

TRUSTS AND ESTATES UPDATE

Expert Analysis

Dramatic Court of Appeals Rulings And Lessons From Supreme Court

In the past month, historic views of privity and legal fees have taken a dramatic turn. Guided by principles of fairness and statutory interpretation, the decisions rendered by the Court of Appeals in *Matter of Schneider* and *Matter of Hyde* require the estate practitioner to take heed. Additionally, opinions rendered by the state Supreme Courts have been instructive to the Surrogate's Court practitioner. From matters involving validity of deeds and res judicata, the Supreme Court, as a court of general jurisdiction, often addresses issues of practice and procedure that are relevant to the area of trusts and estates.

The Court of Appeals

An Exception to Privity. In *Matter of Schneider*, ___N.E.2d___, 2010 N.Y. Slip Op. 05281, the Court of Appeals held that a personal representative of an estate may maintain a legal malpractice claim for pecuniary loss to a decedent's estate resulting from negligent representation in estate planning. In reaching this result, the Court reversed decisions of both the Supreme Court and the Appellate Division, which held that the estate could not pursue the cause of action for damages in the absence of privity.

The record revealed that the defendants had represented the decedent for six years prior to his death. During the course of that representation, he purchased a life insurance policy, which he then transferred to an entity of which he was the principal owner, then to another entity, of which he was also the principal owner, and then back to himself. At his death, the proceeds were included in his taxable estate, thereby provoking a malpractice claim against the defendants for negligently advising the decedent to transfer, or failing to advise the decedent not to transfer, the policy which resulted in increased estate tax liability.

In sustaining the estate's right to sue the defendants for malpractice, the Court recognized that while New York has long applied strict privity to estate planning malpractice suits commenced by the estate representative and beneficiaries, the rule effectively leaves the estate with no

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recourse against an attorney who planned an estate negligently. Refusing to adhere to principles that would provoke such a harsh result, the Court held that privity, or a "relationship sufficiently approaching privity" existed between the personal representative of an estate and the estate planning attorney so as to provide the personal representative with the capacity to sue for malpractice on the estate's behalf.

The Court reasoned that an estate planning attorney certainly is aware that minimizing estate taxes is central to his role. Further, the Court noted that the provisions of EPTL §11-3.2(b) generally

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permit a personal representative of a decedent to maintain an action for injury to person or property after a decedent's death.

Nevertheless, the Court held that despite its ruling, strict privity remained a bar to suits brought by beneficiaries and other third-party individuals for estate planning malpractice claims absent fraud or other circumstances. The Court opined that extending its holding to such classes of party-plaintiffs would produce "undesirable" results, "uncertainty and limitless liability," which were not present in the case of suits brought by the estate's personal representative.

Discretion to Allocate a Fiduciary's Legal Fees Against a Party/Beneficiary. In *Matter of Hyde*, ___N.E.2d___, 2010 N.Y. Slip Op. 05676, the Court of Appeals held that the provisions of SCPA §2110 grant the trial court discretion to allocate responsibility for payment of the legal fees of a fiduciary for which the estate is liable, either

from the estate as a whole or from the shares of individual estate beneficiaries. Breaking from and, indeed, overruling its 1971 decision in *Matter of Dillon*, 28 N.Y.2d 597, the Court concluded that the result in *Dillon* was a departure from its earlier opinions, and ignored the plain meaning of SCPA 2110(2), which provides the trial court with discretion to assess fees against any beneficiary's share in the estate, and not exclusively from the estate generally.

The circumstances that gave rise to the opinion involved two intermediate trust accountings, to which objections were filed by one of two sets of families, the Whitneys, who were the primary beneficiaries of the trusts' income and principal. The remaining beneficiaries, who were members of the Renz family, did not object to either accounting.

In advance of the joint trial on the objections, the non-objecting beneficiaries of the Renz family filed an acknowledgment attesting that they would not be entitled to share in any surcharges that might be imposed against the trustees, in accordance with the dictates of the pro tanto rule. In addition, they cross-moved seeking to require that all future counsel fees of the trustees be deducted exclusively from the shares in the two trusts of the objectants, and to reserve the right to seek reallocation and reimbursement of counsel fees previously advanced from their share of the trust fund.

