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# Probate & Property

May/June 2016 Vol. 30 No. 3

A Publication of the Real Property, Trust and Estate Law Section ABA American Bar Association

## Cell Phone Towers Do Not Affect Property Values

ABA SECTION OF REAL PROPERTY | TRUST & ESTATE LAW
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Defending Liberty
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# eLearning PROGRAM

The eLearning Program is a training series focused on the needs of new lawyers and paralegals working in the areas of trust and estate law.
The ABA Section of Real Property, Trust and Estate Law is proud to continue our training series focused on new lawyers, paralegals, and others working in the areas of Trust & Estate Law, with the 2016 program: More Than the Basics: Estate Planning and Estate Administration.
Attendees of the eLearning Program will learn substantive legal and ethics issues – as well as best practices – from leading industry professionals with in-depth knowledge and hands-on experience in Trust & Estate Law. The program will offer ten 60-minute eLearning sessions, and attendees can register for the entire series or individual sessions.

## UPCOMING SESSIONS

**Finance 101 for Estate Planners and Paralegals: How to read and interpret financial statements and balance sheets**
Thursday, June 9, 2016
1:30 – 2:30 pm ET
Speakers:
Bruce Tannahill, MassMutual Financial Group, Phoenix, AZ
Stephen Bigge, Keebler & Associates, Green Bay, WI

**Real estate basics for estate planning and administration paralegals**
Thursday, July 14, 2016
1:30 – 2:30 pm ET
Speakers:
Derek Taylor, Michael Best & Friedrich LLP, Milwaukee, WI
Charles Delorey, Michael Best & Friedrich LLP, Madison, WI

**Estate Tax Return I (Form 709)**
Thursday, August 11, 2016
1:30 – 2:30 pm ET
Speakers:
Marissa Dungey, Withers Bergman LLP, New Haven, CT
James Dougherty, Withers Bergman LLP, New Haven CT

**Session 9: Estate Tax Return II (Form 709)**
Thursday, September 8, 2016
1:30 – 2:30 pm ET
Speakers:
Toni Ann Kruse, McDermott Will & Emery, New York, NY

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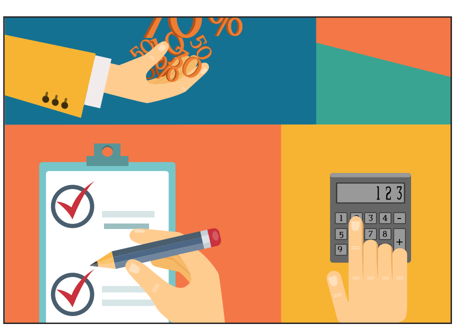

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## Features

# Departments



**Editorial Policy**: *Probate & Property* is designed to assist lawyers practicing in the areas of real estate, wills, trusts, and estates by providing articles and editorial matter written in a readable and informative style. The articles, other editorial content, and advertisements are intended to give up-to-date, practical information that will aid lawyers in giving their clients accurate, prompt, and efficient service.

**The materials contained herein represent the opinions of the authors and editors and should not be construed to be those of either the American Bar Association or the Section of Real Property, Trust and Estate Law unless adopted pursuant to the bylaws of the Association. Nothing contained herein is to be considered the rendering of legal or ethical advice for specific cases, and readers are responsible for obtaining such advice from their own legal counsel. These materials and any forms and agreements herein are intended for educational and informational purposes only.**






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## Adverse Possession

In the January/February issue of *Probate & Property*, Adam Leitman Bailey and Matthew Engle published a very useful and accurate survey of adverse possession in Eastern states—with one exception. In North Carolina there exists a little used but potentially very significant option to enter a title in the Torrens system of registered titles. N.C. Gen. Stat. ch. 43. Once registered, title cannot be lost to an adverse possessor. Id. § 43-21 ("No title to nor right or interest in registered land in derogation of that of the registered owner shall be acquired by prescription or adverse possession"). See, e.g., *Adams Creek Assocs. v. Davis*, 746 S.E.2d 1 (N.C. App.), disc. rev. den. 748 S.E.2d 322 (N.C. 2013).

John V. Orth
William Rand Kenan, Jr. Prof. of Law
University of North Carolina
Chapel Hill, NC 27599-3380

**Adam Leitman Bailey's response:**

Prof. Orth is discussing a law dealing with the archaic Torrens registration system (as compared to the normal title recordation system in general use in this country). That system was only adopted in a few states in this country. Ten states retain it in some limited form. The only state where it plays any significant role is in Massachusetts. Some states still have laws on their books addressing the issue of adverse possession of Torrens land, even though the Torrens system is no longer in use.

Nothing we have in the article is incorrect, with some qualification. The article states in the last paragraph before the conclusion, "Massachusetts has a unique law stating that if a land is registered, it cannot be possessed adversely." That law is referring to Torrens registration. The North Carolina law that Prof. Orth mentions is identical to that Massachusetts law, and a similar law is also on the books of Ohio (RC 5309.89) and New York (RPL 401), in all three cases referring to Torrens System registration of land. The only place where it has seen any significant use is in Massachusetts.

**Prof. Orth's reply:**

Torrens title is hardly archaic. It's the principal system in England, Canada, Australia, and New Zealand. Admittedly it never caught on in America, partly due to opposition from the bar and title insurers. (Australia, I believe, recently refused to allow title insurance to be marketed there because it was unnecessary.)

A title insurance lawyer in North Carolina reported:

> Torrens registration has been used extensively in Eastern NC by timber companies for 2 reasons: (1) because the boundary lines are judicially determined, liability for double damages for wrongful cutting of timber are all but eliminated and (2) because the statute eliminates adverse possession, the company does not need to keep an eye on the vast tracts of land in rural areas.

And a North Carolina property lawyer reported:

> The Torrens System seems to be somewhat popular along the rural coast. There are approximately 30 to 40 tracts in Washington County that were Torrenized. I received a similar report from the Register of Deeds in Pamlico County.

And from *Minnesota Lawyers Weekly*:

> The primary Torrens jurisdictions remaining in the U.S. are Massachusetts, Minnesota, and Hawaii. In the Twin Cities about 40% of the metro area is Torrens property.

Where it is used, the Torrens system is very important. ■


Section News

# Section Officer and Council Nominations

In accordance with Article 6, Section 6.1(g) of the Bylaws of the ABA Section of Real Property, Trust, and Estate Law, the Nominations Committee presents the following for officer and council member vacancies that will occur at the close of the Association year.

The Nominations Committee, consisting of Susan Talley, Chair, Gideon Rothschild, Vice-Chair, Susan N. Gary, Nancy R. Little, and Joseph Lubinski, met during the 2015 Fall Leadership Meeting. The Committee interviewed Section Officers, Delegates, Council members, Standing Committee Chairs, and Editors of the Section's publications. The Committee also solicited and received input from Section leaders who were unable to attend the Fall Leadership Meeting, as well as other Section members. The Committee members participated in follow-up conference calls and communications among themselves and with proposed candidates. The Committee thanks all those who met with the Committee and otherwise shared their insights about the future leadership of the Section.

The Committee hereby submits its nomination of the following persons to serve in the officer capacities noted by their respective names:

*Section Chair*: David J. Dietrich
*Section Chair-Elect*: Elizabeth C. Lee
*Real Property Division Vice-Chair*:
Jo-Ann M. Marzullo
*Trust & Estate Division Vice-Chair*:
David M. English
*Section Secretary*: Robert C. Paul
*Section Finance Officer*:
Stephanie Loomis-Price
*Section Delegate*: Andrew F. Palmieri
*Assistant Secretary (Trust & Estate Division)*: Jessica A. Uzcategui
*Assistant Secretary (Real Property Division)*: Sterling Scott Willis

The following persons are re-nominated to serve a three-year term on the Section Council:

*For the Trust & Estate Division*:
James D. Spratt

*For the Real Property Division*:
Kellye Curtis Clarke
James Geoffrey Durham
Candace M. Cunningham

The following persons are nominated to serve an initial three-year term on the Section Council:

*For the Trust & Estate Division*:
Henry Talavera
Beth Wood
Robert D. Steele

*For the Real Property Division*:
Nelse T. Miller

Pursuant to Section 6.1(g) of the Section Bylaws, a biographical statement of each nominated person follows.

David J. Dietrich
Dietrich & Associates, PC
Billings, Montana

Nominated as Section Chair, term ending August 2017. Positions held in Section: Chair-Elect, Vice-Chair, Chair, and Co-Chair, Estate Planning and Estate Administration for Farmers and Ranchers Committee; Chair, Valuation of Business Property Committee; Assistant Secretary, Trust and Estate Division; Member, Committee on Committees, Membership, and Planning Committees; Vice-Chair, Trust and Estate Division CLE Committee; Co-Chair, Property Preservation Task Force; Council Member; Section Secretary; Member, Planning Committee; Member, Corporate Sponsorship Committee; Member, Special Committee on ABA Relations.

Elizabeth C. Lee
Womble Carlyle Sandridge & Rice
Washington, D.C.

Nominated as Section Chair-Elect, term ending August 2017. Positions held in Section: Vice-Chair, Real Property Division; Section Secretary; Member, Council; Co-Chair, Standing Committee on Continuing Legal Education; Co-Chair, Real Property Division Continuing Legal

Education Committee; Member, Planning, Communications, and Corporate Sponsorship Standing Committees; Member, Digital Signature and E-Commerce Committees; Chair, Construction and Mortgage Lending Committee; Vice-Chair and Chair, Mortgage Loan Structure and Origination; Section Liaison to Property Records Industry Association; Member, Special Committee on ABA Relations.

Jo-Ann M. Marzullo
Posternak Blankstein & Lund LLP
Boston, Massachusetts
Nominated for first term as Section Vice-Chair, Real Property Division, term ending August 2017. Positions held in Section: Vice-Chair and Chair, K-10 Emerging Issues; Member, G-2 Design and Construction; Vice-Chair, G-2 Design and Construction Including ADA Act; Member, Continuing Legal Education; Chair, E-6 Property, Casualty & Other Non-Title Insurance; Group Chair and Vice-Chair, Commercial Real Estate Transactions and Management Group; Vice-Chair, RP Division CLE; Co-Chair and Member, Corporate Sponsorship; Ex-Officio, Council; RP Division Subcommittee Chair, Continuing Legal Education; Member, Planning; Liaison to SOC Task Force on Continuing Legal Education; RP Division Subcommittee Chair, CLE; Member, Council; Member, Planning; Vice-Chair and Co-Chair, CLE; Member, Groups and Substantive; Member, Nominations Committee.

David M. English
University of Missouri School of Law
Columbia, Missouri
Nominated for second term as Section Vice-Chair, Trust and Estate Division, term ending August 2017. Positions held in Section: Section Vice-Chair, Trust and Estate Division; Vice-Chair, Significant Current Probate and Trust Legislation; Editor, Keeping Current, *Probate & Property;* Chair, Committee on Long Term Health Care; Chair, Limited Liability Companies; Chair, Healthcare Decisions; Chair, Organ and Tissue Donation Committee; Member, Bylaws and Handbook Committee; Council Member, Elder Law and Disability Planning; Member, Continuing Legal Education Committee; Member, Study Committee on Law Reform; Member, Publications Committee; Member, Diversity Committee; Member, Section Advisory Board; Member, Nominating; Vice-Chair, Bioethics; Co-Chair, Uniform Acts for Probate & Trust Law; Member, Task Force on American Indian Probate Reform; Member, Task Force on USA Patriot Act and Gatekeeper Regulation; Member, Task Force on Real Property Law School Curricula; Member, Intellectual Property/Patent Task Force; Section Delegate, Council; Co-Chair, Diversity; Liaison, Commission on Law and Aging; Chair, Special Committee on ABA Relations; Member, Groups and Substantive; Chair, National Conference of Lawyers and Corporate Fiduciaries; Co-Chair, Community Outreach.

Robert C. Paul
Rockefeller Group Technology Solutions Inc.
New York, New York
Nominated for second term as Section Secretary, term ending August 2017. Positions held in Section: Section Secretary; Vice-Chair, Co-Chair, and Chair, Securitization and REITs Committee; Associate Editor and Editor-in-Chief, *Real Property, Trust and Estate Law Journal*; Member, Vice-Chair and Co-Chair, Publications Committee; Member, Section Advisory Board; Member, Nominations Committee; Member and Co-Chair, Special Committee on In-House Counsel; Member, Planning Committee; Liaison, ABA Working Group on Corporate Counsel; Member, ABA Standing Committee on Publishing Oversight; Council Member.

Stephanie Loomis-Price
Winstead PC
Houston, Texas
Nominated for third term as Finance and Corporate Sponsorship Officer, term ending August 2017. Positions held in Section: Finance and Corporate Sponsorship Officer; Chair and Vice-Chair, Tax Litigation and Controversy Committee; Member, Vice-Chair, and Co-Chair, Continuing Legal Education Committee; Member, Nominations and Planning Committees; Group Vice-Chair and Group Chair, Income and Transfer Tax Planning Group; Council Member; Assistant Finance Officer, Finance Planning Officer; Section Officers Conference Liaison to ABA Standing Committee on CLE (SCOCLE).

Andrew F. Palmieri
Saul Ewing LLP
Washington, D.C.
Nominated for first term as Section Delegate, term ending August 2019. Positions held in Section: Section Chair-Elect, Section Chair, and Past Chair; Section Representative to the SOC Decennial Review Committee; Vice-Chair, H-1 Development and Financing of Common Interest Communities Committee; Chair and Co-Chair, H-1 Development, Operation and Management of Community Associations; Member, H-6 Homeowners, Community and Common Interest Community Associations; Member, I-5 Collateral for Commercial Real Estate Loans; Member, H-2 Sports, Entertainment, Gaming and Related Real Estate Issues; Member, I-5 Collateral for Commercial Real Estate Finance; Vice-Chair and Co-Chair, Division CLE; Member, Committee on Committees; Co-Chair and Member, Membership; Chair, Fellows Program; Vice-Chair, Co-Vice-Chair, and Member, CLE; Member and Vice-Chair, A-1 Division CLE; Co-Chair, RP Division CLE; Member, Planning; Member, Council; Member, Intellectual Property/Patent Task Force; SOC Task Force on Continuing Legal Education, Liaisons: ABA Entities; Representative, Real Property Synergy Group; Co-Vice-Chair, Communications.

Jessica A. Uzcategui
Sacks Glazier Franklin & Lodise LLP
Los Angeles, California
Nominated for second term as Assistant Secretary, Trust and Estate Division, term ending August 2017.

Positions held in Section: Assistant Secretary, Trust and Estate Division; Vice-Chair, Probate & Fiduciary Litigation; Member, Corporate Sponsorship; Co-Chair, Ethics and Malpractice; Member, Diversity.

Sterling Scott Willis
Fishman Haygood, L.L.P.
New Orleans, Louisiana
Nominated for first term as Assistant Secretary, Real Property Division, term ending August 2017. Positions held in Section: Chair, I-7 Legal Opinions in Real Estate Transactions; Vice-Chair and Member, CLE; Vice-Chair, eCLE; Member, Planning Committee.

James D. Spratt
Bowden Spratt Law Firm PC
Atlanta, Georgia
Nominated for second term on Council, Trust and Estate Division, term ending August 2019. Positions held in Section: Vice-Chair and Co-Chair, C-2 Estate Planning and Administration for Business Owners, Farmers, and Ranchers; Chair, Business Investment Entities, Partnerships, LLCS and Corporations; Member, Property Preservation Task Force; Group Chair and Vice-Chair, Business Planning Group; Liaison to Section of Business Law/LLC Model Prototype Project; Member, Membership; Member, Communications; Member, Group and Substantive Committees; Assistant Secretary TE, Officers; Assistant Secretary TE, Council; Council, Trust and Estate Division.

Kellye Curtis Clarke
Keegan DeVol & Clarke PLC
Alexandria, Virginia
Nominated for second term on Council, Real Property Division, term ending August 2019. Positions held in Section: Member, Fellows; Vice-Chair, Single Family Residential; Member, Membership; Chair, Single Family Residential; Co-Vice-Chair and Member, Diversity; Group Chair and Vice-Chair, Residential, Multi-Family and Special Use Group; Member, Nominations; Member, RP Government Submissions Task Force; Council, Real Property Division.

James Geoffrey Durham
University of Dayton School of Law
Dayton, Ohio
Nominated for second term on Council, Real Property Division, term ending August 2019. Positions held in Section: Standing Committee on Ethics and Professionalism Liaisons to ABA Entities; Chair, Ethics and Professionalism; Group Chair and Vice-Chair, Practice Management Group; Member, Membership; Member, CLE; Member, Task Force on Real Property Law School Curricula; Liaison, Standing Committee on Ethics & Professional Responsibility; Group Chair, Legal Education and Uniform Laws Group; Assistant Secretary, Council; Council, Real Property Division.

Candace M. Cunningham
Robinson & Cole LLP
Hartford, Connecticut
Nominated for second term on Council, Real Property Division, term ending August 2019. Positions held in Section: Books Editor, Real Property; Member, Membership; Managing Editor, Real Property; Member, Publications; Editor, Media/Book Products; Member, Planning; Ex-officio, Council; Member, Corporate Sponsorship; Council, Real Property Division.

Henry Talavera
Polsinelli
Dallas, Texas
Nominated for first term on Council, Trust and Estate Division, term ending August 2019. Positions held in Section: Co-Vice-Chair, Welfare Benefit Plans; Vice-Chair, Plan Transactions and Terminations; Group Chair and Vice-Chair, Employee Benefit Plans and Other Compensation Arrangements Group; Liaison, ABA Joint Committee on Employee Benefits; Liaison, Hispanic National Bar Association; Liaison, RPTE CLE Representative on ABA Joint Committee on Employee Benefits; Member, Membership; Co-Chair, IRA Accounts & Plan Distribution.

Beth Wood
Moore & Van Allen
Charlotte, North Carolina
Nominated for first term on Council, Trust and Estate Division, term ending August 2019. Positions held in Section: Co-Chair and Member, CLE; Vice-Chair, Emotional and Psychological Issues in Estate Planning; Ex-Officio, Council; Member, Planning.

Robert D. Steele
Schwartz Sladkus Reich Greenberg Atlas LLP
New York, New York
Nominated for first term on Council, Trust and Estate Division, term ending August 2019. Positions held in Section: Vice-Chair, K-2 Technology in the Practice; Managing Editor, E-State; Chair, Public Web Site and E-State; Chair, Vice-Chair, Co-Vice-Chair, and Member, Publications; Editor and Articles Editor for TE, *RPTE eReport*; Ex-Officio, Council; Co-Chair and Co-Vice-Chair, Emotional and Psychological Issues in Estate Planning; Vice-Chair, Alternative Dispute Resolution.

Nelse T. Miller
Lorber Greenfield & Polito LLP
Poway, California
Nominated for first term on Council, Real Property Division, term ending August 2019. Positions held in Section: Vice-Chair and Chair, Brokers and Brokerage; Vice-Chair, Real Property Litigation and Alternative Dispute Resolution; Vice-Chair, Design and Construction; Group Vice-Chair and Chair, Commercial Real Estate Transactions; Member, Diversity; Member, Co-Vice-Chair, and Co-Chair, Communications; Member, Planning; Assistant Secretary, Real Property Division. ■

# Client Development Tips for Young Lawyers

**By W. Peter Connick Jr.**

Is it just me or do you also feel like you missed the class in law school in which billing, navigating the office water cooler, and client development were taught? These examples represent just a few of the many things young lawyers realize they learned little or nothing about during their time in law school. I thought that after working hard in law school, my education was essentially over—time to get out and practice. As I am sure most naïve associates realize when starting their new jobs, there is a lot to learn about the practical application of a law degree.

Client development, or "building a book," is one of the more difficult, but necessary, challenges young lawyers face in the beginning stages of their careers. Young lawyers may ask themselves questions when beginning to think about client development. "Where do I search for clients?" "How do I market myself to potential clients?" "How will I get a potential client to trust me with my lack of experience?" Here are a few tips that may provide answers to these questions.

## Start from the Beginning

The best way to meet potential clients is through the relationships you cherish and have built throughout your life. A young attorney, with little experience, often lacks a résumé of deals and projects that displays his or her capabilities to potential clients. At this stage in your career you are building a reputation in your field, but unfortunately this alone is unlikely to generate new clients. Thus, it is important to look to the relationships you have already established with friends and family. Those who already know and trust you personally will most likely trust you professionally, despite your lack of experience.

I am not suggesting you should harass your friends and loved ones to generate business, because this will likely backfire and strain your personal relationships. Be patient. Talk to your friends and family about what you do and the areas in which you practice, and you may be surprised at how much you have in common professionally in addition to your personal connection.

## Get Involved

Getting involved with professional and social organizations will allow you to help others and form relationships with colleagues and potential clients. For example, offering your time, legal education, and experience to a local charity will not only help those in need but also allow you to practice your law degree and show others your capabilities as an attorney. Being an active member of a professional organization relative to your field of practice will allow you to learn from more experienced lawyers and to form strong working relationships with colleagues that may eventually lead to referral business.

## Stay in Touch

When you form a relationship with a potential client, stay in touch. This can be achieved through a dinner, lunch, coffee, or even something as simple as sending a holiday card. One method of staying in touch is to forward news articles or journals to a potential client that might affect his or her business. Doing this reminds the client that you are aware of the client's particular business needs, and maintaining communication with a potential client is very important to developing a long-term relationship. How you achieve this comes down to the specific aspects of your relationship with the client, your own personality, and how you feel most comfortable building that relationship.

## Use Your Resources

Lack of experience is the biggest hurdle for young lawyers trying to build a client portfolio. How can you expect someone to trust you with his business affairs when you cannot promise him that you can handle each and every legal dilemma that may arise in the course of a legal representation? The fact of the matter is you don't have to. Most if not all young lawyers have bosses and mentors who were once young lawyers themselves. They understand that although you are a capable young lawyer, you may not be able to handle every legal need your client may have. Do not be afraid to tell the client that although you do not have the answer, other lawyers you work with do and are willing to help. Ultimately, the client will respect your candor and you will garner invaluable knowledge from working closely with your mentors.

It is important to remember that as young lawyers practice their profession, they are learning how to apply their legal education to the practical aspects of being an attorney. I hope these tips will be helpful in tackling the challenges of client development as you move forward in your legal career. ■

**For more information on the RPTE YLN, please contact:** Wogan Bernard, Chair, Chaffe McCall, L.L.P., New Orleans, Louisiana, bernard@chaffe.com. **Guest Editor:** W. Peter Connick Jr., Chaffe McCall, L.L.P. 1100 Poydras Street, Suite 2300, New Orleans, LA 70163, connick@chaffe.com.


# Uniform Laws Update

**Uniform Laws Update Editor:** Benjamin Orzeske, Chief Counsel, Uniform Law Commission, 111 N. Wabash Avenue, Suite 1010, Chicago, IL 60602. For more information about uniform acts, visit the Uniform Law Commission's web site at www.uniformlaws.org. **Guest Editor:** Marissa Dungey, Withers Bergman LLP, 660 Steamboat Road, Greenwich, CT 06830, marissa.dungey@withersworldwide.com.

**Uniform Laws Update** provides information on uniform and model state laws in development as they apply to property, trust, and estate matters. The editors of *Probate & Property* welcome information and suggestions from readers.

## Uniform Trust Decanting Act

This past July, the Uniform Law Commission (ULC) approved the Uniform Trust Decanting Act (UTDA), which proposes comprehensive legislation dealing with the exercise of a trustee's discretionary power in the increasingly popular action known as "decanting." Generally, decanting refers to a trustee's power to make distributions of trust property in further trust, subject to the terms and conditions of a new governing instrument. Less commonly, decanting can refer to a trustee's power to modify a trust instrument. In all cases, decanting is a flexible tool in the modern practitioner's toolbox to optimize existing trusts for ongoing administration.

Decanting has become a widely used technique because of its potential benefits. One such benefit is the ability to modernize trust provisions by, for example, incorporating directed trust provisions, allowing for a protector or designated representative, and updating provisions for investments and trustee succession. In addition, decanting can preserve certain tax benefits and creditor protections afforded by trusts that might otherwise terminate earlier than necessitated by applicable law. Decanting also can change the governing law or situs of a trust or consolidate trusts for a common class of beneficiaries.

Perhaps the most attractive feature of decanting is that it does not require court approval, which can be a time-consuming and costly process; nor does it require the consent of the grantor or beneficiaries, which may carry with it certain risks, including negative gift, estate, and generation-skipping transfer (GST) tax consequences.

Currently 23 states have some form of decanting statute. The statutes vary greatly from state to state, with significant differences in application and procedural requirements. The ULC drafted the UTDA to facilitate uniformity among the states. This is especially important for trusts that have connections with multiple states where the applicable law is not clear.

