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TRUSTS AND ESTATES UPDATE

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Accounting Decrees and Other Areas of Interest

With terrorist threats, aeronautic catastrophes and massive storms from Mother Nature having consumed our attention during the months of January and February, one wonders what remains in store for us in the year 2003. Indeed, both on the national and local scene, life is moving at perhaps too quick and too tragic a pace.

By comparison, and for some of us, fortunately, on the legal front, developments have proceeded on a slower, steadier, though nonetheless interesting scale. This is particularly evident in the field of trusts and estates where recent decisions have fine tuned and, at times, caused us to reconsider our thinking about areas significant to the practice.

When Is a Final Decree Final?

Generally, in the absence of fraud, a judicial decree entered in an accounting proceeding is final and conclusive as to all matters embraced within it, such that a party will be precluded from subsequently raising and/or litigating issues which could have been raised in the proceeding but were not. This principle has been the subject of opinions and, perhaps, divergent views, over the past several weeks from the Surrogates in Westchester County and New York County. Consider the following:

In *In re Estate of Hunter,* The New York Law Journal, Jan. 14, 2003 (Surrogate's Court, Westchester County), Surrogate Anthony Scarpino was confronted with a contested accounting involving the trust created under Article Eighth (B) of the decedent's will.

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Objections in the proceeding were raised, inter alia, to the trustee's management of shares of stock in Kodak. The trustee moved to dismiss the objections alleging that they were barred by the doctrine of res judicata. Specifically, the trustee maintained that both the 1977 and 1981 decrees which had been previously entered by the court in its executors' accounting and its accounting as co-trustee of the trust created under Article Eighth (A) of the decedent's will conclusively resolved all issues regarding its administration of the Kodak shares as against the objectant who appeared in both proceedings and failed to raise any of the allegations raised in the subject accounting.

In opposition to the motion, objectant maintained that the trustee's reliance on res judicata was misplaced inasmuch as the propriety of the trustee's conduct as fiduciary of the Article Eighth (B) trust was never before the court in either of the previous accountings. Objectant further contended, inter alia, that the trustee was liable as a "successor fiduciary" for failing to redress any misdeeds it committed as co-executor and as co-trustee of the Article Eighth (A) trust.

The court rejected the trustee's position finding that the policy embodying the "special duty" owed by every multicapacity fiduciary to its beneficiaries precluded summary application of the doctrine of res judicata to the circumstances presented, such that the objectant could prosecute its allegations that the trustee breached its fiduciary duty in failing to remedy any improprieties it committed as co-executor or co-trustee of the Article Eighth (A) trust.

In reaching this result, the court relied upon the "special rules" governing a trustee's fiduciary duty as set forth in the Restatement Second, Trusts, §§177 and 223, as well as applicable case law, which seemingly applied the doctrine of res judicata only to situations where the subsequent fiduciary is a different person or entity than the predecessor fiduciary. Where the predecessor and successor fiduciary are one and the same, as in the case presented, the court found no explicit authority in New York in which the doctrine of res judicata was applied, but, instead, found decisions in other jurisdictions which held the doctrine inapplicable in such circumstances. The court found these authorities persuasive.

Further, the court found that the "identity of parties" necessary to warrant application of the doctrine of res judicata did not apply to all the objections at issue, that the objectant was not seeking to open the prior accounting decrees and that the actions of the trustee as fiduciary of the Article Eighth (B) trust were never before the court.

Finally, the court held that it was reluctant to invoke the doctrine of res judicata under circumstances where a colorable claim for breach of trust duty had been raised.

Other Cases: 'Morgan Guaranty'

To be compared with the result in *Hunter,* is the opinion of Surrogate Eve M. Preminger in *In the Matter of the Settlement of the Third Account of Proceedings of Morgan Guaranty,* NYLJ, Feb. 13, 2003 (Surrogate's Court, New York County), where the court also had occasion to consider the finality of an accounting decree, but within the context of a proceedings involving a common trust fund. At issue was the third account of the trustee covering the period from Jan. 1, 1990 to Dec.

31, 1998. The court had settled two prior accounts of the trustee through the period ending Dec. 31, 1989.

The guardian ad litem representing the beneficiaries of the principal of the trust fund raised two objections to the account. In pertinent part, these objections took issue with the purchase of a bond by the trustee at a premium during the prior accounting period, on the ground that the investment was imprudent. With regard to this transaction, the record reflected that in 1989 the fund purchased $6.69 million subordinated capital notes (notes) for the premium price of $1,057,500. The notes accrued interest at the rate of 12.5 percent and matured on Nov. 15, 1996. In the prior account, because the trustee still held the notes in the fund, it posted an unrealized loss on the investment of $857,670. No objections were raised to the investment when the prior account was filed, and a decree was entered judicially discharging the trustee. Thereafter, in 1993, the notes were called, and a realized loss was sustained by the fund for the entire premium. This loss was reported in the accounting period before the court and was the subject of the guardian ad litem's first objection.