The Surrogate's Court dismissed all the objections to the accountings, but denied the cross-motion and ordered, on the basis of *Dillon*, that all counsel fees be paid from the trust fund generally, despite the fact that the interests of the non-objecting beneficiaries, who abstained from the litigation, would be adversely affected. The Appellate Division affirmed, finding no basis for deviating from *Dillon* and the Court's construction of SCPA §2110.

In addition to finding that *Dillon* overlooked the statutory intent of SCPA §2110, the Court held that the result failed to focus on the considerations of fairness that guided precedent established by prior decisions rendered by the Court, which recognized the trial court's discretion to determine on the facts of the case what part, if any, of the trustee's expenses should be allowed and charged against a beneficiary's interest in the trust estate. Finding that this precedent was more aligned with the import of the statute and principles of fairness, the Court concluded that

the plain meaning of SCPA §2110(2) should be restored so as to place discretion in the hands of the trial court to allocate the fees incurred by a fiduciary.

In exercising this discretion, the Court offered a list of seven factors to be considered by a court in assessing the sources from which fees are to be paid, including but not limited to the good or bad faith of the objecting beneficiary, whether there was justifiable doubt concerning the fiduciary's conduct, and the possible benefits to individual beneficiaries from the outcome of the underlying proceeding. Inasmuch as the trial court never exercised its discretion to this extent, the Court remitted the matter to the Surrogate's Court for further proceedings in accordance with the opinion.

The State Supreme Court

Deeds Declared Invalid. In *Matter of Marie F.*, the petitioner requested that she be appointed the guardian of the person and property of her mother, and that the court declare the invalidity of two deeds to property located in Staten Island executed by the AIP (alleged incapacitated person) in favor of her son. The application was opposed by the AIP's son, who requested that he be appointed guardian, and that the deeds be upheld. Prior to the appointment of a guardian, the AIP passed away. Nevertheless, the court held that the issues pertaining to the deeds remained subject to its jurisdiction.

The court noted that pursuant to MHL §81.29(d) it had the authority to revoke a conveyance made by a person determined to be incapacitated at the time of the conveyance. To this extent, the court opined that a person suffering from a mental infirmity is not presumed to be wholly incompetent for all purposes. Rather, it must be established that, because of the affliction, the person was incompetent at the time of the transaction in issue. Moreover, a person is presumed competent to execute a deed, and a person asserting incapacity bears the burden of proving incapacity by clear and convincing evidence.

The record revealed that the AIP had resided in the downstairs apartment of a two-family dwelling since her marriage. Her son resided with his family in the upstairs apartment for 30 years. In May, 2007, the AIP executed a deed transferring her ownership interest in the premises to her and her son equally. Thereafter, in the presence of counsel, who was the draftsman of the deeds, as well as counsel's father, his secretary, and the AIP's son, the AIP executed a second deed to the premises transferring full ownership thereof to her son. Notably, counsel's father was a friend of the AIP's son for many years.

According to the AIP's daughter, several months prior to the execution of the first deed, the AIP needed assistance tending to her personal needs, and beginning in 2005, had continuing difficulty remembering names of relatives. Her granddaughter, who was a dentist, and who had some formal training in Alzheimer's Disease, testified that her grandmother began to progressively deteriorate beginning in 2006 and throughout 2007, such that she was unable to answer basic questions correctly.

On the other hand, the AIP's son and counsel testified that the AIP understood the nature of the

deeds in issue and the import of what she was signing. Her son stated that while at counsel's office, his mother reminisced with counsel's father. Further, the son testified that at no time during his daily interaction with his mother did she exhibit any signs of mental incapacity.