The act includes standard provisions typically found in the existing statutes, as well as a few innovative provisions. Existing decanting statutes allow a trustee who has broad discretion to make distributions of principal for the benefit of one or more beneficiaries to make those distributions into a second trust. When the fiduciary has broad discretion, few restrictions limit the exercise of the decanting power. Some of these statutes also allow a trustee with limited discretion to decant, although the application and restrictions on the power vary widely state to state.

The UTDA permits decanting when the trustee's discretion is limited by an ascertainable standard, but only for administrative purposes; the interests of the beneficiaries in the first and second trusts are required to be substantially similar. These restrictions are relaxed for distributions to a special-needs trust for a beneficiary who becomes disabled. The act also specifically addresses decanting of pet trusts.

For trusts that contain charitable interests, the UTDA is more restrictive. The decanting power does not apply to wholly charitable trusts. For all other trusts with "determinable charitable interests" (as defined in the act), the state's attorney general must be notified before a decanting, and a decanting cannot change the governing law of such a trust without court approval if the attorney general objects. Further, determinable charitable interests cannot be diminished in the second trust, and decanting cannot be used to change an identified charity or stated charitable purpose. These provisions are intended to protect the settlor's charitable intent without unduly limiting the ability to decant.

The power to decant under the

UTDA does not require creation of a separate trust. Rather, the term "decanting" is defined to include the power to *modify* the trust. Similar to an amendment, modification does not require retitling the assets and may avoid needing to obtain a new taxpayer identification number for the "second" trust. The power to modify the trust adds an element of administrative convenience.

Before a decanting, the trustees are required to give 60-days' notice of their intention to decant a trust to the settlor, if living, the "qualified beneficiaries" (defined in the act to include current beneficiaries and the first generation of presumptive remainder beneficiaries), any holders of then-exercisable powers of appointment, any person with the power to remove the trustee, each other fiduciary, and (if there is a charitable interest in the first trust) the attorney general. Beneficiary consent is required, however, only to the extent that the decanting would benefit the decanting fiduciary—for example, by decanting to a trust that permits self-dealing, raises the trustee's compensation, or increases the trustee's liability protection.

Generally, decanting can be accomplished without court approval. But the UTDA specifically allows interested parties to petition a court to approve (or disapprove) an anticipated decanting or to appoint a special fiduciary who may exercise the decanting power.

Because decanting is a flexible tool, it could be used to frustrate the settlor's intent. To address that concern, the UTDA requires that the trustee act in accordance with its fiduciary duties, including the duty to act in accordance with the purposes of the first trust. This reflects the view that decanting is primarily a vehicle to enable the fiduciary to adapt the trust in response to a change in circumstance or law not anticipated by the settlor.

The UTDA also attempts to reduce ambiguity over whether the decanting statute applies. As drafted, it applies to any trust that has a principal place of administration in the enacting state, as well as trusts with a choice-of-law provision designating the enacting state's law, except to the extent explicitly prohibited by the trust instrument.

Various protections are contained in the UTDA. As with many existing statutes, the UTDA includes savings language that prohibits decanting a trust in a manner that would cause the trust no longer to qualify for a tax benefit afforded by the first trust—for example, the benefits afforded to marital deduction trusts, IRC § 2503(c) trusts, or trusts with retirement accounts. In addition, decanting cannot extend the term of the trust beyond the period permitted by the applicable rule against perpetuities. The UTDA also provides a cure for a flawed decanting by reading into the second trust any missing language or reading out of it any invalid language. By providing a cure, the UTDA avoids any question over which trust is operative and avoids the logistical problems associated with trying to undo a decanting. Further, the act permits a trustee to rely reasonably on a prior decanting. These protections facilitate a fiduciary's exercise of the decanting power and acceptance of a trusteeship for previously decanted assets.

Notably, the IRS issued Notice 2011-101 to advise that it was considering the tax consequences of decanting and to request public comment. The IRS has not yet issued guidance. Although the UTDA includes provisions to account for areas that implicate tax issues, one hope identified by the drafters of the uniform act is that its existence may provide common ground for the promulgation of tax guidance.

The UTDA provides a statutory basis for a trustee to exercise the power to decant, but it does not preempt or replace other permitted methods. A trustee can decant or modify a trust in accordance with the trust instrument, common law, any other state law, court order, or a nonjudicial settlement agreement. The UTDA, however, may provide greater opportunities for decanting than available using other methods. And using the statute to decant carries with it the protections it provides against potential negative tax consequences, fiduciary liability, and conflict among states' laws.

The UTDA has been recommended for enactment in all states. In March, New Mexico became the first state to enact a UTDA statute. At press time UTDA legislation was pending in California, Colorado, and Illinois. ■

# Cell Phone Towers Do Not Affect Property Values

## (Or the Case of Three Board Hearings and One Temporary Tower)

By Richard A. Forsten, Wendie C. Stabler, and Olufunke O. Fagbami

Cell phone use has exploded. Ten years ago, the iPhone did not exist. Smartphones did not exist. The iPad did not exist. Blackberries were cutting edge. There was no Twitter, no Instagram, no Pinterest. Facebook was still nascent, and MySpace was still popular. Today, people regularly access the Internet over their smartphones and tablets. They tweet, they post, they snapchat.

In just an eight-year period, from 2007 to 2014, AT&T saw a 100,000% increase in mobile data traffic on its wireless network—not a 100% increase, not a 1,000% increase, but a 100,000% increase. See Randall Stephenson, *Chairman's Letter*, AT&T 2014 Annual Report (Feb. 10, 2015), www.att.com/Investor/ATT_Annual/2014/letter_to_investors.html. National mobile data traffic is estimated to increase another sixfold from 2015 to 2020, at a compound annual growth rate of 42%. See Cisco, *VNI Mobile Forecast Highlights, 2015–2020*, www.cisco.com/assets/sol/sp/vni/forecast_highlights_mobile/index.html (last visited Feb. 23, 2016).

People have responded to this technology. And they like it. A lot.

But one thing people do not seem to like is cell towers—the infrastructure necessary to make the network work. Despite pundits who predicted that technology would reduce the number of towers, the need for additional towers and network capacity is greater than ever, as the network capacity to transmit data has been far outstripped by the ever-growing demands of a population abandoning its landlines in favor of the convenience of smartphones and mobile data access.

In most jurisdictions, proposed new cell towers must undergo some sort of public application process involving a public hearing. Given the chance, those in the area will oppose any proposed new tower. While the Federal Telecommunications Act of 1996, 47 U.S.C. § 332 (7)(B)(iv), prohibits jurisdictions from denying cell tower applications on the basis of alleged ill-health effects, neighbors invariably argue that a new tower will adversely affect property values (specifically theirs), so the pending tower application should be rejected.

Appraisers argue to the contrary. Cell towers, they point out, are much like other modern infrastructure (telephone poles, utility lines, streetlights, and so on). Although cell towers may initially be noticed, they quickly fade into the background and have no appreciable effect on value—just as telephone poles, utility lines, streetlights, and the other infrastructure of modern life do not affect value. Although this conclusion may seem counterintuitive to many, and certainly those opposing a new tower will vehemently disagree, it is borne out by the statistics and studies.

Recently, in Sussex County, Delaware, a unique set of circumstances made it possible to review the effect of a proposed tower on the property values of surrounding properties *before* the final approval was granted. Specifically, after an approval for a proposed tower was granted, it was challenged. While the challenge was pending, a temporary tower was erected in the location proposed for the permanent tower. The challenged approval was reversed and a new hearing ordered. Because the county has a policy of allowing zoning code violations to remain in place while the property owner seeks a variance or undertakes other remedial action (in this case, the new hearing process), the county allowed the temporary tower to remain.

Over the course of the next two years, while the challenges to the tower played out before the Sussex County Board of Adjustment and the Delaware courts, the temporary tower remained, allowing the tower applicant to analyze property values before and after the temporary tower was constructed and to measure its effect on local property values as compared to the market as a whole. In fact, as further described herein, and consistent with the broader literature on the subject, the actual data for the site in question confirmed no effect on value.

This article is divided into three parts. First, it reviews various studies and analyses available on the valuation question, all of which generally indicate that cell towers have little or no effect on the value of nearby properties. Following this general review, the article examines the case of *AT&T v. Sussex County Board of Adjustment*, No. S14A-04-001 MJB, 2015 WL 1975629 (Del. Super. Ct. Apr. 30, 2015), in which AT&T was able to demonstrate that its proposed tower would have no effect on value because, during the pendency of the lengthy appeals process concerning the originally-approved tower, AT&T had erected a temporary tower, which was shown to have no effect on value. Put another way, unlike most cell tower applications in which opponents argue that studies from other areas are not indicative of the effect the proposed tower will have on their properties, AT&T was able to conclusively demonstrate that the proposed tower in the proposed location would have no effect on nearby property values. Finally, this article concludes with some other lessons from the *AT&T* case.

## Generally Speaking, Cell Towers Do Not Affect Property Value

Generally speaking, most studies of the issue conclude that proximity to a cell tower has no significant effect on property values. For example, a 2001 study by Thorn Consultants, which examined 85 transactions involving homes and 26 transactions involving vacant lots, concluded that "proximity to the cell site did not affect sale prices of homes or residential lots within the Potomac study area." See Thorne Consultants, Inc., *Monopole Impact Study on Residential Real Estate Prices for Homes and Residential Lots in the Vicinity of the Bullis School, Potomac, Montgomery County, Maryland* (May 2, 2001), at 3. The 2001 study, in turn, referenced a 1998 study in the Richmond, Virginia, area that examined six towers and 140 properties, and that also concluded "there was no consistent market evidence suggesting any negative impact upon improved residential properties exposed to such facilities in the areas included in the study." See Allen G. Dorin Jr., MAI, SRA & Joseph W. Smith III, *The Impact of Communications Towers*

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*on Residential Property Values*, Right of Way, Mar./Apr. 1999, at 17, available at https://www.irwaonline.org/eweb/upload/0399b.pdf. A 2004 study of homes in Orange County, Florida, found a minimal effect of 2% on value. See Sandy Bond, *Using GIS to Measure the Impact of Distance to Cell Phone Towers on House Prices in Florida*, Appraisal J., Fall 2007. A 2013 study from Chatham County, North Carolina, concluded that "the proposed tower will not adversely affect property values in the general vicinity of the tower," and a study from that same year in Holly Springs, North Carolina, concluded that for an existing tower, "there does not appear to be any significant or consistent change in value from the properties located [closer to or farther from the tower] . . . concluding that the tower does not affect the value of the properties as distance increases from [the] tower." See David A. Smith, *Impact Analysis of a Proposed Telecommunications Tower on the Values of Properties in the General Vicinity of the Tower Located on Poythress Road, Chatham County, North Carolina* (Sept. 10, 2013), at 1, available at www.chathamnc.org/RezoningSubdivisionCases/2013/9-16-13_BOC/Meacham_Cell_Lot/PH_Comments/Impact%20Analysis%20SK011715.pdf; Tom J. Keith & Associates, Inc., *Impact of Cell Tower on Surrounding Properties*, available at http://d39pcpjksqjx5i.cloudfront.net/media/re-research/cell_tower_study.pdf (last visited Feb. 23, 2016). Finally, a 2005 study from New Castle County, Delaware, looked at eight tower sites and similarly concluded that "the market demonstrates no ascertainable diminution of value to surrounding neighborhoods due to the installation or presence of a nearby communications tower." See Appraisal-Associates, Inc., *Impact of a Telecommunications Tower upon Values of Residential Properties* (Aug. 2005), at 93. "The data demonstrates that residences in close proximity to a tower (less than one quarter mile or 2,000 feet in the case of the vast majority of the sales studied) did not incur a measurable diminution in value after development of the tower." Id. at 92.

A 2005 survey conducted by researchers in New Zealand found an interesting bias. Although the study concluded that proximity to a tower did seem to affect value, it also found that those in the "control group," who did not live near a tower, expressed a great deal more concern over the effect of a tower on property value than those who lived near a tower. See Sandy Bond & Ko-Kang Wang, *The Impact of Cell Phone Towers on House Prices in Residential Neighborhoods*, Appraisal J., Summer 2005, at 256, 262–65. Specifically, almost half of the control group expressed concern about the effect on value, while only 13% of those living near a tower expressed concern, and more than 60% were not worried about the effect on value. Id. The researchers theorized that this difference between those who did not live near a tower versus those who did may be because those living near a tower did not want to express fears about property value decline that would then, in fact, lead to lower property values. Id. An explanation just as likely, if not more so, is posited by researchers whose studies find no general effect on value—that is, that because cell towers are perceived as part of today's modern infrastructure, they simply fade into the background and are not noticed. Those living near towers do not express concern, or do not perceive the cell towers as having a negative effect on property values, because the towers have simply faded into the background as part of the existing landscape.

Despite the general consensus that cell towers do not adversely affect property values, courts have sometimes allowed boards and administrative bodies to ignore studies from other jurisdictions and locations, on the apparent theory that such studies fail to take local factors into account. For example, in *Cingular Pennsylvania, LLC v. Sussex County Board of Adjustment*, No. 05A-12-003-RFS, 2007 WL 152548 (Del. Super. Ct. Jan. 19, 2007), at *8, the Delaware Superior Court justified the board's refusal to consider two out-of-state analyses because they "were not substantially similar to the proposed area in question." The court then suggested that Cingular could have studied the effect its proposed tower would have on properties in the immediate area, but how to study an un-built tower was not explained. Indeed, this is the conundrum facing many applications—while studies and data based on other towers indicate no significant effect on value, opponents claim that such studies involving other areas and other towers should not apply to their particular properties.

In 2013, though, AT&T would find itself in the unique and unanticipated position of demonstrating that its proposed tower would have no effect on value based on actual market data from the actual geographic area surrounding the actual proposed tower. Thus, the challenge of disproving a negative had just become much easier.

## *AT&T v. Sussex County*: One Cell Tower, Three Hearings, No Effect on Value

The case that would become *AT&T v. Sussex County Board of Adjustment* began in the early 2000s, when New Cingular Wireless PCS (which would later be acquired by AT&T) first identified the need for a new cell tower as part of its network in the general vicinity of Bethany Beach, Sussex County, Delaware. After several years of fits and starts, Cingular finally found a suitable site with a willing property owner—the rear of a combination Arby's Restaurant/BP Gas Station parking lot. The property was located on the east side of Route 1, the major north/south artery serving the Delaware beaches from Fenwick Island at the Maryland line to Rehoboth Beach to the north. A late night drive-thru for the Arby's was located on the back side of the building (the same side as the proposed tower) and a water retention pond was located at the very rear of the property. To the immediate south of the property was a furniture store and to the immediate north, a small undeveloped parcel. To the east and a portion of the southern boundary was a small (46-unit) condominium community called "Sea Pines." To the south of Sea Pines were a Holiday Inn Express and a seafood restaurant, and to the east of Sea Pines was the much larger, and considerably taller, Sea Colony

Condominiums, consisting of multiple nine-story buildings. See Figure 1.

Under the Sussex County Zoning Code, if a cell tower "is to be erected within 500 feet of any residentially zoned lot," as was the case here, a special use exception is required from the Board of Adjustment. Sussex County Code § 115-194.2(A). In addition to meeting certain technical requirements regarding height, setback, and lighting, among others, the applicant must also demonstrate that the special use exception will not "substantially affect adversely the uses of the adjacent and neighboring property." Sussex County Code § 115-210.

Cingular submitted its original cell tower application in September 2009. Neighbors opposed the tower, but the board granted the request by a 3–2 vote. Opponents of the project then appealed to the Delaware Superior Court; while the appeal was pending, Cingular, with the permission of the county, installed a temporary cell tower. After the temporary tower was erected and while the appeal was pending, it was discovered that the county had posted notice of the hearing on the wrong property (the undeveloped adjacent parcel to the north). Thus, the superior court held that, even though posting of a property is not *required* under county rules, and all other notices (for example, newspaper and mailings) had been properly given, if the county was going to post on a property, it needed to post on the correct property, and a new hearing was ordered. See *Sea Pines Vill. Condo. Ass'n of Owners v. Bd. of Adjustment*, No. S10A-01-003 THG, 2010 WL 8250842 (Del. Super. Ct. Oct. 28, 2010).

So, Cingular (now a part of AT&T) went back to the board for a new hearing. This time, more opponents showed up and the board voted 3–2 to deny the request; in doing so, the board noted in its written decision that "it was impossible for the Board to disregard the large number of individuals opposing the tower." This time Cingular appealed, first to the superior court, which affirmed the board, and then to the Delaware Supreme Court. The supreme court reversed the board's decision because the board applied the wrong standard in evaluating the application; the board found only that the proposed tower would "adversely affect" neighboring properties, not "substantially affect adversely" as required by the Sussex County Code. See *New Cingular Wireless PCS v. Bd. of Adjustment*, 65 A.3d 607, 611-12 (Del. 2013). The matter then returned to the board for a third hearing, some four years after the first hearing, and the stage was now set: with a temporary tower having been in place for over three years, one could look at the movement of property values in the vicinity of the temporary tower both before and after the tower was constructed and compare those movements to the movement of property values in the wider market; or, put another way, one could determine with relative certainty what effect, if any, a tower at the proposed location might have.

Figure 1.

### The Temporary Tower Has No Effect on Property Value

AT&T had two appraisers look at the market effects of the temporary tower. The first appraiser looked at sales of two-bedroom nonwater-view condominium units (that is, units comparable to the condominium units adjoining the cell tower site). He found a total of 36 sales, of which the top two sales, and six of the top 10 sales, were in the Sea Pines Condominium community immediately adjoining the cell tower site. If the tower were going to have an effect on value, one would think that the top sales prices would not be achieved in the community immediately surrounding the tower.

AT&T's other appraiser tracked the movement of prices in the Sea Pines community and the larger beach community for two years before and through two years after the installation of the temporary tower. His analysis demonstrated that as the larger real estate market moved up and down, so did the Sea Pines community in approximately the same way. See Figure 2 on page 14. In testifying before the Sussex County Board of Adjustment, the appraiser explained:

> In this high density mixed use area, there's a lot of influences surrounding this project already. So people, when they're making a purchase decision in Sea Pines and other areas in this resort market, there are many things that impact your decision, your view, your access. And a cell tower pole, a single monopole, really is an expected thing in today's world. As we showed, one side of this property is lined with power lines that have been there forever. People need power. They're an accepted part of the landscape. Apparently, people have been making purchase decisions in Sea Pines for many years in the presence of those lines and the other uses like gas pumps and the convenience store, and we just didn't see any evidence of this one particular structure [having] a unique influence on property value.

Opponents of the project testified at the hearing before the board as well. They offered no appraisal or other direct evidence of any effect on value. In fact, some of their testimony actually bolstered AT&T's case when two residents testified that they had experienced no problems in fully renting their units during the rental season after the temporary tower was installed—or, put another way, the temporary tower did not affect the ability of unit owners to rent their units. Moreover, no unit owners complained of having to lower rents to secure tenants or of any other adverse economic effect. One of AT&T's appraisers also did a study of rental rates and found that Sea Pines's rental rates were consistent with the local market and that there was no effect on rental rates associated with the temporary tower.

In sum, then, the case of the Sussex County temporary tower confirms what studies have shown for years—that cell towers have become part of the suburban landscape and have no appreciable effect on value. Like telephone poles, power lines, streetlights, and the other infrastructure of modern life, cell towers fade into the background and draw no more attention than other infrastructure.

### Some Other Lessons from the *AT&T* Case

AT&T's experience in this case provides two further lessons. First, a land use applicant needs to be absolutely certain that all procedures are followed properly; and, for better or worse, this means confirming that the local governmental body has given the proper notices and made the proper mailings and postings. But for the county's inadvertent error in posting notice of the hearing on the wrong property in 2009, AT&T could have avoided four years of additional litigation. One need not be heavy-handed in confirming that things are done properly, but confirmation should be obtained.

More importantly, the Delaware Superior Court's 2015 opinion, following the third hearing by the board, marks something of a watershed for Delaware courts in the way they deal with decisions by boards of adjustment. Under Delaware law, appeals from the board go to the Delaware Superior Court, which, by statute, has the power to reverse, affirm, or modify a decision of the board. See Del. Code Ann. tit. 9, §§ 1314(f), 4918(f), 6918(f); Del. Code Ann. tit. 22, § 328(c). Significantly, unlike other Delaware statutes

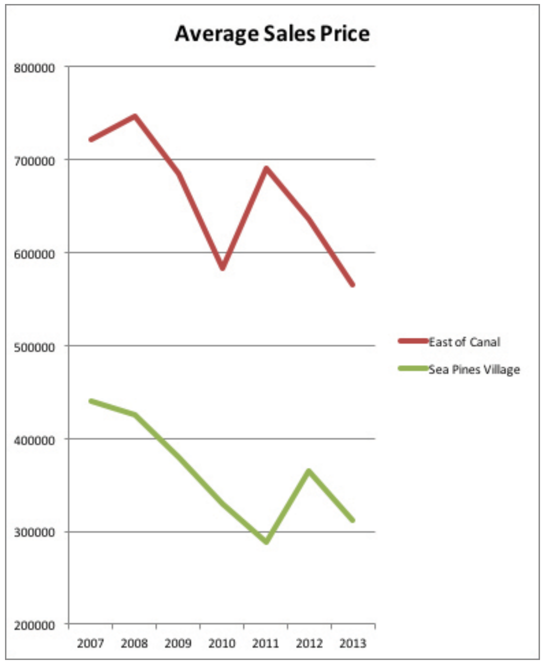


Figure 2.

regarding appeals from other boards and administrative bodies, there is no power to "remand" a decision back to the board of adjustment. (For examples of statutes in which remand is specifically listed as a remedy, see, e.g., Del. Code Ann. tit. 7, § 6612(b); Del. Code Ann. tit. 7, § 6214(b); Del. Code Ann. tit. 9, § 8312(c); Del. Code Ann. tit. 14, § 1414; Del. Code Ann. tit. 18, § 328(h); and Del. Code Ann. tit. 19, § 2350(b).) And this lack of remand is most likely not an accident.

Most matters before a board of adjustment involve homeowners seeking minor dimensional variances for things such as screened porches or additions to their homes. Judicial review, of course, can be a time-consuming and expensive process. Rather than remands and multiple hearings, the Delaware General Assembly gave the superior court the ability to decide the matter (reverse, affirm, or modify) as part of its decision on appeal, rather than remand back to the board for further proceedings. Indeed, although most appeals are on the record, the General Assembly further provided that the superior court could receive additional evidence as part of the appeal process. Del. Code Ann. tit. 9, §§ 1314(e), 4918(e), 6918(e). The only reason for the court to receive additional evidence would be for the court to make findings on its own and resolve the matter once and for all, rather than remand a proceeding back to the board for another hearing and, potentially, another appeal. Homeowners should not be faced with years of litigation over whether they can build an additional two feet into a setback.

But, despite the lack of the power to remand, when reversing a board decision denying a permit or variance request, courts have almost always said that reversal does not constitute a grant of the permit or variance—rather, the court requires the applicant to go back to the board and re-apply for the permit or variance with a new hearing and an entirely new process. In other words, reviewing courts have done the functional equivalent of a remand, even though the courts do not call what they're doing a "remand."

The superior court's 2015 decision is significant, then, because the court did *not* reverse the board and then require AT&T to go back to the board and re-apply (for what would have been the fourth time) for a special use exception for the cell tower. Rather, the court specifically recognized that it did not have the power to remand and therefore modified the board's decision by ordering the special exception granted. Specifically, the court explained:

> At this stage, Appellant [AT&T] has been before the Board and the Court three times regarding this project. The first time, the Board's approval was reversed on procedural grounds. The second time, the Board applied the wrong standard and denied the application, resulting in the decision ultimately being reversed by the Supreme Court. Because the statute provides no authority to remand, Appellant has had to file

> a new application each time. While courts typically reverse rather than modify decisions of the Board of Adjustment Review, the statute [ ] clearly provides the Court with the power to modify when appropriate. This is such an instance. . . . The statute in the instant case only allows the court to affirm, reverse, or modify. In the absence of the option to remand, the Court finds Appellant's argument that the decision be modified to grant the permit especially compelling. . . . For the foregoing reasons, the decision of the Sussex County Board of Adjustment is MODIFIED and AT&T's Application for a special use exception to construct a permanent 100-foot telecommunications tower on [the] Property is GRANTED.

*AT&T,* 2015 WL 1975629 at *14–15. Thus, the court granted AT&T the special use exception it needed to construct a permanent tower. When opponents did not appeal the superior court decision, AT&T's odyssey was finally over.