On the question of whether this objection presented a triable issue, the guardian ad litem argued that although the investment decision was made during the prior accounting period, the wisdom of the transaction could nevertheless be examined in the accounting before the court because the actual loss occurred during the accounting period in issue. He further claimed that had the investment been objected to in the last account there could have been no remedy since the loss was not yet realized. Hence, the propriety of the investment remained an open question to which objections could be made.

The court dismissed the guardian ad litem's objection as meritless, finding, on the basis of the Banking Law §100-c(6) that, in the absence of intentional deception, once judicially settled, any questions that could have been raised in a common trust fund accounting but were not, could no longer be reviewed by the court.

Moreover, the court noted that the prudent person rule does not always require proof of a realized loss. Instead, under that rule, a "trustee's investment decisions [are] to be measured in light of the business and economic circumstances existing *at the time they were made*." *Matter of Janes,* 90 NY2d 41, 51 (Emphasis supplied).

Finally, the court rejected the guardian ad litem's contention that some imprudent investments would escape remedy finding, inter alia, that it had plenary power during an accounting period to remedy an imprudent investment. *Stortecky v. Mazzone,* 85 NY2d 518, 524-525. Nevertheless, the court held that since the decision to purchase the notes was made during the previous accounting period, which had already been judicially settled, it could not be further scrutinized.

Claims and Assets

Claims Against an Estate/Estate Assets Defined. In a contested proceeding to determine the validity of a claim, the Department of Social Services moved for summary judgment directing the fiduciary to pay it the sum of $38,672, representing the cost of medical assistance provided to the decedent prior to his death. The executrix opposed the motion on the grounds that there were no estate assets available from which the Department of Social Services could be paid.

The undisputed facts revealed that the decedent resided in a nursing home before he died and was initially denied medical assistance due to excess resources. Approximately two months after being denied assistance, the decedent transferred a half interest in his home to his daughter, whereupon the two held title as tenants in common. Eight months later, the decedent's application for medical assistance was approved and assistance was thereafter provided to the decedent until his death.

In the interim, the decedent and his sister entered an agreement with the nursing facility in which the decedent resided which provided, inter alia, that the decedent owed the facility approximately $51,000, that the decedent's sister was jointly and severally liable for the debt and that upon the closing of the sale of the decedent's home, the full amount of the indebtedness would be held by counsel in escrow pending payment to the home.

The house was sold after the decedent's death, and half the proceeds were placed in escrow subject to the claim of the nursing home. This claim was paid seven months after the appointment of the decedent's sister as executrix of his estate. In the interim, the Department of Social Services filed a verified claim against the estate.

Summary Judgment

On the basis of the foregoing, the court granted summary judgment to the Department of Social Services and surcharged the executrix for the full amount of its claim. The court rejected the executrix's arguments as to the lack of estate assets to pay the claim finding that the decedent's interest in his home was tenant in common with his daughter constituted an estate asset subject to creditor's claims at the time of his death. Although the property was subsequently sold and half the proceeds were held in escrow, the holding of the funds in escrow did not change the extent of the estate's interest in the monies.

Further, the court found that the Department of Social Services was entitled, pursuant to federal and state law, to seek recovery against the decedent's home inasmuch as the property was a part of the decedent's estate, the decedent was 55 years old when he was receiving medical assistance, and he was not survived by a spouse, or by a child under the age of 21, or one who was blind or totally disabled. See 42 USC §1396p[b][2]; Social Services Law §369.2[b][i].

Further, the court held that it was improper for the executrix to pay the nursing facility in advance of the Department of Social Services, thereby leaving the estate without assets with which to satisfy the department's claim. The court reasoned that pursuant to the provisions of Social Services Law §104(1), the Department of Social Services was a preferred creditor of the estate and, as such, was entitled to have its claim paid prior to that of the nursing home. The court noted that the Department of Social Services had timely presented its claim within seven months of the issuance of letters, and that the executrix acted at her peril when she opted to prefer the claim of the nursing facility to the detriment of the Department of Social Services. *In re Estate of Snell,* NYLJ, Feb. 14, 2003 (Surrogate's Court, Nassau County)

Pending Matters

As the year unfolds, it serves to keep a watchful eye on *Langan v. St. Vincents,* 11618-02, discussed in NYLJ, Feb. 18, 2003. The matter, which is now pending before the Supreme Court, Nassau County, raises the issue of whether a surviving spouse in a same-sex marriage validly entered pursuant to the laws of a sister state (Vermont) has a right to sue for wrongful death as a spouse under New York's EPTL, in light of the provisions of the Federal Defense of Marriage Act, which defines "marriage" as the union of a man and woman and "spouse" as a person of the opposite sex.