁴

273. UTC § 1002(a).

274. UTC § 1003.