The court stated that it was modifying the board's decision, not reversing it. Certainly the statute states that a court may "affirm, reverse, or modify," although one would think that granting a previously-denied application is the very epitome of a "reversal," not a "modification." "Modification" would seem to be reserved for those situations in which, perhaps, the board imposed conditions on a variance and the court modified those conditions or lessened or increased the dimensional component of a granted variance but otherwise left the grant in place. Regardless, though, the *AT&T* court's decision is good news for property owners and other applicants who receive denials from a board—the court has explicitly recognized that it lacks the power of remand and acted accordingly. Perhaps future applicants will now be spared the cycle of hearing, judicial review, new hearing, more judicial review, and so on.

## Conclusion

Studies have long shown that cell towers have no appreciable effect on property values, but opponents of towers, and some boards that consider these applications, refuse to believe these studies. Nevertheless, the results are supported by empirical data, and, although it may seem counterintuitive, the results ultimately make sense. As one appraiser in the *AT&T* case observed, "a cell tower pole, a single monopole, really is an expected thing in today's world. . . . people have been making purchase decisions [ ] for many years in the presence of those lines and the other uses like gas pumps and the convenience store, and we just didn't see any evidence of this one particular structure [having] a unique influence on property value."

The *AT&T* case is especially interesting and uniquely helpful because it allowed the cell tower applicant to demonstrate that there would be no effect on value for the very location at issue. Property values in the vicinity of the temporary tower moved in the same way as property values in the larger market. Not only is this conclusion consistent with the general literature and studies in this area, but AT&T was actually able to demonstrate that its proposed tower in its proposed location would not affect property values in the immediate area. ■

# Keeping Current

# Property

**Keeping Current—Property Editor:** Prof. Shelby D. Green, Pace University School of Law, White Plains, NY 10603, sgreen@law.pace.edu. Contributors: Andrew W. Fowler, Prof. Donald J. Kochan, and Prof. Darryl C. Wilson.

**Keeping Current—Property** offers a look at selected recent cases, literature, and legislation. The editors of *Probate & Property* welcome suggestions and contributions from readers.

## CASES

**DEEDS: Quitclaim deed transfers grantor's rights to surplus proceeds from foreclosure sale.** Hinton purchased a property in 2004 with a loan secured by a deed of trust, which provided that in the event of foreclosure any surplus would be paid to the grantor or his assigns. After a series of conveyances, Hinton's children obtained title to the property subject to the outstanding debt. After the loan became due, Hinton and Rolison agreed that Rolison would pay the debt and obtain clear title by judicial foreclosure. Hinton's children then quitclaimed their interests to Rolison. When the lender instituted foreclosure proceedings, Rolison made the high bid, bidding $147,000 in excess of the amount owed. Hinton claimed the surplus, asserting that the prior transfers did not operate as assignments of his right to the surplus under the deed of trust. The court entered judgment for Rolison, reasoning that the quitclaim deed and prior conveyances divested Hinton of his rights and interests in the property. A quitclaim deed transfers any and all interests a grantor has in the property, including the right to equitable redemption and the right to surplus. *Hinton v. Rolison*, 175 So. 3d 1281 (Miss. 2015).

**EASEMENTS: Easement by necessity does not arise unless at time of severance it would have connected the landlocked parcel to public road.** A landlocked tract of land now owned by Staley was part of an 1853 land grant from the state of Texas. The land grant was partitioned into separate tracts in 1866 at which time the Staley tract was severed from the adjacent tract now owned by Stiles. Staley sued Stiles to establish an easement by necessity running north across the Stiles tract to connect to public road CR 134. Maps introduced into evidence showed roads in the vicinity of CR 134 may have existed as early as the 1930s, but there was no evidence of a public roadway through the Stiles tract or along its northern boundary before that time. The trial court granted judgment for Stiles, which was affirmed on appeal. The court held that when an owner conveys part of a tract of land and retains a landlocked portion, a right of way by necessity over the portion conveyed is implied so the owner of the landlocked part can access it. But a right of way that does not result in access to a public roadway is not "necessary" because it does not facilitate use of the landlocked property. In this respect, the court found that "there was no evidence that at the time of [the 1866 severance], an

Parcels in the Staley Family Partnership case easement running north and south across the Stiles Tract would have resulted in—that is, was necessary for—access between the Staley Tract and a public road." *Staley Family Partnership, Ltd. v. Stiles*, No. 14-0591, 2016 WL 369567 (Tex. Jan. 29, 2016).

**FORECLOSURE: Anti-deficiency protections apply after short sales.** Coker bought a condominium with the help of a $452,000 purchase-money mortgage loan. After default, Coker asked the lender if it would release its security interest on her sale of the property to a third party for $400,000. The lender granted approval, subject to several conditions, including that Coker was still responsible for all deficiency balances remaining on the loan after the short sale. Coker accepted the lender's terms and closed the short sale. Six months later, the lender demanded that Coker pay a deficiency of over $116,000. Coker brought a declaratory action, claiming the protection of the anti-deficiency judgment statute. Cal. Civ. Proc. § 580b. The trial court sustained the lender's demurrer. The state supreme court disagreed. When a homeowner defaults on a purchase money loan, section 580b prevents the lender from obtaining a deficiency judgment against the borrower if the sale proceeds are not enough to repay the loan. This means that the bank can collect proceeds from the foreclosure sale but nothing more. This is the case no matter how the security is exhausted and even if no sale has occurred. Giving the statute its broadest possible reading, the court concluded that section 580b's anti-deficiency protections apply after any sale, including a short sale arranged by the borrower. Moreover, because this protection exists for the benefit of the public as a macroeconomic stabilization measure, it cannot be waived. Thus, Coker's agreement to pay the deficiency balance was unenforceable. *Coker v. JPMorgan Chase Bank, N.A.*, 364 P.3d 176 (Cal. 2016).

**LANDLORD-TENANT: Landlord may not dispose of tenant's personal property left behind without special execution.** After a landlord obtained an order to vacate, the tenants vacated on the appointed date but did not take all their personal property. The landlord arranged for a third party to pack, remove, and store some of the property. When the tenants requested their property, the third party demanded $4,600. After the landlord sold the tenants' washer and dryer to new tenants, the old tenants sued for conversion. Defendants successfully moved for summary judgment based on a statute allowing a landlord to retain or dispose of personal property, without legal process, if the property has a total estimated value of not more than $1,500. The statute further provides that if the lessor removes the abandoned property after a judgment of eviction has been obtained, and a special execution served, the lessor has a lien on the property for the reasonable amount of any storage and moving expenses. The tenants submitted an affidavit valuing their property at $8,000. Instead of disputing the valuation, the landlord contended that the valuation did not matter because a lien was created by statute and the eviction judgment, making special execution unnecessary. The supreme court reversed, finding that while the statute provided for a lien, the landlord failed to meet the requirements by not serving a special execution and by disposing of property valued in excess of $1,500 without legal process. A landlord who wrongfully seizes and sells a tenant's property is guilty of conversion. The tenants were allowed to amend their complaint to seek exemplary damages. *Poppe v. Stockert*, 870 N.W.2d 187 (N.D. 2015).

**MORTGAGES: Writing made after conveyance providing for payment in exchange for release of property does not establish equitable mortgage**. Walker deeded farmland to his sister, Brooks, who occasionally served as his caretaker. She claimed the transfer was a gift in recognition of her considerable emotional and financial assistance. Brooks did not take possession of the property, instead allowing Walker to live and work on the farm. Later at Walker's request, Brooks wrote a note indicating that she would release the property if she received $60,000 due to Brooks from a third party for his conveyance of easement and profit rights. At Walker's death, less than half this sum had been paid. Walker's son, the beneficiary of his estate, offered to pay the balance in exchange for title to the farm. Brooks refused and the son filed suit seeking specific performance of a contract for sale and declaratory relief based on constructive and resulting trust theories. A special referee found in the son's favor but on another basis—an equitable mortgage. But Brooks prevailed on appeal. The supreme court noted that an equitable mortgage is a transaction having the intent, despite lacking the form, of a mortgage. Proof of the parties' intent at the time of conveyance is essential. The estate offered no evidence, aside from Brooks's failure to take possession, that the parties intended to establish an equitable mortgage when the property was conveyed. The characteristics of a debtor-creditor relationship were missing and, most importantly, there was no contemporaneous writing indicating the property was to serve as security for any debt Walker owed Brooks. *Walker v. Brooks*, 778 S.E.2d 477 (S.C. 2015).

**MORTGAGES: Reverse mortgage ordered by court on out-of-state property is valid transfer.** In 2007 an Idaho court appointed a conservator for McKee. To deal with financial difficulties, the conservator obtained judicial permission to arrange for a reverse mortgage on McKee's property in Spokane, Washington. In 2012, the lender filed a Washington foreclosure action. McKee's daughter challenged the foreclosure, claiming that the reverse mortgage was void because McKee conveyed the property to her in 2007 (although her deed was not recorded until 2011) and that the Idaho court had no jurisdiction to affect Washington property. The trial court granted summary judgment for OneWest. The court of appeals reversed and granted summary judgment for the daughter, holding that the Idaho court lacked authority to authorize a conservator to encumber the Spokane residence and also that full faith and credit did not apply because the courts of one state cannot directly affect the legal title to land situated in another state. In reversing, the supreme court distinguished between "jurisdiction to adjudicate personal interests in real property, which is a transitory action, and jurisdiction to adjudicate legal title to real property, which is a local action that must be brought in the situs state." Because Washington follows the lien theory, the reverse mortgage was only an interest in property. Thus, the Idaho court had jurisdiction to order a reverse mortgage as an interest in, rather than transfer of title to, out-of-state property; and the Washington court must give effect to the Idaho court's decree. *OneWest Bank, FSB v. Erickson*, No. 91283-1, 2016 WL 455940 (Wash. Feb. 4, 2016).

**NUISANCE: Whether use of biosolids as fertilizer is normal agricultural operation covered by statute of repose on nuisance actions is question of law.** Starting in 2004, Hilltop Farms applied 11,635 wet tons of biosolids to 14 fields at its farm. Biosolids are solid organic matter recovered from the sewage treatment process. The biosolids were spread over the fields' surface and not immediately tilled or plowed into the soil. Neighbors characterized the odors from the biosolids as unusually noxious, smelling "like death." After failing to obtain relief from the state department of environmental protection, they sued, alleging nuisance and trespass. The farm moved for summary judgment on the basis of the state right-to-farm statute, which bars nuisance actions when "normal agricultural operations" have continued, substantially unchanged, for one year or more before the date of the action. 3 Pa. Cons. Stat. § 954(a). The trial court granted summary judgment for the farm. The appellate court reversed and remanded, ruling that there was a genuine issue of fact regarding whether the use of biosolids was a normal agricultural operation. The supreme court reversed, explaining that the statute was a statute of repose, which operates to extinguish the cause of action and divest a court of jurisdiction to hear the matter, even before a cause of action might have accrued. As such, its applicability is a question of law for the court and not for a jury. The purpose of the statute—protecting agricultural operations from nuisance suits—would not be achieved by permitting idiosyncratic determinations of whether a farming practice is normal. The court then held that the use of biosolids was indeed a normal agricultural operation, having been in practice nationwide for decades with growing use. *Gilbert v. Synagro Cent. LLC*, 131 A.3d 1 (Pa. 2015).

**SALES CONTRACTS: Representation of no knowledge of disposal of hazardous substances does not obligate seller to cover fly ash fill with topsoil.** CPM contracted to sell land to MJM Golf for $700,000 for development into a golf course. The contract recited that Dominion, an operator of a coal-fired power plant, had previously agreed to provide fly ash to CPM for use as fill material in the planned golf course and that MJM would have the benefit of a conditional use permit issued to CPM for the project. The contract included representations by the seller that during the period of CPM's ownership, there had been no use, storage, or disposal of any hazardous substances on the property; that the seller had no knowledge or reason to believe there had been a breach of any environmental laws; that the seller was not aware of any storage or disposal of any hazardous substances by any prior owners nor had allowed anyone to do so; that any activity involving the same complied with local, state, and federal laws and regulations; and that to the best of the seller's knowledge, all activities taken with regard to the property complied with the local zoning and planning laws. Seven years later, CPM filed suit against MJM to collect the deferred portion of the purchase price. MJM counterclaimed, alleging that CPM had violated the representation provision by not covering all fly ash on the property with an appropriately thick layer of topsoil. Although the initial layer of topsoil met the requirements of the Virginia Department of Environmental Quality, after a series of heavy rainfalls, the topsoil washed away, exposing the fly ash. MJM spent $2 million to replace the topsoil. The trial court upheld MJM's claim, but the supreme court reversed. It concluded that the contract language did not obligate CPM to cover the fly ash with topsoil. Instead, the express terms referred to knowledge of any activities involving hazardous substances on the property and to activities already taken complying with law. MJM submitted no evidence that CPM knew of any hazardous substances on the property. Moreover, nothing in the contract obligated CPM to do anything after closing. Although the conditional use permit required compliance with applicable laws "relating to use of fly ash," nothing in the contract required CPM to provide topsoil. *CPM Va. LLC v. MJM Golf, LLC,* 780 S.E. 2d 282 (Va. 2015).

**SALES CONTRACTS: Reliance by buyer is not required for negligence claim against homebuilder.** Rogers contracted to buy a home from Wright that had been built earlier that year. In the contract, Wright represented that there were no "known" violations of codes, ordinances, or regulations. Rogers also acknowledged in the contract, however, that he was not relying on any representations by Wright for any conditions Rogers deemed material to his decision to purchase. The contract gave Rogers typical inspection rights; otherwise Rogers agreed to take the property "as is." After moving in, Rogers discovered cracks in the foundation, leaks, improper grading, and incomplete electrical work. Rogers filed suit against Wright alleging breach of contract, breach of warranty, and intentional and negligent misrepresentation. The trial court granted summary judgment for the defendant on all counts. The supreme court affirmed in part and reversed in part. It held that the existence of code and ordinance violations themselves would not be enough to constitute a breach of contract when the contract made Wright liable only for code or ordinance violations "known" to him. Furthermore, despite Rogers's mistaken belief that he was buying the home with a warranty, contractors' work on the home did not create an implied warranty. Nor could Rogers recover on the intentional misrepresentation claim, because no representations were made about the condition of the property. Nonetheless, the supreme court held that the district court erred in granting summary judgment on the negligence claim because reliance is not required for such a claim. Instead, because the homebuilder has a duty to build the home in a reasonable and workmanlike manner, breach of that duty is enough. *Rogers v. Wright*, 2016 WY 10 (Wyo. 2016).

**ZONING: Variance requires demonstration that zoning regulation destroys value of property for all reasonable uses.** A commercial property owner in the town of Fairfield's "center designed business district" owned a legal nonconforming corner building whose footprint extended well beyond the applicable setback requirements. The owner had received numerous offers to lease the building from fast food restaurant chains but declined those offers, believing they would not be good for the district. Desiring to add a second floor to the building in order to lease the property to a "quality restaurant," the owner applied for a variance. Under the town regulations, a vertical expansion of the building within the applicable setbacks would be a prohibited expansion of the nonconforming use. The Zoning Board of Appeals (ZBA) granted the variance, and after an abutter challenged the decision, the trial court affirmed the ZBA's decision on the basis that the unusual configuration of the property justified a variance. The supreme court reversed, explaining that a variance may be granted only when adherence to the strict letter of the zoning ordinance will cause unusual hardship unnecessary to the carrying out of the general purpose of the zoning plan. Consistent with the state's variance jurisprudence, the court ruled that this requirement means that the applicant must show that the zoning ordinance would destroy the property's value for any of the uses to which it could reasonably be put. The court went on to overrule a long-standing appellate case, which held that a variance can be granted merely on a showing of exceptional difficulty or hardship because of some unusual characteristic of the property. Here, because all that the owner showed was that the zoning regulation prevents the land from being used for its greatest economic potential, it does not create the exceptional kind of financial hardship deemed to have a confiscatory or arbitrary effect to justify a variance. *E and F Assoc., LLC v. Zoning Bd. of Appeals*, 127 A.3d 986 (Conn. 2015).

## LITERATURE

**Covenants.** How courts decide whether to enforce privately imposed restraints on alienation is not about naked preferences favoring the alienation rights of grantees over grantors, or vice versa. That is the starting premise in a recent article by Profs. Luke Meier and Rory Ryan. *Aggregate Alienability*, 60 Vill. L. Rev. 1013 (2015). Instead, they contend, the rules regarding the validity of restraints on alienation have developed based on predictions of whether enforcing the restraint maximizes overall property alienability, looking at the effects such enforcement or non-enforcement have on the incentives of individuals to transfer and acquire property—before, during, and after the particular transfer. This focus on "aggregate alienability" is a new lens for understanding our treatment of restraints on alienability and one that exposes the efficiency concerns associated with these decisions. Profs. Meier and Ryan illustrate that initial transactions are affected by the parties' expectations regarding future enforceability. Some initial transactions might not even occur if the later enforceability of a restraint is not relatively certain. Other transactions, like donative transfers for example, are less likely to face chilling effects from later unenforceability of initially imposed restraints. Similarly, the enforceability of limitations on tenants' assignment and other transfer rights is better explained as necessary to motivate landlords to lease their property in the first place, something which they might refuse to do if the restraints in the lease would not be enforced. Because we wish to encourage greater amounts of leasing, the law imposes relatively weak constraints on landlords' abilities to impose restraints on tenants' alienation rights. Profs. Meier and Ryan use these and several other examples to demonstrate their point. In the end, they believe that viewing future disputes through this new lens and appreciating the efficiency rationale of aggregate alienability can help us better understand and predict how a court will resolve a wide variety of cases dealing with direct and indirect restraints on alienability.

**Land Use.** The sharing economy affects a variety of components of property and land use law—whether dealing with Airbnb, Uber, or other similar new business models. Regulators are struggling with figuring out how existing regulatory models fit these new modes of using and sharing property resources. In a recent article, *Regulating Sharing: The Sharing Economy as an Alternative Capitalist System*, 90 Tul. L. Rev. 241 (2015), Prof. Rashmi Dyal-Chand contends that misguided focus is precisely the reason regulators are so flummoxed. Regulators are erroneously trying to use existing regulations to fit round pegs into square holes, but, even more importantly according to Prof. Dyal-Chand, those existing regulatory models are destined to fail because they are models designed to work within a different form of capitalism. As Prof. Dyal-Chand puts it: "The behavior of market participants in the sharing economy is so qualitatively different that it does not comfortably fit the rules of American capitalism" or what might be called a "liberal market economy." Drawing from a field of research known as "varieties of capitalism," she identifies the sharing economy instead as a nascent form of a "coordinated market economy." Understanding that it is a market of an entirely different kind should allow regulators to develop new approaches—in part borrowing from experiences in other coordinated market economies like Germany—to address concerns like consumer safety, regulation of anticompetitive behavior, worker protection, equitable participation, and financial monitoring. Prof. Dyal-Chand proposes a "Sharing Institutions Model" that prioritizes the regulatory inquiry on understanding the functions of sharing economy service providers and their institutions (that is, the internal formal and informal rules that the actors follow in functioning as sharing economy businesses) and that focuses on the peculiar market behaviors including the high degrees of coordination between market participants, social and psychological rewards to users of their institutions, noncapitalistic values like prioritizing access over ownership, competitive pricing, greater product and service variety, and the facilitation of democratic-like participation. Prof. Dyal-Chand concludes by examining how her Sharing Institutions Model applies to some of the most well-known businesses currently existing in the sharing economy, thereby giving guidance to those seeking to embrace a new and distinct kind of regulatory approach to address potential sharing economy concerns.

**Mortgages.** Residential mortgage-backed securitization (RMBS) has been the subject of extensive study since the housing crisis. Usually, that scrutiny has led to calls for regulatory reform. In a recent article, *Getting Residential Mortgage-Backed Securities Right: Why Governance Matters*, 20 Stan. J.L. Bus. & Fin. 273 (2015), Harvard Law School fellow June Rhee offers an alternative approach that focuses instead on developing internal governance and contractual structures as a means to rebuild market integrity for RMBS. Rhee contends that the role of the RMBS trustee should be expanded to monitor servicers and review mortgage documentation in a way that removes that policing responsibility from investors who seem either unwilling or unable to inject proper discipline into this market. Rhee explains the critical importance of information to the integrity of RMBS investment. Using a sampling of RMBS sales documents, she illustrates the failures, to date, of the system to properly develop internal governance structures that can adequately provide critical information to the RMBS investment market about the quality of mortgages. Existing RMBS parties can take on the needed governance roles to develop private ordering tools that efficiently provide missing informational links. Rhee explains that current legal rules fail to identify a minimum standard for the trustee's actions before default. Yet, no legal rules prohibit the trustee from taking on predefault responsibilities to monitor and control, and thereafter report on, the quality of mortgages. According to Rhee, if investors can use trustees as informational intermediaries, they can more effectively police incentive problems of mortgage originators, enforce buy-back of faulty mortgages, and generally better identify misbehavior that may adversely affect the interests of investors. Consequently, they can thereafter make demands on originators and servicers to correct exposed problems.

**Recording Acts.** In their recent article, *Of Property and Information*, 116 Colum. L. Rev. 237 (2016), Profs. Abraham Bell and Gideon Parchomovsky identify an underappreciated property-information interface that is vital to completing our understanding of the nature of property rights. The authors posit that we cannot know the value of property—real, personal, intellectual, or intangible; nor can we fully evaluate the benefits of ownership—without understanding the information that surrounds any piece of property. Registries, as the repositories of information about property, are critically important (especially for real property and other certain types of nontransformable property) for shaping ownership and mediating property relationships. Yet, surprisingly, registries and their purposes are highly understudied. The authors set out to provide "the first in-depth legal-theoretical analysis of the intricate relationship among title information, rights, and assets in the domain of property, as mediated by registries." In that process, the authors identify both when registries are useful and when their utility is limited. They explain how and why registries are useful in a market-facilitative role by providing demanded information in a verifiable and streamlined manner between willing sellers and buyers in a property transaction. They likewise explain how and why registries serve an "obstructive role" by making it more difficult for others to take property away from owners in a nonconsensual manner because the owners have some means of proving their superior claim. When people know who owns what and can point to a registry to validate an ownership claim, the value of the owned thing increases. After analyzing the comparative utility of registries across various forms of property, Profs. Bell and Parchomovsky provide a blueprint for the optimal state registry, one that reflects judgments about the efficacy of a registry for types of property, contains limits on rewriting property rights to clear away invalid claims, and contains protections against manipulations by thieves. They make us realize that our choices regarding when and how to use registration systems are filled with complex concerns and that making the right choices can have profound effects on injecting the optimal amount of valuable information into the system of property.

## LEGISLATION

**CALIFORNIA regulates electrified fences.** The law authorizes an owner of real property to install and operate an electrified security fence if the property is not in a residential zone, the fence is identified by prominently placed warning signs, the height of the fence does not exceed 10 feet, the fence is located behind a perimeter fence that is not less than 6 feet in height, and the fence meets specified electrotechnical and local requirements. 2015 Cal. Stats. ch. 273.

**FLORIDA enacts law to publish, update, and maintain a database of conservation lands.** The comprehensive legislation also contains provisions on water supply development, management of existing water supply, and watershed protection. 2016 Fla. Laws ch. 1.

**ILLINOIS assesses a 1% fee at foreclosure sales of residential real property for an abandoned property fund.** The fees are to be deposited into the Abandoned Residential Property Municipality Relief Fund. They are collected at the time of public sale, but cannot exceed $300. Purchases by the mortgagee making a credit bid are exempt. 2015 Ill. Laws 493.

**NEW JERSEY prohibits charges to an escrow agent.** The act makes it an unlawful practice to charge an escrow agent for the costs of evaluating the capacity of that agent for performing real estate settlement services. 2015 N.J. Laws 196.

**NEW JERSEY shortens the time for acting on an application to construct wheelchair ramps.** The local official must either approve or deny an application for a permit within five days, rather than the 20 days applicable for other permits. The amendment applies to one- to two-unit dwellings. 2015 N.J. Laws 159.

**NEW JERSEY limits actions to foreclose to "established holders" of mortgages.** "Established holder" is defined as the "record holder of the mortgage" (either the original mortgagee or the latest assignee of record) or a person determined to be the holder in a civil suit. 2015 N.J. Laws 225.