With respect to the issue of the AIP's capacity, the court credited the testimony of the AIP's daughter and particularly her granddaughter over that of her son, counsel and other lay witnesses. The court found that the testimony of counsel that the AIP understood the initial deed was belied by the fact that while she had asked that her home be transferred out of her name entirely, the deed in issue transferred the property into her name and her son's name equally. The court also found the son's testimony was full of inconsistencies. Further, the court resolved the sharp conflict between the conclusions of experts called by the parties in petitioner's favor, with the result that the AIP did not have the requisite mental capacity to execute the deeds in issue.

Additionally, the court found that the deeds were the product of undue influence by the AIP's son. Of particular note was the fact that the conveyances excluded the AIP's daughter, in contravention to her previously expressed testamentary plan to divide her assets equally between her two children, and that there was no evidentiary explanation as to why she changed this plan other than the self-serving declaration of the AIP's son that it was her desire to do so. Of further note was the fact that the subject deeds were executed at a time when the AIP was in a weakened condition, when the AIP's daughter was out of state, and that they were prepared and overseen by an attorney selected by the son, and whose father was the son's long-time childhood friend.

Accordingly, the deeds were declared null and void.

Matter of Marie F., NYLJ, May 10, 2010, p. 20 (Sup. Ct. Richmond County).

Res Judicata Bars Relitigation of Accounting Issues. In contested accounting proceedings, the beneficiaries of the intervivos trusts in issue moved for partial summary judgment against the trustee alleging that in 1927, when the trusts were created, the trustee breached its fiduciary duty of loyalty by making investments in companies in which it had substantial interests. The trustee cross-moved to dismiss the supplemental objections raising this issue.

The record revealed that the subject trusts were two of seven trusts created by the settler in 1927 for the benefit of her children. In 1953, when the settler died, the trustee accounted with respect to all of the trusts. Thereafter, in 1974, second intermediate accountings were filed with respect to some of the trusts. Decrees settling the accounts in 1953 and in 1974 were entered. In 2001, petitions were filed for a compulsory accounting with respect to two of the trusts, of which the movants were beneficiaries. These accountings were filed, together with petitions for their judicial settlement.

In 2005, the movants sought to vacate the court's orders of 1953 and 1974 settling the trustee's accountings, claiming that the trustee had engaged in constructive fraud against them, and that the court had failed to obtain personal

jurisdiction over them. These motions were denied, and the Appellate Division affirmed. Prior to the Appellate Division's decision, the movants filed supplemental objections to the trustee's accountings, alleging that the trustee breached its duty of loyalty by investing in trust assets in which it had a substantial interest.

In support of its motion, the movants maintained, inter alia, that the prior orders settling the trustee's account do not preclude the court from considering the self-interested investments inasmuch as the investments, while listed in the account, did not reveal the trustee's interest in the assets. Hence, the beneficiaries claimed they were not foreclosed, despite the court's orders settling the accounts, from now seeking to set them aside and requesting damages. The trustee argued that the arguments pertaining to the investments were, or could have been, raised on the prior motions to vacate the orders settling the accountings, and in any event, the supplemental objections were precluded by the "law of the case" doctrine.

In denying the motion for summary relief, and granting the trustee's cross-motion, the court relied on the doctrine of res judicata, which holds an accounting decree conclusive not only as to issues that were actively presented and determined, but also as to those issues which could have been raised regarding all matters set forth in the accounting. Although the court recognized that the rule does not apply where the facts have not been sufficiently disclosed in the account to put the parties on notice that there has been self-dealing, in the case sub judice, the court found that the account listed the investments in issue, and correspondence between the trustee and the settler sufficiently apprised the beneficiaries of the self-dealing with respect to the trust investments.

At the very least, this correspondence, stated the court, was sufficient disclosure made to put the beneficiaries on notice, and imposed upon them a duty of inquiry even prior to the entry of the 1953 decree. Having failed to raise such inquiry regarding the investments, or to object at that time, the court held the beneficiaries were barred from raising any issue with respect to the investments.

Matter of Sanchez, NYLJ, April 5, 2010, p. 18 (Sup. Ct. New York County).