**SOUTH DAKOTA revises procedures for the recovery of abandoned mineral interests.** The claimant of the mineral interest must serve notice of lapse both by publication and by mail to the record owner. 2016 S.D. HB 1058. ■

# Estate Planning for the Chronically Ill, Aging, and Otherwise Vulnerable or Isolated Client

By Martin M. Shenkman

Attorneys routinely build flexibility into their documents to address the uncertainty of future tax laws. This same care can be applied to helping clients deal with the uncertainties aging and chronic disease may bring. Certain clients are more vulnerable to financial abuse and other gaps in their estate planning safety nets. This heightened risk may be because of the challenges of aging, chronic illness, and other similar circumstances. Those clients who require extra precautions in the planning process will be referred to as "vulnerable clients." This article will explore four key points of planning for vulnerable clients:

- Some practitioners seem to assume that planning for the aging and those with chronic diseases is identical to Medicaid planning. Whether or not Medicaid planning is relevant, many other issues remain that aging or chronically ill clients, even those with substantial net worth, should address. Thus, a different approach and focus to planning is called for.
- Professional literature, although addressing how clients need specialized estate planning to address human vulnerabilities arising out of the aging process, rarely addresses the needs of the much wider array of clients who are affected beyond their normal aging, such as those living with chronic illness. This is important to consider because the planning for such persons may differ. What is sometimes referred to as "later life" planning in the literature is just as applicable to younger clients facing the challenges of chronic diseases.
- The traditional or typical estate plan often is inadequate to provide for the safety and human needs of many vulnerable, aging clients or those with chronic diseases. This article will discuss the scope of those needs with a particular emphasis on the chronically ill client. This article then will provide practical suggestions to enhance traditional planning and documents by incorporating additional safeguards. As a result, readers should gain an increased appreciation for dealing in a broader way with the challenges of what typically has been viewed as estate planning.
- Traditional estate planning relies to a significant extent on naming family fiduciaries as the primary means of providing protection from life's challenges, for example, a health-care agent or agent under a financial power of attorney. Elderly and chronically ill clients without the safety net of a spouse, siblings, or other close family member on whom to rely for help need a different approach to planning, one component of which may be to designate outside fiduciaries. Such clients are referred to as "isolated" vulnerable clients, and planning for them is different and requires special documentation. This article will offer suggestions on how to plan estates and craft documents for these isolated vulnerable clients.

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Jon Krause

## Aging: A Growing Number of Clients Are Affected

Although the aging of the population is common knowledge, the magnitude of this event may not be:

- 5 million baby boomers will retire every year for the next 15 years. Retirement is a major life inflection point that will have many of these people reconsidering their estate plans.
- By 2050, people age 65 and older are expected to constitute 20% of the total U.S. population.
- The fastest growing demographic segment of the American population is those age 85 and older. In 2010, 5.8 million people were age 85 or older. By 2050, it is estimated that 19 million people will be in this group. Considering that approximately half of them will have some degree of cognitive impairment, planning for this client segment needs to be more robust than merely using a durable power of attorney. Further, if almost half of those age 85 and older face some cognitive impairment, many of those without such impairment will find themselves cast in the role of a caregiver. The caregiver's needs also must be addressed when crafting an estate plan. Naming each spouse as the primary fiduciary for the other is certainly appropriate (and

customary) for many clients, but is it truly realistic and protective of older clients?

The effects of aging alone do not illustrate the full range of challenges faced by the aging client. Notably, the number of divorces among older Americans has grown rapidly, and such divorces even have earned a nickname, the "silver divorce." Since 1990, the divorce rate has doubled for Americans over age 50, and more than doubled for those over age 65. This trend suggests that careful consideration of the possibility of divorce is a factor when designing an older client's estate plan, in particular as it relates to the selection of agents. If an older client is likely to be divorced, is it reasonable or safe to rely on the current spouse to serve as a fiduciary? If divorce is so common, is it really advisable to fund a spousal lifetime access trust, one to which the donor spouse will have no direct access? Perhaps a "floating spouse" clause, which is one that defines a beneficiary spouse as whomever the client is married to at the time of a distribution, rather than by a spouse's name, should be more commonly used for older clients.

### Chronic Disease: A Large Number of Clients Are Affected

The incidence of chronic disease is far more prevalent than most practitioners realize. In part, this is because 96% of the symptoms of chronic illness, such as chronic fatigue and chronic pain, are invisible. This lack of awareness is compounded by the reality that many clients facing the challenges of chronic disease do not understand the need to be open about their symptoms and disease course even though such disclosure is essential to their attorney tailoring an estate plan for them. Chronic illness is by no means limited to the elderly. It is just that the incidence of chronic disease increases as people age. Chronic disease must be factored into planning because of the effect it has on the lives of those affected. For example, 26% of those ages 65 to 74 are living with a chronic illness that has a significant effect on their lives. For older clients the statistics are worse.

Consider the following:

- 130 million Americans are already living with a chronic disease.
- 5 million Americans are estimated to have Alzheimer's disease.
- 60 million Americans now suffer from multiple chronic conditions.
- 400,000 Americans are now living with multiple sclerosis.
- 12 million Americans are living with chronic obstructive pulmonary disease.
- 1 million Americans are living with Parkinson's disease.

The clear implication of these statistics is that a substantial number of clients are living with chronic illness, but practitioners may not become aware of it when meeting with them. In sum, the implications of the increased rates of divorce and chronic illness must be factored in when planning for aging clients. Many clients living with chronic illness, regardless of their age, will be isolated, vulnerable, or both, and planning for their estates must address the issues these clients currently face, or which they may confront as their disease progresses. Merely completing the traditional array of estate planning documents is not sufficient to provide these clients with adequate protection. More is necessary.

### Financial Abuse Is Important to Address

Elder financial abuse is a significant problem for the aging client, and, as more clients continue to age, the statistics will grow worse in the absence of good planning. According to one study, major financial exploitation occurs at a rate of 41 per 1,000. Practitioners proactively need to help clients build a planning team and address this widespread risk. For example, a common tool used in committing elder financial abuse is the ubiquitous power of attorney. In many cases after the agent has made transfers or payments, it is uncertain whether the principal intended those transactions. When the agent's actions were inappropriate, redress is often impractical or impossible. Creating a broader-based and more comprehensive plan may offer the needed protection, not only for the vulnerable or isolated client but also for all clients. This is important to consider because there is no certainty which client will become vulnerable or when.

### Financial Abuse Is Not Just "Elder"

The phrase "elder financial abuse" is inappropriate and should never have been coined. It detracts from the broader challenges because it suggests that only those of advanced age are taken advantage of financially. The reality is that anyone with an infirmity, weakness, or dependency, whether because of the challenges of aging, chronic illness, mental illness, disability, or other incapacity, faces an increased risk of financial abuse. A young client facing challenges brought about by young onset Parkinson's disease (YOPD) deserves the same attention and protection from possible financial abuse as does an elderly client. The message is that the possibility of financial abuse affects not only the elderly, but also other vulnerable clients, and practitioners need to guide all of these clients on what can be done to protect against such abuse. Commentators should broaden the scope of their discussions about financial abuse by eliminating the misleading modifier "elderly." Doing so might encourage more estate practitioners and advisors to reach a more realistic view of this significant issue and address these risks as they affect a larger class of their clients.

### Broaden the Scope of Services Provided

Many practitioners, even those aware of the challenges faced by a vulnerable or isolated client, do not sufficiently guide that client on some of the protective steps that are available. These practitioners do not expand beyond using what are typically described as "traditional" estate planning documents. Although the approaches taken in the traditional documents clearly are helpful, they fail to use a number of techniques that would more fully protect such a client. A broader perspective is essential for the client's benefit. It also will lead to a larger array of services that can be offered by practitioners and can emphasize the estate planner's importance to such clients, especially as estate tax planning concerns become less important with the current inflation-adjusted exemptions.

**1. Selection of Potential Fiduciaries for Vulnerable or Isolated Clients**

Although every practitioner is knowledgeable about the characteristics of a "good" fiduciary, more discussion about the selection of fiduciaries would be beneficial, especially in light of the risks of chronic disease and aging. How often is a client who names a spouse, followed by a sibling, as agent engaged in a discussion about the health and age of such potential fiduciaries? With the growth of silver divorce, it may not be appropriate to name a client's spouse in many instances. A common scenario, and one that will become more common as our population ages, is the client with no spouse or partner, no children, and no siblings. Traditional planning will not suffice if a client is single, perhaps has no immediate family, or, if there is some family, the family members live too far away or, even if geographically close, are not appropriate for the client to rely on. Planning for someone without relationships that safely can be tapped for fiduciaries presents unique challenges. The modifications or additional steps to better safeguard vulnerable or isolated clients can be viewed as comprising four different categories.

**Family Fiduciary Risks**. Conventional estate planning often presumes that the client has a safety net and several trustworthy family members to designate as fiduciaries. The reality is often quite different. Consider:

- Only about 20% of people currently live in a nuclear family (married with children). Much of estate planning literature presumes the presence of nuclear families. This, in fact, has not been the norm for quite some time. As family structures evolve, more focus is needed when creating a safety net for the vulnerable or isolated client.
- Single women over 85 are one of the fastest growing demographic categories in the United States. According to the U.S. Census Bureau, about 700,000 women are widowed each year, and they will be widows for an average of 14 years. Men also are becoming widowers at increasingly higher rates. With advancing age, widowers and widows will find that their friends and siblings also are dying or are facing the same health or aging challenges as they are. As a result, many of those facing the challenges of chronic illness or aging, or, as often will be the case, both, will have few or no close family members and are otherwise becoming increasingly isolated from their wider family.
- The burgeoning growth in elder financial abuse, most of which is committed by family members, highlights the importance of proper precautionary measures. Practitioners need to more carefully guide clients in their selection of agents and other fiduciaries and design safeguards against abuse by those eventually selected. The reality of financial abuse should call into question the common default practice of automatically designating family members as fiduciaries.

**Conversation About Individual Fiduciary Candidates**. Even with clients who suggest that their spouse, child, nephew, or cousin be designated as an agent, it becomes incumbent on the practitioner to engage those clients in a conversation about the advisability of choosing such a person to serve in such a powerful capacity. How long has the client had a relationship with the proposed agent? What is his financial status? Does the candidate-agent have drug, gambling, criminal, or other issues that might make him inadvisable? Is the client's relationship with the candidate-agent realistically close? Does the candidate-agent have the sophistication to serve? What is the candidate's age and health status? Vulnerable clients need to consider seriously the use of joint fiduciaries, corporate fiduciaries, and other safeguards.

**Consideration of Corporate Fiduciaries**. Many clients have an initial negative reaction to naming a corporate fiduciary. Often their concern is based on a perception about the incremental costs or a corporate fiduciary's rigidity. These perceived issues are ones practitioners aptly can address by educating clients about how corporate fiduciaries approach their job and what can be included in estate planning documents to guide such fiduciaries in their decision making.

For many vulnerable clients, relying on family members (assuming they even exist) alone can be a mistake. The statistics about the prevalence of financial abuse, especially in the use of powers of attorney, should be a warning to such clients. Also, depending on the age and health of family members sought to be named as an agent or fiduciary, is it really practical for them to take on the responsibilities the vulnerable client will need addressed? Handling all the financial affairs for someone who might live for decades with a chronic illness is a very significant commitment. For these reasons, in many instances, naming family members together with a corporate fiduciary will provide a vital safeguard. In fact, for clients facing the challenges of isolation as well as those of vulnerability, a corporate trustee may be the only wise choice.

Acting as an executor, an initial trustee, initial co-trustee, or successor trustee for a revocable trust is a familiar role for a corporate trustee. Even so, additional steps in the creation of estate planning documents are advisable. Such steps will be described later.

Existing, long-term relationships between a client and a bank or trust company with a full array of fiduciary services can serve as the keystone of the vulnerable or isolated client's safety net. In such cases, the practitioner needs to take advantage of, and expand on, the use of such services. The gist of such planning is to put a structure in place to address the added and changing needs of the client if and as aging or the progression of a chronic disease worsens. The traditional paradigm of a well client who suddenly becomes incapacitated, while applicable to an acute medical event or injury, is simply the wrong construct to understand or plan for aging or chronic illness. The reality is often a slow, erratic loss of capabilities. As that progression occurs, at some range of points, the involvement of the institution could steadily grow. With proper planning, a reputable bank or trust company can be placed in a position to assist with many aspects of that client's finances, from bill-paying and managing credit cards, to more services as are appropriate for any particular phase of the client's aging or disease.

If a client is so isolated that he has no individual to name as the agent under a power of attorney, then a fully-funded revocable trust could be the keystone of that client's estate plan. Even then, employing a durable power of attorney to catch assets or matters that were not transferred to the revocable trust should be incorporated into the plan. If the client is unable to select a reliable agent, appointing an institutional agent is a potential solution. Not all corporate fiduciaries, however, are familiar or comfortable with acting in such a capacity and may decline such an assignment, at least when initially approached.

If a corporate fiduciary's initial response is to decline, what can be done to give a corporate trustee comfort to act as an agent?

- If the keystone of the estate plan is a funded revocable trust and a corporate trustee is named as a current or successor trustee, it may be feasible to name the corporate trustee as agent under the durable power of attorney. If the corporate trustee is serving as trustee of the revocable trust, it may be more inclined to view serving under the same client's power of attorney as merely an extension of its role as trustee of the trust.
- If the client fully funds the revocable trust with all of her assets, the role of the agent is greatly reduced. Perhaps the sole remaining duty of the corporate trustee as agent under the power of attorney would be to transfer any assets to the subsequently acquired trust. The corporate fiduciary then would handle the assets as the trustee and not as attorney-in-fact.
- The corporate trustee might prefer a clear event to trigger the beginning of its service as attorney-in-fact, such as a notice from the client or designated person. In this event, the corporate trustee could minimize or avoid liability exposure before it knowingly accepts an active role as agent.
- The corporate agent could be given an unrestricted right to resign at any time.

**Professional Health-Care Surrogate**. If state law permits, an isolated client with no family member or friend to name as an agent may be able to hire (contractually designate) a professional, paid health-care agent to act on his or her behalf. If this approach is used, the revocable trust could direct the successor trustee to pay the fees of, and costs incurred by, such a professional health-care surrogate in carrying out the client's wishes. Such wishes should be specified in the agreement with the hired surrogate and also included in the client's living will.

## 2. Document Modifications for the Vulnerable or Isolated Client

To better protect and safeguard an isolated client, that is, one without a closely known fiduciary to nominate, consider the following suggestions.

**Disability Provisions**. Disability clauses must be treated with particular care. Practitioners too often assume a client will become incapacitated at a discrete point in time and, before such point, will have no challenges. Although this situation might be true in the case of an acute health event or accident, it generally is not the case for an aging client or one with a chronic disease. The decline from what might be viewed as the client having capacity, to the point at which the client might not be deemed to have capacity, is often a gradual and fuzzy progression. Most importantly, the client may need assistance long before he is incapacitated (or realizes it), and he may never be incapacitated in the sense of not having the intellectual capacity to make decisions. For example, someone living with rheumatoid arthritis in his hand and wrist joints may find it difficult or even impossible to write or handle paperwork. He otherwise is perfectly capable of decision making but still needs assistance with those tasks. Will the disability clause in a springing power of attorney account for that? Many common chronic diseases (for example, COPD, multiple sclerosis, Crohn's disease, and colitis) are typified by attacks or flare-ups. If the client is hospitalized for several weeks, the client may well meet the definition of disability during the period of hospitalization and technically be terminated from serving as a trustee of his or her revocable trust. But when the client is released from the hospital, he or she may be perfectly capable and desirous of resuming management of his or her revocable trust. An on-again/off-again pattern of removal and reinstatement could result. Apart from the sheer awkwardness of such transitions, there could be significant legal concerns. Was the client-trustee incapacitated at the time a particular contract was signed? Modification of standard disability provisions may be vital to protecting the client.

**Physician Orders for Life Sustaining Treatment (POLST).** For an isolated client with no one to name as her health-care agent, using a POLST, if permitted under state law, could be a viable alternative approach. A POLST is a medical order addressing end-of-life treatments and is prepared by the client's physician. One advantage it affords is that the POLST is an actual medical order and will be included in the client's patient chart. It also is binding on emergency medical workers, such as ambulance personnel, whereas a living will is not. For the isolated client, a POLST affords the important advantage of effectiveness once done and does not require decision making by an agent designated by the client.

**Living Will.** This common document can be of increased importance to the isolated client who does not have a person to designate as a health-care agent. Practitioners should review whatever standard form is used to be certain that it operates independently of a health proxy, which may not exist. If a POLST is used in conjunction with a living will, practitioners should endeavor to make sure the two documents are not inconsistent and that they will operate in concert.

**Power of Attorney.** The real issue of a client's naming a friend or more distant family member as her or his attorney-in-fact is the risk that the appointee's loyalty might prove to be more toward his or her own pocket than to the client's needs. A fully-funded revocable trust and corporate agent could avoid this risk. If a family member or friend is named as agent in a power of attorney, but concerns exist about one or more of a form's typical powers, such as gifting, then those particular powers can be tailored to address such concerns or eliminated. For clients with significant health issues, consider coordinating any financial power of attorney with each of the client's medical documents. Agents controlling financial powers should not be able to override health-care decisions by interposing their beliefs as to end-of-life care by what they will or will not pay for. Estate planners should consider mandating each financial agent to pay for any medical or health-care decision contained in the client's other documents. Practitioners should consider integrating a monitor position into the power of attorney. For example, an independent CPA firm and its successors could be given the role of maintaining records for the agent, thereby introducing a valuable check and balance on the agent.

**Revocable Trust**. For the vulnerable client, estate planners should consider a revocable trust instead of a durable power of attorney to manage the client's financial affairs during incapacity. As discussed above, the use of a revocable trust could permit the naming of a corporate fiduciary as co-trustee or successor trustee. Corporate trustees have the professionalism, safeguards, reporting, and other mandates of which few individual fiduciaries are even aware. Thus, the corporate fiduciary's internal controls and safeguards become those of your client. For the vulnerable client to fully avail himself of these benefits, practitioners should consider some or all of the ancillary steps noted below. Even with the use of a corporate fiduciary, practitioners should consider implementing several different types of monitoring relationships to add checks and balances. For example, perhaps the client has an individual friend or family member who can be given limited powers as a trust protector and, as such, could remove and replace the institutional trustee in the event that the current one is not providing the desired level of service. A trust protector role, rather than a fiduciary, can be a much safer use of such a relationship. It also can provide an important check on the corporate trustee named. In powers of attorney for vulnerable clients, practitioners should consider using a reporting monitor, such as the independent CPA suggested above. Finally, practitioners should consider adding a requirement that the corporate trustee engage an independent care manager to periodically assess the client and issue a written evaluation to the institution and perhaps to a trust protector.

### 3. Ancillary Planning Steps to Enhance the Document Safety Net

Estate planning documents are not sufficient to serve the vulnerable client. Planning for such a client should include assuring that the client has additional mechanisms to protect him in light of current or anticipated health challenges. Ideally, this type of planning should be implemented before the client has significantly deteriorated from a chronic illness or the challenges of aging so that the client can test the mechanisms and refine them if desired. Frequently, this type of ancillary planning is vital for allowing the client to retain control of his finances while minimizing the risk of financial abuse and other risks. Unfortunately, this type of planning often is not seen as the primary responsibility of any of the client's advisers, such as the attorney, CPA, or wealth manager, and consequently is often left unaddressed.

**Record Keeping**. Automating the client's checkbook and finances can help address many of the practical issues for the vulnerable client. For example, reminders easily can be set in Quicken and similar programs so that the client does not overlook important bills, tax filing deadlines, and the like. As the client ages or disease progresses, automating reminders (and other important steps) can protect the client. Whether the estate planning attorney assists in setting this up, or involves the client's accountant to handle the entire matter, what is vital to the client is that these matters are addressed proactively. Even wealthy clients require a financial plan to assure there will be adequate resources for what might be decades of post-retirement life. Keep in mind that, although some chronic illnesses reduce one's life expectancy, many do not. So, the assumption that long-term financial planning for chronically ill clients is less important for a particular client should not be made unless the attorney has specific knowledge about how long that client will live. The core of every financial plan is a realistic budget and investment plan built on financial targets (a grandchild's wedding or automating a home to make it accessible in light of the client's deteriorating health). Too often, budgets are based on computerized assumptions or estimates because the client provides no hard data. Once a client's checkbook and other financial transactions are computerized, it becomes a simpler task to generate current and prior year expenditures by category and use that information to develop a realistic budget. If the client has a particular chronic disease, or is facing the challenges of aging, a care manager can provide a care plan and estimates of the costs that may be incurred in the future. The plan or estimate then can be incorporated into a budget. The practitioner should guide the client to convert to paperless record keeping. The boxes of old bank statements and tax returns so many clients retain in a basement or attic are a tempting target for home health aides, repair persons, and others. Having these documents scanned and then shredded can be a simple, yet powerful safeguard against financial abuse. If the client is not able to handle this, vendors can pick up the documents at the client's home, scan them, shred them, and deliver a DVD or portable hard drive with images of those documents. Although this may be a simple step conceptually, few practitioners view such actions as part of their estate planning responsibility. But not addressing this issue shortchanges their clients.

**Power of Attorney Implementation**. The mere execution of a durable power of attorney will not suffice to protect the vulnerable client. Further steps are advisable. The client should be guided to simplify her financial matters so as to minimize the complexity and challenges that will face an agent having to operate in the future. The consolidation of one's assets into a limited number of institutions will result in less paperwork and the need for fewer approvals an agent must obtain. Basically, consolidation makes an agent's work simpler, easier, and less costly. It will make it easier for a monitor to oversee the agent's activities.

**Funding the Revocable Trust**. Estate planners should guide their clients to create new checking and other accounts in the name of the revocable trust and to transfer appropriate assets to the trust. Consolidating accounts into one institution, especially if it is the institution serving as a current trustee or named as a successor trustee, will provide greater security for the client. Even switching credit cards to ones issued by the institution named as successor trustee can simplify the work for that trustee and create a readily available record of transactions. Such a record quickly provides data to that institution about the client's spending patterns and standard of living. Each of these steps can make it safer, quicker, and less costly for a successor trustee, especially a corporate one, to step in to assist the client in an emergency. These steps also will make it simpler and more secure when the baton is passed from the client (as initial trustee) to a bank or other corporate trustee (as the successor trustee).

**Residence Considerations**. A corporate trustee might have concerns about holding the client's residence in the revocable trust, especially when the institution is based in a state other than the one where the home is located. A single member limited liability company could be formed to own the home. The home then might be deemed an intangible asset and not subject to the laws of a state other than where the corporate trustee is based. Because a single member LLC is disregarded for tax purposes, the LLC will create no negative income tax effect (although it might adversely affect a senior citizen's property tax discount). Also, the trust instrument could be modified to expressly permit the trust to hold and retain personal use assets, such as a residence.

### 4. Collaborative Team Approach

Vulnerable clients are protected by established safeguards, checks and balances, and independent oversight. A powerful way to accomplish these objectives is to form a broad-based, collaborative, advisory team: an estate planning attorney, a trust officer, an insurance consultant, a care manager, wealth manager, a CPA, and others. Such an approach would enable the client's disparate advisers to collectively share information, and, if one adviser is aware of one issue and another adviser is aware of a different issue, the entire picture can be more easily known to the team. A collaborative team effort can greatly reduce the risk of any one adviser missing an important issue. A collaborative team effort also can minimize the likelihood of an adviser acting alone (the "silo" view of planning) inadvertently permitting abuse of the client. Further, a team approach can reduce the risk of a single adviser actually abusing the client or aiding in the client's abuse.

**Involve a CPA Firm**. Vulnerable clients can use an independent CPA to add safeguards to any plan. As noted above, a CPA could be named in a formal role as the monitor under a power of attorney or revocable trust. The CPA industry promotes CPAs as trusted advisers, and in many instances, they can be preferable to other options clients have. The client should create a relationship with a CPA firm now, even if only to provide simple tax return preparation services at the outset. This relationship should be fostered over the years. Then, if the client ever becomes incapacitated, the then-existing relationship with such an independent CPA would aid the CPA in her role as a monitor, resulting in additional protection for the client. CPAs have training and experience to serve in the monitoring role and can be part of a program of checks and balances. The CPA should monitor the client's bank accounts, investments, and payment activities, even before such monitoring appears to be needed. Encourage clients to begin developing such a relationship now, well before they require it. Practitioners should consider a provision in the revocable trust mandating that the trustee pay an independent CPA to maintain books and records of the client's finances. This role should not be particularly costly or difficult and can prove to be an invaluable safeguard.

**Care Manager**. Practitioners should incorporate a care manager as an active member of the advisory team. As noted above, practitioners should consider mandating that the trustee of the revocable trust have an independent care manager conduct periodic evaluations and report to the trustee and perhaps to an independent person as well. This allows a skilled professional to see the vulnerable client in his living environment to identify care, lifestyle, and other issues or concerns that a bank or trust company needs to know but may not have the expertise to observe for itself. The financial planner should obtain specific input from the care manager about large future costs.

## Conclusion

Clients living with chronic illness, or facing the challenges of aging, require enhanced estate planning. Their need for a comprehensive, broad-based estate plan gives practitioners an opportunity to expand the scope of their practices, while providing greater protection to a class of clients much in need of such expanded assistance. Whatever any individual practitioner chooses to do, be assured that the task of addressing the challenges faced by an increasing number of vulnerable and isolated clients is becoming a significant aspect of the estate planning process. ■


# Keeping Current Probate

**Keeping Current—Probate Editor:** Prof. Gerry W. Beyer, Texas Tech University School of Law, Lubbock, TX 79409, gwb@ProfessorBeyer.com. Contributors include: Dave L. Cornfeld, Christy Lee, Kerri G. Nipp, Claire G. Hargrove, and Prof. William P. LaPiana.

**Keeping Current—Probate** offers a look at selected recent cases, rulings and regulations, literature, and legislation. The editors of *Probate & Property* welcome suggestions and contributions from readers.

## CASES

**ATTORNEYS: Attorney for trustee did not owe duty of care to beneficiary.** The life beneficiary of a charitable remainder trust sued the trustee's attorney, alleging malpractice in advising the trustee on the beneficiary's rights in the trust and on complying with federal tax provisions applicable to the trust. The trial court dismissed the action and the Supreme Court of Rhode Island affirmed, holding as a matter of first impression that the attorney for a trustee owes no duty of care to the beneficiaries of a trust for the attorney's representation of the trustee. *Audette v. Poulin*, 127 A.3d 908 (R.I. 2015).

**OMITTED SPOUSE: Property subject to pretermitted spouse statute includes decedent's revocable lifetime trust.** The decedent married after executing his will and lifetime revocable trust, neither of which made a gift to the surviving spouse nor were made in contemplation of the marriage. Under state law, a surviving spouse is entitled to "the share of the estate" to which the surviving spouse would have succeeded had the deceased spouse died intestate. 20 Pa. Stat. Cons. Stat. § 2507(3). The surviving spouse claimed that the "estate" included the property held in the revocable trust. The court agreed, holding that the "estate" referred to in the pretermitted spouse provision must include the property held in the decedent's lifetime trust. *In re Trust Under Deed of Kulig*, 131 A.3d 494 (Pa. Super. Ct. 2015).

**SAME-SEX RELATIONSHIPS: Termination of same-sex relationship after commitment ceremony is not equivalent to divorce for purposes of revoking will.** The decedent executed a will in 2001, making substantial gifts to his partner and nominating him as executor. The next year they celebrated a "commitment ceremony." The couple separated in 2010 and the decedent then died, never having changed his will. The decedent's family petitioned to disqualify the partner as executor and as a beneficiary on the theory that the couple would have married if they had been able to do so, that their relationship should be treated as a marriage, and its ending as equivalent to a divorce so that the partner as a "ex-spouse" could not serve as executor or take under the will. The trial court denied the petition, and the Appellate Division affirmed, holding that the legalization of same-sex marriage does not "compel a retroactive declaration" that the commitment ceremony was equivalent to a marriage; and that in any event, for the statutory disqualification to apply, the marriage must end by "decree or judgment," and there was no such decree here. In addition, the dissolution of the relationship was informal and accompanied by nothing equivalent to the commitment ceremony, which indicated that the parties never believed they were married. *In re Estate of Leyton*, 22 N.Y.S.3d 422 (App. Div. 2016).

**TRUST DISTRIBUTIONS: Trust terms allowed settlor's distribution to himself.** The spouses created an irrevocable trust, serving as co-trustees and the only present beneficiaries. After the death of both spouses, the trust made their children the first beneficiaries. The trust terms authorized the trustee to make discretionary distributions of principal to either or both settlors. After the wife died, the husband distributed trust property to himself, including stock, in one of the two farming businesses controlled by the trust. He was president of that business, his daughter was president of the other. The daughter sued for "wrongful termination" of the trust, and her father prevailed. The court held that the distribution was a proper exercise of discretion because the trustee's action was authorized by the trust terms and it was no longer "financially reasonable" to operate the two businesses as a "single farming operation." *Fay v. Grafton*, No. WD 78302, 2015 WL 7252704 (Mo. Ct. App. Nov. 17, 2015).

**TRUSTS: Trustees' duties to business entities held in trust, which trustees as individuals control, are defined by role and authority granted in trust instruments.** The long-running litigation over the Rollins family's estate planning has again reached the Supreme Court of Georgia in *Rollins v. Rollins*, 780 S.E.2d 328 (Ga. 2015). The court overruled the intermediate appellate court, which had held that a jury trial was necessary to determine in what role the trustees were acting for various actions affecting the trusts and the business entities controlled by the trustees as individuals, of which minority interests were trust property. The court reiterated its prior holding that actions taken as managers of the various business entities were to be reviewed in accordance with a "corporate fiduciary standard" and that actions taken as trustees must be reviewed "by applying a trustee-level fiduciary standard" in light of the terms of the trusts granting authority to the trustees, the standard of liability imposed, and the purposes for which the trusts were created.

**UNDUE INFLUENCE: Inference, but not presumption, of undue influence arises when contestant shows confidential relationship between testator and beneficiary.** Several children contested their mother's will, alleging that their brother had exerted undue influence. They requested a jury instruction that a "presumption of undue influence" arose based on evidence showing a confidential or fiduciary relationship coupled with "other suspicious circumstances." The court refused, holding that, when both parties have met their respective burden of production, the burden of proof remains on the contestants. It is, however, proper to state that an "inference" of undue influence arises. *Clinger v. Clinger*, 872 N.W.2d 37 (Neb. 2015).

## TAX

**CHARITABLE DEDUCTION: Charitable deduction for façade easement denied after failure to attach appraisal to return.** A couple granted a façade easement over their house, which the National Park Service had certified as an historic structure for charitable contribution purposes. But the taxpayers did not include an appraisal for the façade easement when claiming a charitable contribution on their return. The Tax Court upheld the commissioner's denial of the deduction for failure to include a copy of the appraisal and imposition of a penalty for gross-valuation misstatement because the deduction was more than 200% of the value provided by the IRS's expert. *Gemperle v. Commissioner*, T.C. Memo. 2016-1.

**COLLATERAL ESTOPPEL: Collateral estoppel does not apply when IRS is not party to state court litigation.** After the taxpayer and her boyfriend ended their relationship, the boyfriend reported transfers of property and cash he made to her during their relationship on a Form 1099-MISC. He sued the taxpayer in state court, with the court later determining that some transfers were gifts and others had to be repaid because of being fraudulently induced. The IRS claimed that all amounts were taxable income. In the Tax Court, the taxpayer claimed collateral estoppel to the extent the transfers were considered a gift. This defense failed because the IRS was not a party or in privity with a party in the state court action. The doctrine of rescission also did not apply for the amount the state court ordered the taxpayer to repay because it was a post-year-of-receipt rescission. *Blagaich v. Commissioner*, T.C. Memo. 2016-2.

**ESTATE TAX: Bona fide transfers and loans affect gross estate inclusion and deductibility of expenses.** The decedent transferred property to a family LLC. The Tax Court found several factors supported a finding that a bona fide sale had occurred such that the property would not be included in the gross estate. First, the decedent's desire to manage marketable securities and building interests as a family asset was a legitimate nontax motive for the transfer of the property. In addition, the decedent received interests in the LLC proportional to what she contributed, was not financially dependent on distributions from the LLC, did not commingle funds with the LLC's funds, and respected formalities of the LLC. The decedent and her husband were in good health when they made the transfer. The Tax Court also held that the estate could deduct the accrued interest on loans from family members to pay estate tax liabilities because the loan was bona fide and became necessary when LLC members could not unanimously agree on approving a dividend from the LLC for paying the tax. Finally, the decedent's gifts of LLC interests to a family trust were present-interest gifts that qualified for exclusion under IRC § 2503(b) as the donees could obtain use, possession, or enjoyment from the income of the LLC interests. *Estate of Purdue v. Commissioner*, T.C. Memo. 2015-249.

**GIFT TAX: Taxpayer's voluntary transfer of stock in closely held corporation to please his father is a gift.** The donor, his brother, and their father owned a closely held company. After litigation regarding the ownership of shares, under a settlement agreement the brother transferred one-third of his shares to a trust for his children in exchange for being treated as the outright owner of the remaining shares. Those transfers were determined in an earlier case to be made in the ordinary course of business. Three weeks later the brother transferred his remaining stock to his children, voluntarily to please his father. Because the brother was not bound by the agreement to transfer the shares and received no consideration, the Tax Court determined the transfer was a taxable gift. The price negotiated at arm's length for the brother's shares was used to determine the value of the gift. The donor was not liable for additional tax for negligence, failure to file a gift return, or fraud because the donor relied in good faith on a tax professional's advice, which was memorialized in a letter. *Redstone v. Commissioner*, T.C. Memo. 2015-237.

**TAX FRAUD: Last minute change of heart before trial does not exclude evidence of fraudulent failure to file.** A taxpayer filed tax returns for multiple years with false documentation based on a fictitious trust. One such return was filed even after he was interviewed by the IRS and instructed to file as an individual and not as a fiduciary. The taxpayer was indicted and convicted in federal district court on six counts of making false claims for tax refunds. After conviction, the taxpayer filed amended returns with the IRS but continued protesting. At the time of trial, he abandoned his earlier positions and stated he had taken those positions in good faith. Despite the taxpayer's abandonment of his earlier arguments, the Tax Court held that the evidence established fraud (conduct to conceal, mislead, or otherwise prevent the collection of taxes) and imposed a civil penalty. The Tax Court also imposed a failure to timely pay penalty on both the taxpayer and his wife. *Crummey v. Commissioner*, T.C. Memo. 2016-9.

**TRUST DIVISION: Division of trusts does not trigger adverse tax consequences.** A husband and his wife created an irrevocable trust for the benefit of their three daughters and their issue. They allocated sufficient generation-skipping transfer (GST) tax exemption to cause the trust to have a zero inclusion ratio. The trustees could accumulate net income or in their discretion distribute the net income to the daughters in equal shares. If any daughter was deceased when income was to be distributed, her share would be distributed among her living issue at the time or if no issue, then to the other living daughters. The trustees also were authorized to distribute to the issue as much of the principal as they believed desirable for the health, support, or education of the settlors' issue. The husband later created a revocable trust. When he died, under the provisions of the revocable trust, those assets equivalent to his GST tax exemption were transferred back to the trust. On the trustee's petition, the court issued an order authorizing the trustees to separate the trust into three equal trusts, one for each daughter and that daughter's issue, so that each new trust would operate under the same terms and provisions as the original trust. In PLR 104310-15, the IRS concluded that the proposed division of the trust into separate trusts for each daughter and her issue (1) would not alter the trust's inclusion ratio, which would remain the same for each of the separate trusts; (2) would not cause the daughters or their issue to become transferors of the assets of the trust for purposes of IRC §§ 2036–2038; (3) would not result in a transfer of property or beneficial interests in the trust by the daughters or their issue for purposes of IRC § 2511; (4) would result in the trusts' being treated separately for federal income tax purposes because the separate trusts have different primary beneficiaries; (5) would not result in a distribution under IRC § 661 or Treas. Reg. § 1.661(a)-2(f); (6) would not result in realization of gain or loss under IRC § 61 or § 1001 to any beneficiary of the trust; and (7) would not change the basis of the trust assets.

## LITERATURE

**Adult Guardianship.** In *Restoration of Rights in the Termination of Adult Guardianship*, 23 Elder L.J. 83 (2015), Jenica Cassidy indicates that petitions to restore an adult ward's rights are uncommon but meet with moderate success.

**Alzheimer's.** Alzheimer's disease biomarkers create new end-of-life issues for individuals, medical professionals, and policymakers. In *A Fate Worse than Death? How Biomarkers for Alzheimer's Disease Could Affect End-of-Life Choices*, 12 Ind. Health L. Rev. 651 (2015), Rebecca Dresser considers potential end-of-life responses to biomarker test findings and examines ethical and legal issues raised by those responses. She concludes with recommendations for clinicians and policymakers addressing the potential end-of-life effect of biomarker test findings.

**Arbitration Agreements.** In *Predispute Arbitration Agreements Between Trustees and Financial Services Institutions: Are Beneficiaries Bound?*, 40 ACTEC L.J. 273 (2014), Prof. Mary F. Radford concludes that, because of the uncertainty that exists, "lawyers for beneficiaries in most states should weigh carefully whether to spend client time and money resisting predispute arbitration clauses and instead devote more energy and resources to managing the arbitration itself."

**Assisted Suicide.** In his Note, *Linking Assisted Suicide and Abortion: Life, Death, and Choice*, 23 Elder L.J. 123 (2015), David Busscher compares the treatment of the inherent value of life and the state's interest in protecting life in decisions regarding abortion and assisted suicide. The author proposes that the state's unqualified interest in the value of life necessarily leads to the conclusion that once life begins, the state may preserve it, even against the wishes of the individual.

**Australia—Testamentary Capacity.** In *Testamentary and Decision-Making Capacity Assessment in Australia*, 7 J. Int'l Aging L. & Pol'y 73 (2014), Kelly Purser assesses the nature of testamentary capacity, discusses the most common general assessment models used in Australia, and concludes by suggesting a test for assessing legal capacity given the significant ramifications of getting it wrong.

**California—Wills.** David Horton reports the results of a study of every probate matter stemming from deaths during the course of a year in a major California county in *Wills Law on the Ground*, 62 UCLA L. Rev. 1094 (2015). He analyzes the issues that divide the formalists and the functionalists, including the requirement that wills be witnessed, holographic wills, the harmless error rule, the doctrine of ademption by extinction, and the anti-lapse doctrine.

**Charitable Giving.** In *The Secret Economy of Charitable Giving*, 95 B.U. L. Rev. 1663 (2015), Allison Anna Tait proposes a theory that justifies cy pres modification of charitable gifts based on factors intrinsic to charitable gifts and puts forth the idea that charitable gifts represent a particular type of property requiring special treatment.

**Cy Pres.** Katie Magallanes provides a detailed review of the operation of cy pres in *Beyond Donor Intent: Leveraging*

*Cy Pres to Remedy Unintended Burdens Caused by Charitable Gifts*, 40 ACTEC L.J. 407 (2014).

**Domestic Asset Protection Trust.** Alexander B. Shiffman's Note discusses *The Domestic Asset Protection Trust and Its Federalism Implications*, 13 Cardozo Pub. L. Pol'y & Ethics J. 853 (2015).

**Educational Dynasty Trusts.** Susan T. Bart provides a thoughtful critique of *Saving for Education: Creating Educational Dynasty Trusts Using 529 Plans*, 40 ACTEC L.J. 197 (2014).

**Elder Financial Abuse.** In *Society's Response to the "Invisible" Abuse of Elders: Understanding and Addressing the Financial Abuse of Society's Most Vulnerable Citizens*, 23 Elder L.J. 151 (2015), Taylor Lemick describes elder financial abuse and examines its effect on the elder population. Further, this Note examines current Illinois mandatory reporting laws for elder abuse and neglect, along with reporting laws from across the nation.

**Family LLCs.** Evan Michael Purcell's Comment, *The Family LLC: A New Approach to Insuring Dynastic Wealth*, 8 J. Bus. Entrepreneurship & L. 499 (2015), explores the benefits and possible pitfalls of creating a family LLC that purchases and holds life insurance policies on its members for the purpose of long-term estate planning.

**Holograms.** Stephen Anson's Comment, *Hologram Images and the Entertainment Industry: New Legal Territory?*, 10 Wash. J. L. Tech. & Arts 109 (2014), examines the new technology that creates holographic performances, outlining the steps that a living artist or a deceased artist's estate can take to plan for the most robust protection.

**Illinois—Malpractice.** In *How to Avoid Estate Planning Malpractice Claims*, Ill. B.J., Dec. 2015, at 32, Zachary J. Freeman, Thomas M. Staunton, and Arthur W. Friedman discuss how estate planning lawyers are uniquely exposed to legal malpractice liability, including the third-party beneficiary rule and the modified statute of repose, and offer tips to minimize the risk of malpractice claims.

**Insurance.** In *Recent Developments in Health Insurance, Life Insurance, and Disability Insurance Law*, 50 Tort Trial & Ins. Prac. L.J. 401 (2015), William A. Chittenden III, Elizabeth G. Doolin, Julie F. Wall, and Joseph R. Jeffery cover key recent developments in life, health, and disability insurance law.

**Intentionally Defective Grantor Trusts.** Aaron D. Evans explains the potential benefits of making an installment sale to an intentionally defective grantor trust (IDGT) along with the potential pitfalls posed by recent IRS scrutiny of this technique in *Sales to Intentionally Defective Grantor Trusts: The Risks and the Rewards*, Ill. B.J. 34, Feb. 2016, at 34.

**Medicaid.** In his article, *Medicaid Spend Down, Estate Recovery and Divorce: Doctrine, Planning and Policy*, 23 Elder L.J. 41 (2015), John A. Miller posits that, unless the law is changed, divorce may become the standard Medicaid planning practice in many circumstances.

**Medicare.** Richard L. Kaplan's article, *Reflections on Medicare at 50: Breaking the Chains of Path Dependency for a New Era*, 23 Elder L.J. 1 (2015), offers two major recommendations to bring Medicare's offerings into greater alignment with the health-care challenges and needs faced by older Americans.

**Michigan—Rule Against Perpetuities.** In *A Newly Revised Post Perpetuities Reform RAP Applicability Flowchart for Property Subject to Michigan Law*, 59 Wayne L. Rev. 1347 (2014), James P. Spica not only provides a newly updated perpetuities flowchart but also presents primers on the common law rule against perpetuities (RAP), federal tax aspects of the common law RAP, the Uniform Statutory Rule Against Perpetuities (USRAP), and the regulatory RAP invented by the U.S. Treasury for purposes of the generation-skipping transfer tax regulations.



**New Jersey—Ante-Mortem Probate.** In *Ante-Mortem Probate in New Jersey—An Idea Resurrected?*, 39 Seton Hall Legis. J. 331 (2015), Susan G. Thatch argues that ante-mortem probate legislation would permit a testator, who fears that his estate may be subjected to a will contest in which it will be alleged that he lacked the mental capacity to execute his will, to bring suit against potential contestants and to obtain an adjudication regarding his capacity while he is alive and best able to inform the determination.

**North Carolina—Joint Tenancy.** In *North Carolina's Reincarnated Joint Tenancy: Oh Intent, Where Art Thou?*, 93 N.C. L. Rev. 1649 (2015), Daniel R. Tilly and Patrick K. Hetrick address key real property and public policy issues triggered by the 1990 legislative reincarnation of joint tenancy with right of survivorship in North Carolina with a special emphasis on creation and severance issues.

**Omitted Heirs.** Adam J. Hirsch discusses *Airbrushed Heirs: The Problem of Children Omitted from Wills*, 50 Real Prop., Tr. & Est. L.J. 175 (2015). Significantly, the article provides the results of "the first-ever empirical study of individual attitudes toward inheritance by children whom fathers are unaware they have."

**Rule Against Perpetuities.** James P. Spica provides a highly technical and effective discussion of how to avoid problems with the Treasury's generation-skipping transfer tax regulations in *Means to an End: Electively Forcing Vesting to Suit Tax Rules Against Perpetuities*, 40 ACTEC L.J. 347 (2014).

**Testamentary Capacity.** In his article, *Testamentary Incapacity, Undue Influence, and Insane Delusions*, 60 S.D. L. Rev. 175 (2015), Thomas E. Simmons offers an analysis of the holdings and outcome in *In re Estate of Berg*, 783 N.W.2d 831 (2010), concluding it was correctly decided because its reasoning squares with long-standing deference toward the freedom of testamentary disposition, even for individuals with diminished capacity and mental delusions.

**Trust Protectors.** In *Trust Protectors: Why They Have Become "The Next Big Thing,"* 50 Real Prop., Tr. & Est. L.J. 267 (2015), Lawrence A. Frolik "discusses the origin of trust protectors, their current statutory basis, and the few existing cases that analyze the legal status and role of a trust protector."

**Virtual Currency.** Abigail J. Farmer and Cory Elizabeth Tyszka address the issues that virtual currencies such as bitcoin pose for estate planners in *Virtual Currency Estate Planning, Bit by Bit*, 40 ACTEC L.J. 249 (2014).

## LEGISLATION

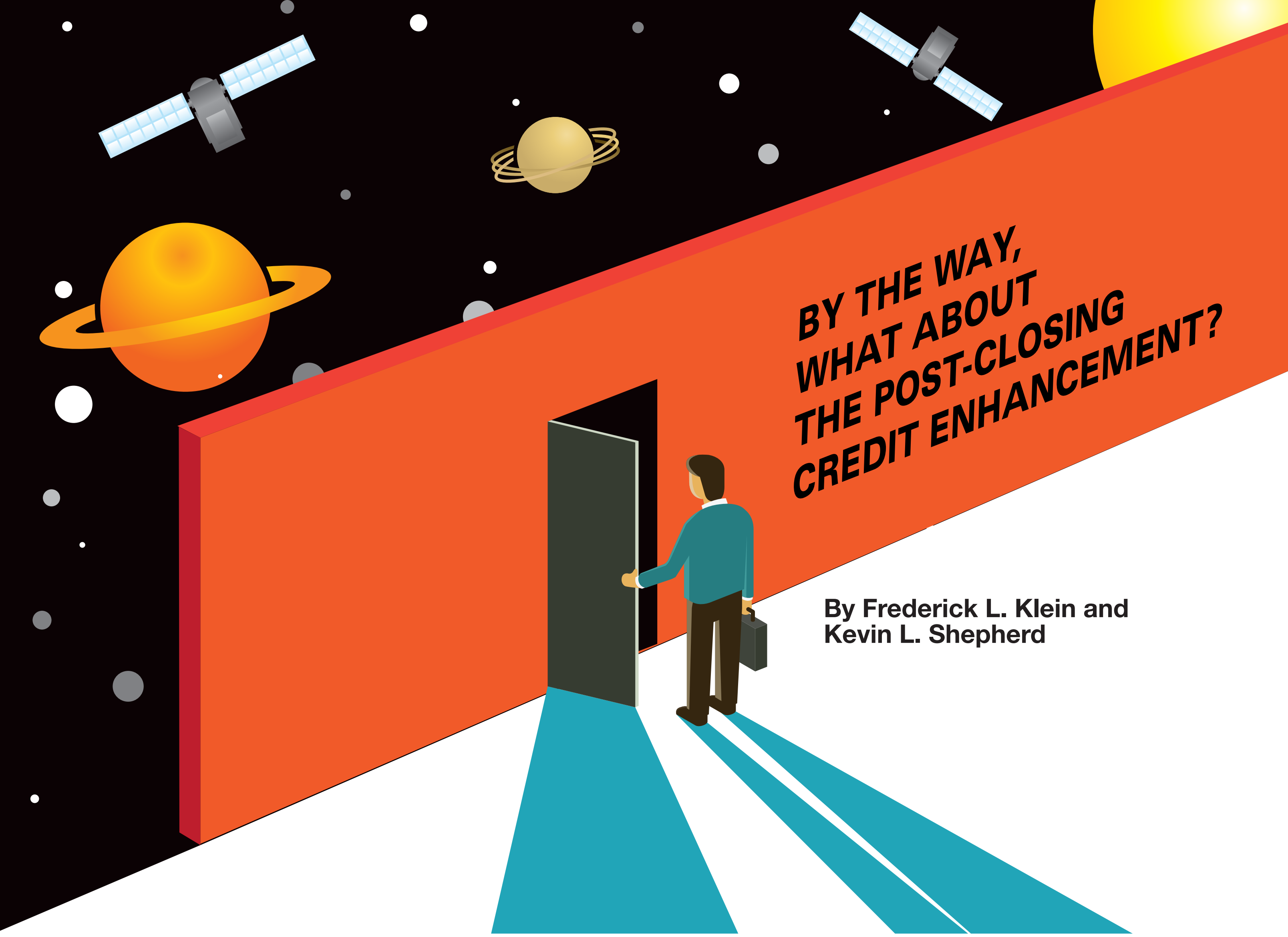
**DISTRICT OF COLUMBIA authorizes Achieving a Better Life Experience (ABLE) accounts**. 2015 D.C. Laws 21-61.

**NEW JERSEY authorizes Achieving a Better Life Experience (ABLE) accounts**. 2015 N.J. Sess. Law Serv. Ch. 185.

**OHIO authorizes probate judges to issue search warrants**. 2015 Ohio Laws File 43.

**PENNSYLVANIA permits an organ or tissue donor to indicate his or her donor status on a driver's license or identification card**. 2015 Pa. Legis. Serv. Act 2015-79.

**VIRGIN ISLANDS allows a child born after the execution of a will to collect from a decedent's estate by establishing paternity through DNA testing**. 2015 V.I. Laws Act 7808. ■



# By the Way, What About the Post-Closing Credit Enhancement?

By Frederick L. Klein and Kevin L. Shepherd

As counsel to seller, you have finally resolved the final language for the representations and warranties made by the seller in a purchase and sale agreement (PSA) for a significant commercial real estate asset. You have also agreed on the date, after closing, before which the buyer must assert a claim for a breach of a seller representation or warranty, the amount of the floor and ceiling damage caps relating to any breach, and the scope of the seller indemnities in case of a breach of one or more seller representations or warranties. The parties have also agreed that the buyer cannot assert a claim after closing for breaches of any seller representation or warranty of which the buyer had knowledge before the closing. These negotiations were extensive and tedious, but you feel comfortable that the seller's exposure is limited given the qualifications you were able to negotiate, the modest post-closing survival period, the market floor and ceiling damage caps, and the fact that the seller is a single-purpose entity with no assets other than the property being sold and the proceeds of the sale.

You believe the document is complete and the parties are now in a position to sign and deliver the PSA and proceed to closing. When you contact the buyer's counsel to work out the logistics for executing and delivering the PSA, the buyer's counsel mentions that the PSA looks fine, but notes, somewhat nonchalantly, that the parties need to resolve one final issue. You are nonplussed. The buyer's counsel says the issue is the post-closing security, or "credit enhancement," for a breach of a seller representation or warranty that is discovered after closing. The buyer's counsel insists that the buyer needs a cash escrow to be held for the duration of the survival period (and longer in case the buyer asserts a claim during the survival period) to support the seller's representations and warranties, especially because the seller will have promptly distributed all of the net sales proceeds, and thus, the seller will have no assets post-closing.

You were hoping, perhaps naïvely, that this issue would not arise, but it has. How do you deal with it? Are there forms of security other than a cash escrow that could be used as the

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credit enhancement that will satisfy the buyer? Are there other creative alternatives? What is market in this area?

This article will discuss types of credit enhancement, their relative pros and cons, and when and how to use them. It will also propose language that can be employed for the most common types of credit enhancement.

### Why Bother?

Anecdotal information from experienced commercial real estate lawyers suggests the likelihood that a buyer will actually seek recourse against a seller for a post-closing breach of a representation or warranty is low. Indeed, in the course of a commercial real estate lawyer's career, it may be unusual to encounter a situation in which a buyer actually sues a seller for a post-closing breach of a representation or warranty (although claims for resolution of pro-rations arise with somewhat more frequency). If that anecdotal information is correct, then why do the parties spend so much time and effort negotiating the post-closing credit enhancement framework?

One practical reason may be the *in terrorem* effect of having cash (or its equivalent) at risk for a breach of a seller representation or warranty that is first discovered after closing. A seller expects to achieve a certain economic return for the sale of a commercial real estate asset, and the prospect of temporarily degrading that return by effectively reducing the net purchase price persuades sellers to ensure that their representations and warranties are accurate so that a post-closing claim does not arise. A seller is also interested, perhaps to a lesser extent, in preserving its marketplace reputation by avoiding allegations of post-closing breaches of representations and warranties. These allegations move swiftly through the commercial real estate industry and can affect a sponsor's ability to raise capital from institutional investors. By the same token, a buyer seeks to ensure that the amount of the post-closing credit enhancement is sufficient to provide comfort that the seller is economically and reputationally motivated to ensure that its representations and warranties are accurate.

### Types of Post-Closing Credit Enhancement

The types of post-closing credit enhancement span a considerable range of choices, but the bottom line is liquidity. These choices are often dictated by relative bargaining strength, the type of transaction (for example, fee conveyance vs. entity interest transfer), the cost (for example, letter of credit fees or insurance premiums), and the nature and scope of the underlying seller representations and warranties. The choices include the following: (1) no post-closing credit enhancement, (2) the seller's promise to maintain a certain post-closing net worth, (3) a guaranty from a creditworthy affiliate of the seller, (4) an irrevocable letter of credit provided by a financial institution on behalf of the seller, (5) a cash escrow held by a third-party escrow agent, and (6) representations and warranties insurance (RWI). Variations or combinations of these basic choices are possible as well, but these generally represent the universe of possible post-closing credit enhancement devices. This article will discuss these choices in turn.

### No Post-Closing Credit Enhancement

From a seller's perspective, the optimal choice is not to have any post-closing credit enhancement at all, even when the seller is a single-asset, special-purpose entity. It is surprising (and yes, jarring) how often a buyer's counsel carefully negotiates the contours and content of the seller's representations and warranties but neglects to negotiate any post-closing credit enhancement—at least during the initial round of comments. If a seller is successful in avoiding an obligation to provide some form of post-closing credit enhancement, the buyer may be unable to recover damages from a post-closing defaulting seller, particularly if that seller no longer has any assets. Of course, it's possible that a seller (especially if it is a limited liability company) may have a statutory obligation to maintain a certain level of liquidity to address post-closing contingent claims, but a seller's failure to do so leaves a buyer with no practical and efficient legal remedy. Other remedies—such as tracing the proceeds or piercing the corporate veil—may involve significant hurdles and, hence, legal fees that could easily exceed the amount in dispute.

### Seller's Contractual Promise to Maintain Post-Closing Net Worth

Moving up the scale from a seller having no post-closing credit enhancement obligation, the next choice is the seller's express contractual obligation to maintain a specified post-closing net worth to support the possibility that the buyer may successfully assert a claim for a breach of a seller representation or warranty after closing. A seller may not object to having this obligation so long as the net worth period coincides with the survival period under the PSA and the seller is not obligated to provide the buyer with ongoing evidence that the seller is maintaining the specified net worth. Variations on this theme may include an obligation by the seller to maintain a separate account funded with the required net worth amount at a designated bank or other financial institution for the requisite time period, and perhaps for the seller to provide written evidence, such as a bank statement, proving the existence of the amount on deposit.

For a buyer, this choice is far from optimal. The buyer has no practical means to verify or confirm that the seller is maintaining the required net worth absent an affirmative contractual obligation by the seller to provide periodic bank statements or other written evidence confirming compliance. If the buyer discovers, post-closing, a seller breach of a representation or warranty, the buyer will then have to demand payment from the seller up to the agreed-on damage cap (which presumably is equal to or less than the net worth maintenance amount). If the seller refuses or fails to pay the amount in controversy, the buyer will be forced to file suit against the seller to enforce the seller's contractual obligation. Such a suit will entail time, expense, and uncertainty.

Set forth below are examples of provisions in which the seller is required to maintain a specific net worth for a specific time period and in which the seller is obligated to maintain funds in an account at a bank or other financial institution in an amount equal to the damage cap. If the seller agrees to maintain such an account, the seller may require that any amount in the account in excess of the buyer's pending damage claim be released to the seller at the end of the survival period.

> **Example of Seller Obligated to Maintain Certain Net Worth:** Notwithstanding any contrary provision in this Agreement, as a material inducement for Buyer to enter into this Agreement, during the Survival Period Seller covenants and agrees to maintain a tangible net worth in an amount equal to the Damage Cap; *provided, however*, that if Buyer files an action, suit, or proceeding prior to the Suit Deadline, Seller shall continue to maintain such tangible net worth until such time as the action, suit, or proceeding has been finally resolved as more fully provided in Section ___ above. Seller further covenants that it shall not dissolve or liquidate during the Survival Period and at all relevant times thereafter during the pendency of any such action, suit, or proceeding. This paragraph shall survive Closing.

> **Example of Seller's Obligation to Maintain Account at Bank:** During the Survival Period (and for so long thereafter as any written claim made by Buyer remains pending), Seller covenants and agrees to maintain its legal existence and retain or cause to be retained in a savings or deposit account at _________ or another federally insured, national banking association an amount equal to the Damage Cap. Such account shall be in the name of Seller and no other party, and at any time and from time to time, within five (5) days of a written request, Seller shall deliver to Buyer (which delivery may be effected by electronic mail) a copy of statement issued by the deposit bank confirming the amount on deposit. To the extent Buyer timely delivers a Notice of Breach to Seller during the Survival Period and the loss or damage resulting from the alleged breach or failure of a representation or warranty of Seller is less than the Damage Cap, at the end of the Survival Period Seller shall be entitled to withdraw from such account an amount equal to the difference between such loss or damage and the Damage Cap.

## Guaranty from a Creditworthy Affiliate of Seller

A seller may propose that an affiliate guaranty the seller's post-closing obligations in case of a breach of a seller representation or warranty. Before a buyer readily agrees to this proposal, the buyer should consider several factors. First, the buyer needs to ensure that the proposed guarantor has the financial ability to satisfy the seller's post-closing obligations. The buyer thus needs to underwrite the creditworthiness of the proposed guarantor, and, to that end, the buyer should request, and the seller should provide, copies of audited financial statements and other information on the proposed guarantor. As part of the underwriting process, if the seller is an investment fund, the buyer should confirm that the fund does not intend to liquidate its portfolio before the survival period expires. Second, the buyer should evaluate any particular challenges it may encounter in seeking to enforce the guaranty. For instance, is the guarantor domiciled outside of the United States or in an inconvenient jurisdiction where obtaining or enforcing a judgment may be difficult? Third, the parties will need to agree on the form of the guaranty, which can range from a single-sentence joinder provision or a full-blown payment guaranty attached as an exhibit to the PSA. The buyer may strongly prefer a robust guaranty, but most sellers will attempt to get by with the bare minimum.

Set forth below is a form of guaranty contained in a joinder provision in a PSA. This form of guaranty results in a self-contained guaranty that makes it unnecessary for the guarantor to execute and deliver a separate guaranty agreement.


**Guaranty via a PSA Provision and Related Joinder (Simple):** Seller represents that Seller is indirectly owned or controlled by ___________, a _____________ ("Guarantor"), the ultimate recipient of all or a material portion of the proceeds from the Purchase Price. As such, Guarantor hereby guaranties the payment (and not just the collection) of Seller's obligations under the representations and warranties made by Seller in Section ___ and Seller's indemnification obligations under the Assignment and Assumption of Leases and Contracts to be delivered at Closing, such guaranty being limited by Seller's Damage Cap and being deemed given only to the extent of Seller's liability under this Agreement, as the same is so limited as set forth in Section ___ and this Section ___. Such guaranty shall survive Closing for the Survival Period with any Proceeding (as defined below) to be brought on or before expiration of the Survival Period. Seller acknowledges and agrees that the resolution of such Proceeding might not occur until after the expiration of the Survival Period and the Survival Period shall be deemed to be tolled with respect to (and only with respect to) any such Proceeding brought on or before the expiration of the Survival Period. Guarantor joins in the execution of this Agreement to acknowledge its guaranty of Seller's obligations hereunder as aforesaid and as limited hereby. If Buyer brings an action against Guarantor based on such guaranty (it being understood that Buyer shall not be obligated to first pursue a claim against Seller), Buyer acknowledges that Guarantor may assert any and all rights, defenses, and offsets that Seller may have against Buyer. For purposes of this provision, "Proceeding" means a legal proceeding by Buyer in a court of competent jurisdiction against Seller alleging that Seller was in breach of a representation or warranty contained in Section ___ as of the date made and that Purchaser has suffered damages as a result thereof thereon.

• • •

_______________, a ___________, joins in the execution of this Agreement solely for the purpose of evidencing its guaranty of Seller's obligations hereunder as set forth in and as limited by Sections ___ and ___ above [*these limitations include the Damage Cap and Survival Period*].

**Guaranty via a PSA Joinder (Detailed, with Net Worth Maintenance):**

_______________, a ____________ ("Guarantor"), by Guarantor's execution of this Joinder (this "Guaranty"), hereby irrevocably joins in execution of this Agreement (this Agreement, collectively with any amendments, modifications, supplements, or extensions of this Agreement consented to in writing by Guarantor entered into by Seller and Buyer, being herein referred to as the "Purchase Agreement") to guarantee absolutely and unconditionally to Buyer, its successors and assigns, the prompt payment and performance of all of Seller's representations and warranties set forth in Section ___ of the Purchase Agreement (collectively, the "Guaranteed Obligations"), subject to any applicable limitations set forth in the Agreement (including, without limitation, to the extent applicable, Sections ___ and ___ [*these limitations include the Damage Cap and Survival Period*]). In the event of the failure of Seller to perform timely the Guaranteed Obligations, Guarantor shall make the payment or performance in question immediately upon notice of such failure, it being agreed that the guaranty of the Guaranteed Obligations set forth herein is a guaranty of payment and performance and not of collection. Guarantor is an affiliate of Seller, and Guarantor is executing this Guaranty to induce Buyer to enter into the Purchase Agreement, and therefore, Guarantor is receiving full and adequate consideration for the execution and delivery of this Guaranty. Guarantor hereby waives any and all suretyship defenses (other than full and timely payment and performance of the Guaranteed Obligations and any modification of the Purchase Agreement without Guarantor's written consent) with respect to the Purchase Agreement and this Guaranty. [*Guarantor shall maintain a tangible net worth of at least __________ Dollars ($________) for the duration of the Survival Period.*] This Guaranty shall be governed by and construed in accordance with the internal laws of the State/Commonwealth of ________, and not the laws pertaining to choice or conflict of laws of the State/Commonwealth of ________. Guarantor hereby irrevocably appoints ________________ as its agent for service of process, and agrees that Guarantor shall submit to the personal jurisdiction of the local and federal courts of the State/Commonwealth of ______________ in connection with any action or proceeding to enforce the Guaranteed Obligations. The Guaranteed Obligations shall be binding on Guarantor and its successors, legal representatives and assigns. Notices to Guarantor shall be provided in the same means as specified in Section ___ of the Purchase Agreement, and shall be sent to __________. This Guaranty shall survive the Closing.

### Letter of Credit Provided by Seller

A seller that is reluctant to deliver a cash escrow or to offer a creditworthy affiliate as a guarantor may propose to deliver an irrevocable letter of credit in a specified amount for a specified time period. A chief attribute of a letter of credit is its liquidity. The seller may be willing to pay the letter of credit fees imposed by the issuing bank in lieu of allocating a portion of the purchase price to serve as the escrowed funds; or, alternatively, the parties may elect to share the letter of credit fees. The parties will need to decide whether the letter of credit itself will be held in escrow or whether it will be directly delivered to the purchaser for it to hold during the survival period. Because the issuing bank often will require the account party to deposit cash in an amount equal to the maximum amount of the letter of credit, in addition to an annual fee of as much as 1% of the face amount, this alternative poses the same issue to a seller as a cash escrow—the seller's investors will be forced to wait to receive all of the expected proceeds.

Set forth below is representative language that may be included in a PSA obligating the seller to deliver a letter of credit into escrow. In some transactions, the seller may have the option to deliver a letter of credit or a cash escrow. The PSA will need to include the form of the letter of credit as well as the form of the escrow agreement. A seller would prefer that the letter of credit be held by an escrow agent (and not by the buyer), and, if it is so held, the parties will need to make sure that the beneficiary is the escrow agent (and not the buyer) so that the escrow agent can present a draw on the letter of credit when requested to do so. The escrow agreement will need to detail the draw conditions, which will include a requirement that the escrow agent present a draft for payment, in the absence of a post-closing claim, if the letter of credit is not timely renewed or if the issuing bank's credit rating falls below a specified level.

**Letter of Credit Provision:** As collateral security for the Damage Cap, Seller shall deliver to Escrow Agent at Closing an unconditional and irrevocable sight draft letter of credit in an amount equal to the Damage Cap ("Letter of Credit"), which escrow shall be governed by the terms and conditions of an escrow agreement ("Escrow Deposit Agreement") among Seller, Buyer, and Escrow Agent. The Letter of Credit and Escrow Deposit Agreement shall be in form and substance reasonably acceptable to Seller and Buyer. The Letter of Credit shall (i) be issued by ______________ or other FDIC-insured financial institution reasonably satisfactory to Buyer; (ii) be an "evergreen" letter of credit that shall be renewed automatically unless the issuing bank gives Buyer and Escrow Agent at least sixty (60) days' notice prior to expiration; (iii) permit drafts to be presented in the ___________ metropolitan area; and (iv) be in a form satisfactory to Buyer. The Letter of Credit or Escrow Deposit Agreement shall survive Closing for the Survival Period with any action, suit, draw, or proceeding thereon to be brought on or before the Suit Deadline.

### Cash Escrow with a Third-Party Escrow Agent

From a buyer's perspective when the focus is on liquidity, a cash escrow deposit is highly preferable—and perhaps the best alternative. Not surprisingly, a seller may take a dim view of being required to escrow a portion of the purchase price at closing for some of the reasons noted above. As with a letter of credit, the seller, the buyer, and the escrow agent will need to enter into an escrow agreement that will govern the disposition of the cash escrow. Set forth below is an example of a PSA provision requiring a cash escrow:

As collateral security for the Damage Cap, at Closing Seller shall deliver into escrow with Escrow Agent an amount in cash equal to the Damage Cap

("Escrow Deposit"), which escrow shall be governed by the terms and conditions of an escrow agreement ("Escrow Deposit Agreement") among Seller, Buyer, and Escrow Agent in the form of *Exhibit* ___ attached hereto. The Escrow Deposit Agreement shall survive Closing for the Survival Period with any action, suit, draw, or proceeding thereon to be brought on or before the Suit Deadline.

In drafting, the buyer's and the seller's counsel must ensure that the policy coverage language and the PSA language regarding survival of representations match.

### Representations and Warranties Insurance

The insurance industry has developed a product that will provide coverage in case of losses from a breach of a seller representation or warranty discovered post-closing. Referred to as RWI, this product is increasingly used in merger and acquisition transactions, but it is also for the purchase and sale of commercial real estate. When a buyer is making a competitive bid to acquire an asset, its willingness to obtain RWI, rather than insist on a cash escrow or letter of credit to back up the seller's representations and warranties, can make the buyer's bid more attractive.

RWI basically allows a seller to avoid the need for a cash escrow, letter of credit, or guarantor. The insurer will underwrite its risks, and this insurance product generally entails a deductible (that is, "retention") along with an initial premium payment. Because RWI presents significant benefits to both buyer and seller, the parties may decide to share the premium cost. The insurer typically structures the policy period so that it aligns with the survival period under the PSA. From a buyer's perspective, it may benefit from looking to the insurer for recovery and not to the seller, which may no longer have any assets. In the current insurance market, the cost of RWI insurance may be as much as 4% or 5% of the policy limit.

RWI typically takes the form of either a seller policy (referred to as a "sell side policy") or a buyer policy (referred to as a "buy side policy"). Under a sell side policy, the insurer will indemnify the seller from loss arising from a breach of a representation or warranty discovered post-closing. Under a buy side policy, the insurer will pay the buyer for a loss arising from such a breach.

Even though several insurance companies offer this coverage, it is critical that the insurer be engaged as early as possible in the sale process, because the insurer will need to conduct its own due diligence, which may include one or more conversations with the buyer's and the seller's counsel. In drafting, the buyer's and the seller's counsel must ensure that the policy coverage language and the PSA language regarding survival of representations match. The seller's counsel will want to take special care to ensure that the RWI carrier does not have the right to subrogate against the seller.

### Caps, Floors, and Related Monetary Limits

Although beyond the scope of this article, a few words are in order dealing with the damage cap and floor amounts and related monetary limits. Sellers do not want unlimited post-closing liability exposure to buyers. Sellers will insist on a monetary cap on their post-closing liability and, for good measure, will negotiate a floor beneath which they will not want to be bothered with claims from buyers. Buyers, viewing the situation from a much different vantage point, want to ensure that sellers are willing to stand behind their representations and warranties.

If the parties agree on a floor amount, the buyer wants to ensure that the PSA clearly states that any claim in excess of that amount will allow the buyer to recover damages from the first dollar of the claim (and not amounts only in excess of the cap). For example, if the floor amount is $50,000 and buyer's damage claim is $75,000, buyer should be allowed to recover $75,000 from seller, not just the amount in excess of the floor amount (that is, $25,000), so that the floor does not serve as a deductible. Buyers should take care to expressly state that the floor amount does not apply to seller indemnities for pro-rations and other true-ups, broker indemnities, and other indemnities not related to a specific seller representation or warranty. Buyers often overlook this point, and controversy can arise when buyers demand payment on an indemnity that is less than the negotiated floor amount.

Damage caps are often the subject of intense discussion. There is no magic in negotiating these caps, and they are nearly always driven by market forces and not from a prescriptive formula or grid that specifies the appropriate amounts. Market forces, however, are subject to interpretation and one's most recent experiences. For example, what is considered a market liability cap for the sale of an office building for $100 million? Experience suggests that the damage cap range is somewhere between 2% and 3.5% of the purchase price. Obviously, each deal is unique and the ultimate damage cap may fall outside this range.

### Conclusion

Negotiating the scope of seller representations and warranties, along with the attendant survival period and damage floor and cap amounts, should not blind a buyer to the need to have contractual protection that will actually support a buyer's post-closing claim for damages arising from a breach of a seller representation or warranty. Sellers need to protect their interests from burdensome post-closing obligations, and they should avail themselves of options designed to minimize that burden while still affording protection to buyers. ■


# Bipartisan Budget Act Significantly Changes Social Security Retirement Benefit Options

By Steven A. Brand, David G. Freitag, Ron R. Robinson, and Bruce A. Tannahill

The Bipartisan Budget Act of 2015 (BBA), Pub. L. No. 114-74, signed by President Obama on November 2, 2015, created a sea change in Social Security analysis and planning. The authors' article, *Social Security Retirement Benefit Options,* in the November/December 2015 issue of *Probate & Property,* described pre-BBA Social Security claiming options. Except for limited grandfathering, most options are no longer available. This article summarizes the changes, who can still benefit from the strategies described in our previous article, and why Social Security planning is still an important part of retirement and estate planning for all clients.

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Andrew Alcala

### Background to the Social Security Changes Included in the BBA

The inclusion of any changes to Social Security claiming options in the BBA was a surprise to almost everyone. Mary Beth Franklin, a Social Security expert and retirement planning columnist for *Investment News*, stated that she was shocked when she heard about the proposed changes. A former Capitol Hill reporter, she learned that the changes were the price extracted by the White House and congressional leadership for including provisions that addressed a Medicare premium increase faced by some Medicare recipients and preventing the Social Security Disability Income Trust Fund from running out of money in 2016.

Medicare premiums for 2016 were scheduled to jump by approximately 52% for the approximately 30% of Medicare beneficiaries who are not protected from an increase in Medicare premiums that exceeds the Social Security cost of living adjustment. The Social Security Disability Income Trust Fund was projected to run out of money to pay benefits in 2016. Previous shortfalls in that fund had been resolved by temporarily transferring money from the Social Security Retirement Trust Fund to the Disability Trust Fund, but this solution was being blocked by some in Congress who wanted other changes to the Social Security Disability Income program.

The President's fiscal year 2015 and 2016 budgets proposed eliminating "aggressive [Social Security Administration] claiming strategies," which the budgets stated were used primarily by those with higher incomes. These proposals were aimed at the file-and-suspend and file-and-restrict strategies discussed in our previous article. The 2016 Social Security Administration budget justified this proposal as a way to eliminate the opportunities to "manipulate" the file-and-suspend and file-and-restrict claiming options to maximize Delayed Retirement Credits (DRCs), "result[ing] in equitable treatment of all individuals, regardless of income." SSA FY 2016 Budget Justification, www.ssa.gov/budget/FY16Files/2016FCJ.pdf. *Before enactment of the BBA, no legislation to make these changes was introduced nor were any public hearings of any kind held on the proposal.*

The Social Security Administration Chief Actuary stated these changes are expected to have "essentially no cost effect through 2025, with cost reductions increasing thereafter." The changes will reduce the long-range Social Security deficit by 0.02% of taxable payroll. Letter from Stephen C. Goss, Social Security Chief Actuary, to Speaker John Boehner, October 27, 2015.

### Summary of the BBA Changes

Section 831 of the BBA made two major changes to Social Security claiming options. First, if a worker suspends his or her Social Security benefits, the benefits of all persons receiving Social Security benefits based on the worker's record also are suspended. This change is effective for benefit suspension requests made at least 180 days after the November 2, 2015, BBA effective date. Social Security has announced that the deadline is April 29, 2016. After that date, a worker cannot file and suspend to allow his spouse to claim spousal benefits while earning DRCs on the worker's own benefit.

Second, an individual who is at least full retirement age (FRA) can no longer restrict his Social Security application to only spousal benefits. Filing for Social Security benefits will result in Social Security paying the maximum benefit that the individual is entitled to receive, based on the individual's own record and any spousal benefits the individual is entitled to receive. Individuals who file for Social Security benefits before

**The good news for current Social Security beneficiaries is that none of the BBA changes is retroactive.**


FRA are currently subject to this rule. Survivor benefits are not considered in making this determination. A limited grandfathering provision allows individuals who are age 62 on or before December 31, 2015, to file and restrict his benefits to only spousal benefits after reaching FRA.

In addition, the BBA prevents an individual who files and suspends after April 29, 2016, from requesting a retroactive payment of the suspended Social Security benefits.

### Effect of the BBA Changes

The good news for current Social Security beneficiaries is that none of the BBA changes is retroactive. These changes effectively divide individuals into four classes for Social Security purposes:

- Class I—individuals currently receiving Social Security benefits and surviving spouses;
- Class II—individuals who were age 66 by April 29, 2016;
- Class III—individuals who were age 62 by December 31, 2015; and
- Class IV—individuals who were not age 62 by December 31, 2015.

Individuals who do not qualify for Class I are divided into Class II, III, or IV, based on their ages. Because Social Security considers an individual to reach his next age on the day before his birthday, individuals born on April 30, 1950, are considered age 66 on April 29, 2016, and those born on January 1, 1954, are considered age 62 on December 31, 2015.

### Class I—Individuals Currently Receiving Social Security Benefits and Surviving Spouses: No Effect

Individuals who have already filed for Social Security are not affected by the BBA changes, regardless of what filing strategy they used. These include individuals who filed and suspended or filed and restricted. Similarly, those Social Security recipients who are receiving benefits based on a worker who filed and suspended are not affected by the BBA changes.

Surviving spouses still have the same options they had before the BBA. They may file for survivor benefits as early as age 60 (age 50 if disabled) and later file for their own benefits or file for their own benefits as early as age 62 and later file for their survivor benefits. For a surviving spouse, it remains important to compare benefits available as a surviving spouse and benefits based on the spouse's own record.

### Class II—Individuals Who Were Age 66 by April 29, 2016, Could Have Filed and Suspended: No Effect If They Acted by April 29, 2016

Individuals fall into Class II if they were age 66 by April 29, 2016. These individuals could have filed and suspended their Social Security benefits by April 29, 2016. Doing so would allow a spouse and qualifying children and parents to receive benefits on the worker's record. Once the benefits have been suspended, the individual can reinstate his benefits at any time to receive either a lump sum payment of the suspended benefits or benefits that include the DRCs earned through the date benefits are reinstated. A worker who did not take action by April 29, 2016, cannot now file and suspend his benefits to allow family members to receive benefits while the worker earns DRCs.

Individuals in Class II provided themselves with the most flexibility if they filed and suspended before the April 29, 2016, deadline. If they decide to start receiving Social Security at a later date, they can either request retroactive payment of the suspended benefits or begin to receive benefits with the DRCs earned to that time.

### Class III—Individuals Who Were Age 62 by December 31, 2015, Can Still File and Restrict: Limited Effect

Individuals who reached age 62 by December 31, 2015, can file and restrict their benefits to spousal benefits when they reach their FRA of age 66. Receipt of spousal benefits requires that the worker spouse must either be receiving benefits or have filed and suspended before April 29, 2016. If not, the spouse must wait until the worker files for Social Security benefits to receive spousal benefits.

### Class IV—Individuals Who Were Not Age 62 by December 31, 2015, Cannot File and Restrict: Potential Significant Effect and Planning Continues to Be Important

Workers under age 62 will see the most effect from the BBA on their Social Security filing strategies. They cannot file and suspend or file and restrict. This limits the decision to when to claim their own benefits.

The combination of the 25% to 30% benefit reduction for filing before FRA and the 8% annual DRCs can produce a significant difference in Social Security benefits on a worker's own record. For a worker whose FRA is age 66 (those born before 1955), claiming benefits at age 62 reduces Social Security benefits by 25% compared to claiming benefits at 66. Waiting until age 70 provides four years of 8% DRCs for an effective 76% increase in benefits over the benefits received at age 62.

A worker born in 1960 or later has a FRA of age 67. Filing for benefits at age 62 produces a 30% reduction in benefits compared to waiting until age 67. Waiting until age 70 provides three years of 8% DRCs and

**The Social Security changes included in the Bipartisan Budget Act of 2015 change the Social Security planning landscape for those in Classes II through IV but do not mean that Social Security planning is obsolete.**


more than a 77% effective increase in benefits.

Planning for Class IV individuals also should consider the effect on survivor benefits. The survivor receives the greater of his own benefit or an amount equal to the deceased spouse's benefit. This means that the death of one spouse reduces a couple's Social Security benefits by the smaller Social Security benefit. Delaying Social Security benefits can significantly increase the survivor's Social Security benefits.

### Filing Early and Suspending Benefits Later May Be Helpful

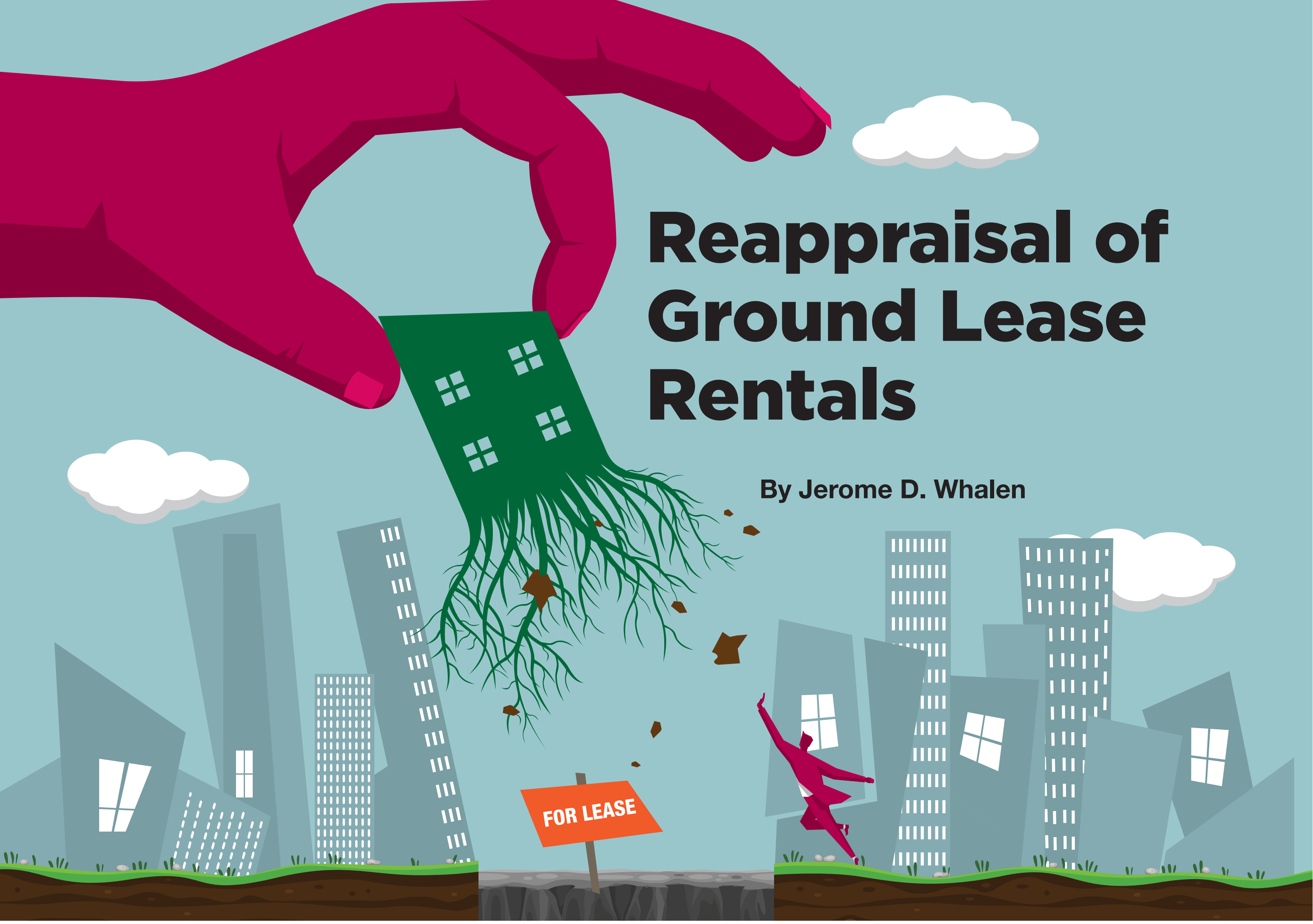
Some individuals may find filing for benefits before FRA is beneficial. This commonly occurs when a worker has a spouse, dependent children, or parents and wants them to receive benefits on the worker's record. The worker can file for benefits on reaching age 62, entitling family members to receive benefits. The benefits will be limited to 150%–180% of the worker's FRA benefit and subject to the earnings test, based on the worker's earnings. When the worker reaches FRA, if the family members no longer qualify for benefits, the worker can suspend his benefits and earn DRCs. For a worker who filed at age 62 and took a 25% reduction, suspending at age 66 and earning DRCs of 8% annually for four years will produce a benefit at age 70 that is 99% of the benefit he was entitled to receive at age 66. Even for workers whose FRA is after age 66, this strategy will produce a larger benefit than continuing to receive Social Security benefits between FRA and age 70 once family members no longer qualify for benefits.

### Effect of Suspending Benefits on Divorced Spouses

The Social Security Administration has stated that a worker who suspends his benefits will not affect the benefits received by an ex-spouse. A divorced spouse must have been married for at least 10 years and unmarried to qualify for benefits on an ex-spouse's record. An ex-spouse who has been divorced for at least two years can receive spousal benefits on the former spouse's earnings record, regardless of whether the former spouse had filed for benefits. If a former spouse suspends her benefits after April 29, 2016, it will not affect a divorced spouse's benefits.

### Conclusion

The Social Security changes included in the Bipartisan Budget Act of 2015 change the Social Security planning landscape for those in Classes II through IV but do not mean that Social Security planning is obsolete. Making the appropriate decision still requires a careful evaluation of the options available. While everyone has choices on when to file, the classes differ on whether there is any additional flexibility. People in Class II who filed for Social Security benefits by April 29, 2016, preserved significant additional flexibility. An individual in Class III has some additional flexibility after attaining age 66 if his spouse has filed for her own benefits. Those in Class IV no longer have any additional flexibility and are limited to deciding when each spouse should file for his or her own benefits. Overall, the BBA changes mean that people in Classes III and IV will generally need to wait to claim Social Security benefits until as close to age 70 as possible to maximize their benefits. ■




# Reappraisal of Ground Lease Rentals

By Jerome D. Whalen

iStockphoto

With most ground leases, the parties agree to the initial base rent even before the letter of intent, typically as a percentage return on the value of the land. That's the easy part. Over the following decades, the landlord knows that inflation will seriously erode the value of that rent unless there is some provision for periodic adjustment. The tenant, on the other hand, is concerned that increases in the rent will diminish the value of the leasehold and, even more importantly, endanger project financing. Potentially unlimited increases in ground rent, by either indexing or appraisal, are unacceptable to most leasehold mortgage lenders, at least for new development projects. For the first 10 or 20 years of the lease term, this issue can be finessed by either scheduled fixed rent increases or indexed adjustments with a cap, or both. But after 20 years or more, most prudent landowners will insist on some sort of reappraisal of the land value as a means of assuring that the ground rent will be a fair return to them and their heirs. So, in many long-term ground leases there is a provision for resetting the basic ground rent at some point or points during the term or on the exercise of an option to extend the term by the tenant.

Fixing the value of the land alone when it has been substantially improved is a highly theoretical exercise. The appraisal process usually involves a current determination of the value of the land and also may require setting a rate of return, although many leases will specify a rate to be applied to the newly determined land value. This is probably the single most common subject of arbitration and appraisal proceedings between the parties to ground leases, and sometimes a lot of money is at stake. Some years ago a hotel ground lease rental in Waikiki reportedly went from $187,000 per year to more than $3.5 million as a result of an arbitration *that the tenant won.* Alan W. Weakland, *Hawaiian Hospitality*, Hospitality Rep. (Paul, Hastings, Janofsky & Walker LLP Jan. 1997), at 1, www.paulhastings.com/Resources/Upload/Publications/417.pdf.

Most of these disputes are resolved by arbitrators or appraisers. In the relatively few instances resulting in judicial decisions, the dispute is usually whether the land valuation should be based on the "highest and

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best" use of the property or on a "use assessment," that is, as used by the tenant and subject to any restrictions on the use contained in the lease.

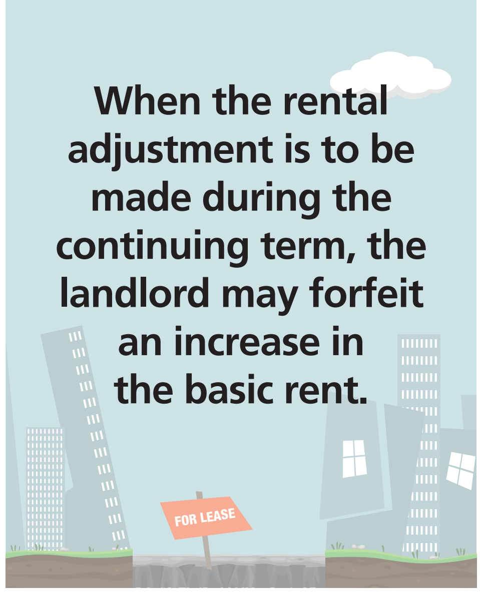
This article will focus on the determination of land value for unsubordinated ground leases in which the landlord owns the land and the tenant built or purchased the improvements. For a more detailed discussion of ground lease appraisals and other ground lease topics, see the author's treatise, Jerome D. Whalen, *Commercial Ground Leases* (3d ed. 2013, Supp. Mar. 2016).

### The Legal Context

Legally, the issue is the intent of the parties when the lease was written. The courts often maintain this to be a matter of interpreting the lease as a whole to determine the parties' intent, but that is not always what happens. At least in the two states that have shaped most of the relevant law, discussed in further detail below, courts have identified specific language that dictates one of two results.

No two clauses in the reported cases are the same, and the generalized, nonspecific nature of the language suggests that the parties may not have had any mutual understanding on the point. It is fairly easy to write a clear statement of intent: "value the Land at its highest and best use, vacant and unimproved, and unencumbered by this Lease"; or, if that is not the agreement, then "value the Land as used by the Tenant under this Lease." The language in the contested cases (and many other ground leases that have not made their way to the public record) is seldom so clear. The lease may say only something like "value the Land at its fair market value" and might continue to say "unimproved and unencumbered," without defining any of the terms. Separate provisions in the lease often limit the tenant to the original use anticipated by the parties and may prohibit any demolition and rebuilding.

It may be that clarity did not serve the interests of sophisticated parties when they were trying to complete a complex ground lease, which often consumes months of negotiations and drafting. Generally in lease negotiations, the attention given to any matter is inversely proportional to its proximity in time. In many cases it is likely that at least one party to the original lease, and perhaps both, did not fully understand the legal significance of the terminology employed concerning future reappraisals.




When the dispute reaches arbitration or the courts, however, a decision is required. If a court should determine that there was no meeting of the minds regarding the rent to be paid during an extended term, the option to renew might be invalidated, causing the tenant to lose the extended term and the use of the improvements. When the rental adjustment is to be made during the continuing term, the landlord may forfeit an increase in the basic rent. The majority rule among the several states is that, when the parties have failed to specify definite terms for the determination of renewal rent, the option to renew is unenforceable as an "agreement to agree." *Friedman on Leases* (Patrick Randolph ed., 5th ed. 2005, Supp. July 2015) § 14:1.3, nn.79–84. The courts have more recently sought to avoid this result. *Friedman on Leases* § 14:1.3, n.87. In "a respectable minority of cases," courts have held that renewal rights should be enforced even when little or no agreement is manifested regarding renewal term rent, often finding that a reasonable or market rent was intended, or declaring as a matter of law that a reasonable rent should be judicially determined to save the renewal rights. Id.; see, e.g., *City of Kenai v. Ferguson*, 732 P.2d 184, 187–88 (Alaska 1987). And virtually all states will enforce agreements to arbitrate rent revisions, even when the parties do not set forth the basis for the redetermination. *Friedman on Leases* § 14:1.3, n.74. If there is an applicable arbitration or appraisal provision, then asserting (or conceding) that there was no meeting of the minds regarding renewal rent should not affect the validity of an option to extend or a provision for the reappraisal of the ground rent during the term.

### Approaches to Lease Interpretation

In New York and California the courts have adopted approaches to lease interpretation that presume certain intentions regarding ground rent adjustments when little or none is manifested. These interpretations do not usually turn on reading the lease as a whole but instead on presumptions attached to specific wording, attributing intent to the parties when the lease language is ambiguous.

First, there is agreement in the case law on this: if the lease clearly requires one or another basis of valuation, then that will control, even if disastrous for one party or another. If the lease requires valuation of the land at its highest and best use, unimproved, and free of the lease, then restrictions in the lease on use and the existence of the tenant's improvements on the land will be disregarded. *Ruth v. S.Z.B. Corp.*, 153 N.Y.S.2d 163, 165 (Sup. Ct. 1956). If the zoning has changed to permit a much larger and more valuable project, the tenant will face a new rent much greater than previously in effect and maybe more than the existing improvements can afford to pay, even if the tenant does not have the right under the lease to adopt the more valuable use or build the larger project, or if it is uneconomic to do so.

Inversely, if the property has been downzoned to permit only smaller, less valuable uses, at least in New York, the landlord will receive a lesser rent even though the project on the property constitutes a legal nonconforming use that will become the property of the landlord at the expiration of the lease. *New York Overnight Partners v. Gordon*, 673 N.E.2d 123, 125–26 (N.Y. 1996); *201–203 Lexington Ave. Corp. v. 205/215 Lexington L.P.*, 637 N.Y.S.2d 125, 126 (App. Div. 1996). Chances are that neither party to the original lease intended these results and that, if these possibilities had been raised before the lease was signed, some sort of clarifying language might have been included.



The "New York rule" might be described as presuming, absent a clear indication to the contrary, that the valuation of the land must take into account any restrictions on use and other relevant provisions of the lease. In New York, when the lease required the rent to be based on the value of the land "exclusive of the improvements," but limited use to a hotel, that restriction controlled and not the "higher and better" use as an office tower. *Plaza Hotel Assocs. v. Wellington Assocs., Inc.*, 285 N.Y.S.2d 941, 944, 946 (Sup. Ct. 1967), aff'd without opin., 293 N.Y.S.2d 108 (App. Div. 1968). A phrase like "free of lease" or "unencumbered by this lease" will overcome this presumption and require the land to be valued at its then highest and best use, even if the property has been downzoned or if the lease restricts the tenant to a less valuable use. In New York, when there is no use restriction in the lease, highest and best use will control absent some clear indication to the contrary. *185 Lexington Holding Corp. v. Holman*, 189 N.Y.S.2d 269, 270 (Sup. Ct. Spec. Term 1959), aff'd, 197 N.Y.S.2d 404 (App. Div. 1960), aff'd, 204 N.Y.S.2d 345 (N.Y. 190).

The "California rule" can be described as presuming that the "value" of the land means fair market value in a standard appraisal at its highest and best use, not limited by any use restrictions in the lease or by the nature of the existing improvements, unless a clear intention to the contrary appears from the lease. This approach grew out of two early cases in which there were no applicable use restrictions. The first held that "value" meant fair market value and not "use" value and that if the parties had meant anything else "they would have said so expressly." *Bullock's, Inc. v. Security-First Nat'l Bank of L.A.*, 325 P.2d 185, 188–89. (Cal. Ct. App. 1958). The second followed this approach and specifically refused to consider the New York *Plaza Hotel* opinion. *Eltinge & Graziadio Dev. Co. v. Childs*, 122 Cal. Rptr. 369, 372 (Ct. App. 1975). Two later decisions expressly affirmed this approach while avoiding its application, both relying on "all the facts and circumstances." *Humphries Invs., Inc. v. Walsh*, 248 Cal. Rptr. 800 (Ct. App. 1988), and *Wu v. Interstate Consol. Indus.*, 277 Cal. Rptr. 546, 548 (Ct. App. 1991).

So, California presumes that "value" means the fair market value of the land at its highest and best use, and in New York use restrictions in the lease must be taken into account in the valuation, unless there is a clear indication to the contrary. In either jurisdiction the parties are free to reach whatever agreement they like. When the circumstances indicate the absence of any real agreement on the issue, which is commonly the case, then these presumptions will control even when the result is unreasonable in terms of economic fairness and common sense. Courts are fond of saying that "a poor bargain may not be made good by judicial construction or recasting of the contract," *185 Lexington Holding Corp.*, 189 N.Y.S.2d at 270; see also *Eltinge & Graziadio Dev. Co.*, 122 Cal. Rptr. at 371 ("it is not our function, nor do we have the power, to make a contract for the parties other than the one that they themselves have entered into"), even though these rules are not statutes but judicial declarations, often made long after the lease in question was written, ascribing to unsuspecting landlords and tenants intentions that they never had.

### The Economic Substance

"Highest and best use" or "use value"? The answer should depend on when during the term of the lease and the life of the improvements the reevaluation occurs. Ideally, a developmental ground lease would have an initial term coincident with the anticipated economic useful life of the project to be constructed by the tenant.

In a financially viable project, lenders, developers, and investors develop a common idea of the period needed for the projected net cash flow and other financial benefits of the project to service debt and provide reasonable returns to project participants. See Whalen, *Commercial Ground Leases* § 8:7.1. A strip mall or low-rise commercial structure may need an initial term of 25 years, but a high-rise office building or hotel might require 50 years or more.

Before the end of the anticipated useful life, any reappraisal of the land value for purposes of ground rent should require consideration of the existing use and improvements, that is, a "use value" appraisal to reflect the fact that the parties, by entering into the lease, expected that the land would be committed to the project for at least the period required to make the original project economically viable. Appraisal Institute, *Dictionary of Real Estate Appraisal* § 2:5.4 (3d ed. 1993). A use value appraisal should give some comfort to leasehold mortgage lenders that a reappraisal will not result in an unreasonable increase in ground rent for an established project. Even if zoning and land use patterns have changed so that other, more valuable uses might now be possible (or only less valuable uses are permitted), the revised land rent should be based on the use value of the existing improvements until the expected useful life is over. Interviews with Anthony Gibbons MAI, CRE, in Bainbridge Island, Wash. (discussion of perspectives and observations on the issues in ground rent reappraisals from an appraiser's standpoint).

Sometimes a landowner with a valuable piece of property may insist on premature re-evaluations of the ground rent based on the then-highest and best use. If so, the lease should clearly state that understanding in words like "highest and best use." One should not infer or presume that an uneconomic result was intended in the absence of a clear statement of the intent of *both* parties. In that circumstance, if the parties actually contemplated this result, one might expect the tenant to have some right to cancel the lease, change the use, or redevelop the property as evidence of his understanding of its terms.

If the tenant has any options to extend beyond the end of this ideal initial term, which is also often the case, rent should then be based on the highest and best use. The tenant at that time should either renovate or redevelop the property to its highest and best use, or sell to someone who will. If the tenant wants to wring the last drop of profit from the existing improvements, he should not do so at the expense of the landowner if a more valuable use is available for the property. If the existing improvements are a more valuable nonconforming use than the then-permitted uses, that should be a consideration in the valuation.

Sadly, long-term ground leases are seldom, if ever, written this way. Instead, the initial term may be for 10 or 20 years with five or more options to renew for five or 10 years each. Or there might be a single term of 99 years because that seemed like the right length for a ground lease. Often the developer wants options to extend well beyond the useful life of the initial improvements. Sometimes the tenant is restricted to a specific use of the land, but sometimes not. The tenant may have a right to demolish the improvements and redevelop the property, or not. Usually there is a single provision in the lease for reappraisal of the land rent that would apply whenever a reappraisal is called for, both during the initial term and on exercise of extension options. A reappraisal at highest and best use may be compelled at a point long before the original (and still existing) use has justified its cost of investment; or a use valuation may apply to remote extensions of the term when the original improvements should be demolished and replaced with more valuable structures. For these uneconomic results, there seems to be no judicial remedy.

Most cases dealing with this issue have come from either New York or California. There is a sprinkling of decisions from other jurisdictions, mostly holding that use restrictions in the lease, or the landlord's knowledge or approval of the tenant's intended use and improvements, require a use valuation, including consideration of any legal nonconforming use. See, e.g., *The Warwick Corp. v. Hartel*, 516 So. 2d 1340, 1343 (La. Ct. App. 1987); *Certain v. Kovens*, 314 So. 2d 184, 187 (Fla. Dist. Ct. App. 1975); *Moolenaar v. Co-Build Cos., Inc.*, 354 F. Supp. 980, 984 (V.I. 1973); *City of Kenai v. Ferguson*, 732 P.2d at 188. In effect, the California "rule," presuming a highest and best use valuation in the absence of a compelling indication to the contrary, is the outlier; California's is the "minority rule." No other jurisdiction has followed California's lead (except New York when there is no use restriction in the lease). Most states where this issue might arise in the future should have no controlling precedent to follow, and arbitrators or appraisers in a private proceeding in many jurisdictions also may have greater latitude. See, e.g., *Blvd. Assocs. v. Seltzer P'ship,* 664 A.2d 983, 988 (Pa. Super. Ct. 1995).

So there may be hope, in many jurisdictions, if not in New York or California, that courts (or arbitrators or appraisers) might adopt approaches to these issues that do not impel uneconomic results. It would not be unreasonable to presume that the original parties to the lease, in the absence of some clear statement to the contrary, anticipated that any reappraisal of the land for the purpose of redetermining the ground rent would reflect their economic expectations from the transaction. One might further reasonably presume that the parties intended that the tenant would build and maintain a certain project with a determinable useful economic life, and when that life had expired the land rent would be adjusted to reflect the then-highest and best use of the property (including consideration of any legal existing nonconforming use); and that any reappraisals before that would reflect the value of the land as a component of the project to which the land was committed (not to say "residual land value," a technique rejected for reasons described in *Medical Towers, Ltd. v. St. Luke's Episcopal Hosp.,* 750 S.W.2d 820 (Tex. App. 1988)). See *Commercial Ground Leases* § 2:5.4.

### Deconstructing the Terminology

In the real world, the only sure way to resolve these problems is to draft a well-written ground lease. If left to their own devices, appraisers will do what they normally do, and that is usually a highest and best use valuation. As suggested above, the necessary language is simple and clear and should be a part of the parties' understanding at the letter of intent or term sheet stage. Even then care is required in the drafting. Too often long, complex ground leases contain inconsistent terminology, such as capitalized terms like "Property," "Premises," and "Project," that unintentionally confuses what elements are to be appraised or ignored.

The appraisal provision in many modern ground leases may say something like "the Land should be valued as vacant and unimproved, unencumbered and free of this Lease." This choice of words has the appearance of legal significance but really does not address the core issues, at least not directly or unambiguously.

The term "free of lease" has been held in New York to require a highest and best use valuation even when the lease does not allow the tenant to adopt that use. *Ruth v. S.Z.B. Corp.*, 153 N.Y.S.2d at 167. There *are* cases in which the parties agree to a highest and best use valuation long before the anticipated useful life of the project has run, but then they should be clear, as suggested above, in words that do not require presumptions to be understood, to demonstrate that both parties understand that agreement. In the absence of such clarity, "free of lease" or "unencumbered by this lease" might stand for the unexceptional proposition that the appraisal for the purpose of establishing the ground rent should ignore the financial terms of the lease, that is, that the land should not be valued based on the net present value of the ground rents. Trying to base the value of the land for purposes of determining ground rent using an income approach based on the existing ground rent involves a hopeless circularity. *Springer v. Borden,* 71 N.E. 345 (Ill. 1904); *Hirt v. Hervey,* 578 P.2d 624, 628 n.1 (Ariz. Ct. App. 1978). In New York, as explained above, the underlying assumption is that use limitations in the lease should control the appraisal; so "free of lease" is a critical change. There is nothing inherent in the phrases "free of lease" or "unencumbered by this lease" that indicates either a highest and best use or current use analysis.

"Unencumbered" seems ambiguous in this context. No one suggests that applicable zoning should be ignored in determining highest and best use. It also seems obvious that certain encumbrances must be considered, such as an easement for light and air restricting building height on the land, or conditions, covenants, or restrictions binding the land and adjacent properties. Certainly financial liens, mortgages, and the like should be excluded as well as encumbrances created by the tenant without the participation of the landlord. For better or worse, subleases by the tenant affect the value of the leasehold but should usually be ignored in the valuation of the land. But these conclusions would follow from a standard appraisal; "unencumbered" doesn't seem to add anything, unless it is shorthand for "free of lease."

"Vacant and unimproved" may be more meaningful, although in this context redundant. "Vacant and unimproved," like "free of lease," says nothing to indicate either a highest and best use or a current use analysis. Generally the language is understood to exclude the value of the tenant's improvements in calculating the new rent. Still, the existence of the improvements may affect the value of the land, one way or another. "Unimproved" may exclude consideration of that effect on value, not necessarily to the landlord's benefit. When the existing improvements are a legal nonconforming use of greater value than the then-permitted highest and best use, they could add to the land value. Under most jurisdictional permitting schemes, entitlements run with the land; the issue becomes murky when the tenant has created the entitlement, but the land is to be valued "unimproved." No other jurisdiction has followed New York's example of ignoring the more valuable nonconforming use. An existing legal nonconforming use should be considered part of the zoning, but may require explicit language in the lease to reach that result. If the lease states no more than that "the *value* of the buildings (or improvements) shall be excluded," that should permit consideration of the improvements to the extent their existence affects land value.

"Fair market rental value" has taken on magical qualities, at least in California. *Wu v. Interstate Consol. Indus.* basically assumed without explanation that "rental value" and "use value" are the same. 277 Cal. Rptr. at 550. The term should be either avoided or used only when there is a clear definition of the basis of reappraisal.

Even "use value" may be ambiguous. Should it reflect the value as actually used by the tenant, or the land value for the same sort of use in the current market and under current zoning, so that, if the zoning had changed to permit a larger project, or only a smaller project, of the same kind, the land value would be based on the then-permitted size rather than the tenant's actual improvements? The court in *Medical Towers* opted for the then-permitted size. 750 S.W.2d at 823–24. An "economically useful life" approach would opt for the tenant's actual improvements (including consideration of any legal nonconforming use) unless the tenant had the right under the lease to build the larger project and it was economically practicable to do so in the circumstances, considering the remaining term of the ground lease and other relevant factors. To be fair, the *Medical Towers* court pointed out that the tenant had had the option of building the larger project. Id. at 824.

## Conclusion

One of the challenges of long-term ground leases is our inability to anticipate all of the changes that may affect the property over the following decades. But the matters discussed here are clearly capable of being understood by the parties when drafting and signing the lease. Presumptions attached to terminology that is not clear in itself (does "free of lease" mean highest and best use, or does "fair market rental value" mean use value?) are trip wires for the unsuspecting landlord or the overanxious tenant, sometimes leading to unfortunate results. Drafters and courts should look to the underlying economics of the transaction.

Unless the parties agree explicitly to the contrary, ground rent reappraisal clauses should be written so that:

1. Ideally, the initial lease term reflects the expected economic useful life of the tenant's project, in effect memorializing the understanding of the parties.
2. Any reappraisals arising during the expected useful life are based on the tenant's actual use of the property (or as it should be used in accordance with the lease, for instance, meeting maintenance and repair requirements).
3. Any reappraisals after the expected useful life are based on the land's then-highest and best use; a corollary would hold that the tenant should have the right, at that time, if not before, to adopt the better use and redevelop the improvements as necessary to do so.
4. Any reevaluation includes consideration of any existing legal nonconforming use on the land. ■

## A Note on Rates of Return in Ground Leases

Ground leases often state a single rate of return to be applied throughout the life of the lease to the reappraised value of the land. *Friedman on Leases* opines that this practice is "objectionable" because the stated rate may not reflect a fair rate of return at the time of the reappraisal and that the lease should provide instead for "the then current return on comparable investments." *Friedman on Leases* § 14:1.3, n.101. The landlord's position on an unsubordinated ground lease, at least once the initial development has been successfully completed, is very much like a financial instrument. Chris Carneghi, *Determining Ground Lease Rental Rates*, The Appraiser, Apr. 1994, at 256, 262–63. Once construction is completed, the landlord under the typical ground lease has little or no operating or maintenance responsibility, is not subject to depreciation of her investment because she did not pay for the improvements, and is something like a passive investor collecting a secured return. Of course, "subordination of the fee" is a major game-changer.

But the landowner is not in the same position as the holder of a bond or a CD. Even an unsubordinated ground lease is qualitatively different from a financial instrument; the real estate risks will exist from the beginning to the end of the term. Construction and initial development will involve substantial risks that, at their worst, may be catastrophic. At the end of the lease, the landowner may inherit another host of issues—operational, environmental, or holdover tenancies. In between, there are still casualty and operating risks inherent in real estate, including tenant default. Each ground lease and each ground lease project is unique. The only actual comparable rate of return for a ground lease would be other ground leases, but very few places outside of Manhattan or Hawaii would provide much of a basis for a ground lease market rate of return. In most locales, there would be very few *recent actual* ground lease transactions to compare. Carneghi, supra, at 256. In most market areas, it will be feasible to establish the fair market value of the land but not a ground lease rate of return.

Initial ground lease rates are generally determined by the then-current demand for developable land in the area of the property, the location and characteristics of the site, and, to a lesser extent, the terms of the lease itself. Carneghi, supra, at 259–61; Whalen, *Commercial Ground Leases* § 2:1. In a reappraisal, the appraisers or arbitrators cannot change the terms of the lease, but the relevant terms might have some effect on the rate they choose, such as the frequency of reappraisals and other interim rent adjustments. If there is a determinable ground lease rate of return in the locale at the time of the reappraisal, demand for developable sites and the landlord's risk profile after completion of development may have changed dramatically, so that the landlord might want the assurance of a fixed rate.

Over the last several decades, financial market rates have fluctuated to an unprecedented degree. In 1981 the 10-year Treasury rate reached 15.8%; in 2012 the rate sank to 1.6%. See Sam Ro, *An Annotated History of the 10-Year US Treasury Note Since 1790*, Bus. Insider (Apr. 23, 2013, 8:44 p.m.), http://businessinsider.com/the-10-year-us-treasury-note-since-1790-2013-4. The "long term average rate" has been 6.39%. See YCharts, *10 Year Treasury Rate* (Feb. 12, 2016), https://ycharts.com/indicators/10_year_treasury_rate. Setting a ground lease rate of return by reference to market interest rates in 1981 or in 2012 would have produced results that were very likely not in the contemplation of the original parties to the lease. If reappraisals under the lease are frequent, say every five years or so, or if there are frequent inflation adjustments between reappraisals, then reference to market rates might be more justifiable. But if reappraisals are every 10 years or more, as is often the case, then financial or ground lease market rates are problematic.

Anecdotally, it seems that historically rates have run anywhere from 3% to 12%, probably forming something like a bell curve with the peak between 6% and 9%. Carneghi reports that ground lease rates of return in the San Francisco Bay area during the 1980s were in the range of 8% to 12% with the preponderance between 9% and 10%. Carneghi, supra, at 260–61. Given the increasing volatility of financial markets, it seems prudent that the parties should establish a rate of return in the lease. If they feel compelled to give a nod to financial markets, such as 10-year Treasury rates, they should at least fix a "window," say between 6% and 9%, to protect against extreme changes in market conditions. ■


# Technology

# Property

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**Technology—Property** provides information on current technology and microcomputer software of interest in the real property area. The editors of *Probate & Property* welcome information and suggestions from readers.

## Business Productivity Software by Subscription

A couple of years ago, I switched the way I acquire the right to use productivity software for my work. Two products to which I am subscribing, rather than purchasing a license for, are Microsoft Office 365 and Adobe Creative Cloud.

The primary reason I chose the subscription route is that it appeared to be the least expensive way to keep up-to-date with the latest versions of the software. I was disappointed, however, to receive a notice from Microsoft at the end of last year that my subscription would no longer include Microsoft Access, a database program. I must admit that my disappointment is not likely to be shared by many lawyers, because database management is not an activity commonly engaged in by lawyers.

## Microsoft Office 365

The Microsoft 365 subscription I obtained is currently called Office 365 Business Premium and includes, among other applications, Word, Excel, Outlook, PowerPoint, OneNote, Publisher, and Skype for Business. It is important to note that the subscription entitles each user to download the full desktop versions (or mobile versions) of the Office applications on up to five PCs or Macs, five tablets, and five phones. With Microsoft 365, I can also create Word, OneNote, PowerPoint, and Excel documents from a browser. This is handy when using a computer that does not contain the desktop applications. I believe the browser versions of the Office applications are not as fully featured as the desktop versions.

It should be noted that the right to install the Office applications on five computers does not include the right to install the applications on the computers of a secretary, assistant, paralegal, or associate. Each of those persons is required to have a separate subscription.

My subscription also includes 1 terabyte of storage on OneDrive for Business at no additional charge. Documents stored on OneDrive can be accessed in their most recent versions from any computer (so long as the user enters the applicable user ID and password), and these files can be shared with others to the extent permission is granted by the user.

A disadvantage of the subscription approach is that it effectively requires a user to pay the subscription price every year. If a user does not continue the subscription, the applications obtained through the subscription can no longer be used. An advantage to the subscription is the user obtains the latest version of the included Office applications at a fairly reasonable price (of course, pricing is always subject to change by Microsoft at the annual renewal of the subscription).

Under the subscription, a user is not required to download the newest version as soon as it is released. Many users will prefer to avoid bugs that tend to infest the early versions of a major update. Nonetheless, users should expect that at some point in time, migrating away from the older versions of the Office applications will be required because they will no longer be part of the subscription.

At the time this column was written in February 2016, my Microsoft 365 subscription cost $12.50 per month per user with up to 300 users available. Of course, with 300 users the monthly charge is $3,750; but companies with many subscriptions may be able to negotiate a better deal. Different business subscription packages are available at costs from $8.25 to $20.00 per user per month. Alternatively, Office Home and Business can be purchased directly from Microsoft for one PC or one Mac for a lump sum price of $229.

The subscription also includes mobile versions of the software. In fact, the initial draft of this column was written with Word on my iPad. Just in case I had trouble transferring the file to my office computer, I e-mailed the file to myself. That turned out to be unnecessary. Once I clicked on "File Open" in Word on my computer, the name of the file appeared at the top of my most recent files.

For more detail regarding Office 365, take a look at Office 365 at wikipedia.com.

### Adobe Creative Cloud

Adobe Creative Cloud makes the applications of Adobe Systems Inc. available by annual or monthly subscription. An annual subscription is payable in one lump sum or in monthly installments, at a lesser rate than the monthly subscription for which the user is not committed for an entire year.

I originally started using Adobe Acrobat by purchasing Adobe Acrobat Professional in the former conventional way of acquiring software. When Adobe Creative Cloud became available, I noticed I could obtain the right to practically use the entire portfolio of Adobe applications for a monthly fee of $49.99. If I were to purchase all of the Adobe Applications, I would have to pay an aggregate purchase price in excess of $2,000.

As of this date, the only Adobe application I actually use is Acrobat Professional. I would like to learn and use a number of other of the Adobe applications, but I have yet to find the time to do so.

In preparing to write this column, I navigated to the Adobe web site (www.adobe.com) to see the current cost comparison between subscription and purchase. I was surprised to note that it appeared that the only way to use the current versions of the Adobe applications is by subscription. I called the sales number from the website, and the sales representative advised me that the applications were available for purchase, but the versions generally available for purchase are older versions without the recent updates available in the subscription versions. The one exception is for Acrobat Professional with a purchase price of $449.

I also noticed that subscriptions are now also available on a per application basis at $19.99 per month for each application, except Adobe bundles a special Photography Package subscription for both Photoshop and Lightroom at $9.99 per month.

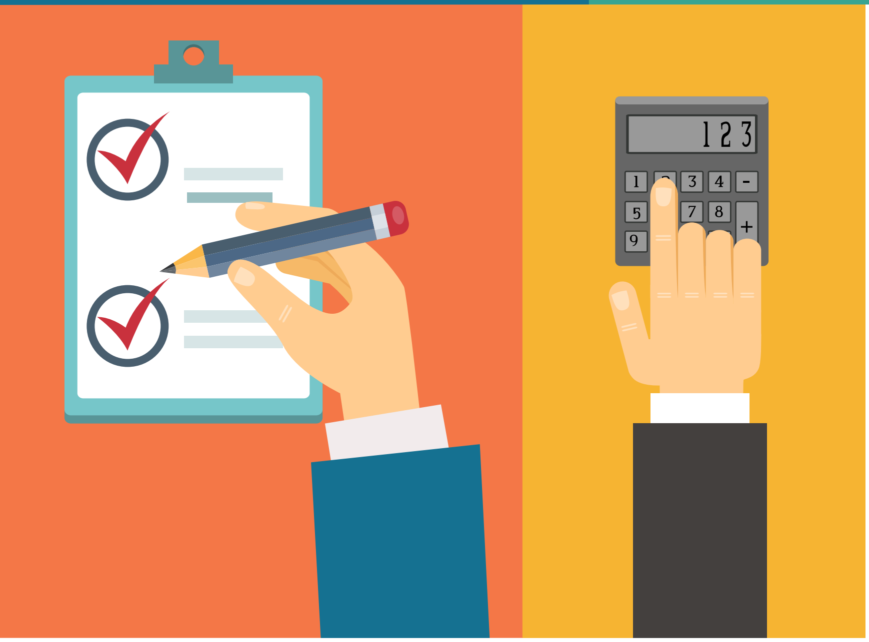
Since Adobe makes Adobe Reader available as a free download to all, I suspect that most users of PDF documents simply use the free application for reading PDF documents.

It is important, however, to note the benefits of using Adobe Acrobat Professional (now called Adobe Acrobat Pro DC). I have found significant benefits in using Acrobat Pro for reviewing documents on my computer rather than on paper. My workstation definitely contributes to the benefits I receive. I have two 27" monitors (which are now relatively inexpensive). In reviewing a document, I usually use one monitor to view the document and use the other monitor to make notes in Word. If necessary, with the large screens I can easily add to the view a couple of additional windows with related documents. This permits me to be more organized than having several documents sitting on my physical desktop in some degree of disarray.

### Enhancement to Document Review Process

Acrobat Pro has the following features that enhance the document review process.

- Easily create any number of bookmarks for ready reference to any parts of the document.
- Annotate any portion of the document.
- Perform optical character recognition (OCR) of all or any part of the document (this process takes very little time with an up-to-date computer). This enables full text searches within the document.
- The same document may be opened in two or more windows so that the user may view multiple portions of the same document at the same time.
- A revised version of the document can be compared to a prior version by using the comparison feature. (I must point out that I have had some difficulty with Acrobat Pro's ordinary comparison feature. A number of times I have compared documents that clearly have differences, and Acrobat Pro has reported that no changes were made. I get around this problem by using Acrobat Pro's ability to create a Word document from a PDF document. I then run the comparison in Microsoft Word, which always recognizes the differences. I should also note that the ability to run comparisons depends on the quality of the image of the document being reviewed. If the document has gone through a few generations of faxing or copying, the text may become difficult to read by the OCR engine, as well as by the human eye.)
- All related documents may be merged into one PDF file, so that in one window on the screen, the user can quickly jump from one document to the other by using bookmarks.
- Any portion of the document that is difficult to read can be magnified to help decipher the text that is not clear.
- With the subscription to Creative Cloud, the user may store any document in the Adobe cloud for access to the same document by the user's smartphone, tablet, or other computer. ■


# Explaining Estate Funding with Hands-On Examples

By Paige K. Ben-Yaacov

## Introduction

This article discusses certain estate funding calculations, timing issues relating to estate funding, and various provisions that executors and beneficiaries of estates may wish to include in funding agreements.

### Explaining Estate Funding Calculations with a Focus on GST Trusts

The most complicated estate funding calculations arise when the personal representative of an estate is required to fund trusts to which the testator's GST exemption under IRC § 2631 will be allocated (referred to below as "GST Trusts"). Thus, this article focuses on issues that arise when funding GST Trusts, on the theory that if these issues are understood, other funding calculation issues that might arise can be more easily handled. The section of this article titled "Funding GST Trusts" first explains the rationale behind the various funding requirements, then illustrates the means of satisfying these funding requirements with hands-on mathematical examples.

### Timing

Personal representatives and beneficiaries of estates invariably ask early on in the estate administration process, "How long is this going to take?" Clients often want to have things wrapped up within a relatively short time frame (that is, a time frame measured in months rather than years), which probably is not practical or advisable for a taxable estate. Simply achieving finality on the amount of federal estate tax due can take years. The section of this article titled "Timing" addresses why the personal representative of the estate may wish to wait until matters have been settled with the IRS before distributing the assets of the estate to its beneficiaries, as well as other timing issues.

### Funding Agreements

Once the personal representative of the estate is ready to fund, the personal representative and the beneficiaries of the estate may wish to address a number of matters in a written agreement. Among these issues are (1) reserves, (2) assumption of debts and expenses by the beneficiaries of the estate, (3) releases and indemnities, and (4) the documentation of the division of estate assets. The section of this article titled "Funding Agreements" addresses each of these issues.

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## Funding GST Trusts

### Getting to a Zero Inclusion Ratio

When funding a GST Trust, the typical goal is to create a trust that is exempt from the generation-skipping transfer tax (the "GST Tax"). A trust is exempt from the GST Tax if it has an inclusion ratio of zero (the zero inclusion ratio denotes that none of the trust's assets are subject to the GST Tax).

**Inclusion Ratio = 1 – Applicable Fraction.** In general, a trust's inclusion ratio is the excess of 1 over its "applicable fraction." IRC § 2642(a)(1). Thus, to create a GST Trust with an inclusion ratio of zero, the applicable fraction for the trust must be 1.

**Numerator of Applicable Fraction.** The numerator of a trust's applicable fraction is the amount of GST exemption allocated to the properties transferred to the trust. IRC § 2642(a)(2)(A). Thus, for the applicable fraction to be 1, the denominator of the applicable fraction also must be equal to the amount of GST exemption allocated to the properties of the GST Trust.

**Denominator of Applicable Fraction.** The denominator of the applicable fraction is equal to the value of the property transferred to the GST Trust, less certain taxes actually recovered from the trust and any charitable deduction allowed under IRC §§ 2055 or 2522 for the trust property. IRC § 2642(a)(2)(B). Thus, for the applicable fraction to be 1 (resulting in a zero inclusion ratio), the will must require that the GST Trust be funded with properties having a value equal to the amount of GST exemption that will be allocated to the GST Trust. This can be done by way of a fractional share formula or a pecuniary gift.

*Value Under Fractional Share Approach.* Under a fractional share formula, the gift to the GST Trust is a fractional share of the residuary estate. For example, the will could direct that the GST Trust's fractional share of the residuary estate be determined by dividing the testator's remaining GST exemption by the estate tax value of the residuary estate. In such a case, Treas. Reg. § 26.2642-2(b)(1) provides that "in determining the denominator of the applicable fraction, the value of property included in the decedent's gross estate is its value for purposes of chapter 11." "Value for purposes of chapter 11" is not the same as the value of the property on the date the assets actually are distributed to the GST Trust. To illustrate this point, assume the hypothetical facts in Table 1.

| TABLE 1 | |
| --- | --- |
| Remaining GST tax exemption | $5,000,000 |
| Estate tax value of residuary estate | $10,000,000 |
| Value of residuary estate as of date of distribution | $20,000,000 |

Under these hypothetical facts, the GST Trust's fractional share is 50% ($5 million divided by $10 million), meaning the GST Trust would receive assets with a value, as of the date of distribution, of $10 million (50% of $20 million). The $10 million date of distribution value, however, is not the value used for purposes of determining the trust's inclusion ratio. Instead, it is the federal estate tax value of the property distributed to the GST Trust that is the relevant value. The total federal estate tax value of the residuary estate was $10 million and the GST Trust received 50% of those properties, meaning the federal estate tax value of the property transferred to the GST Trust was $5 million (50% of $10 million).

In the example above, the numerator of the applicable fraction also is $5 million (the amount of GST exemption allocated to the properties of the GST Trust), which results in an applicable fraction of 1 ($5 million of GST exemption allocated divided by $5 million of federal estate tax value) and an inclusion ratio of zero (1 minus the applicable fraction of 1). Thus, the personal representative of the estate achieved the testator's goal of creating an exempt GST Trust using a fractional share formula.

*Value Under Pecuniary Gift Approach.* Under a pecuniary gift approach, the testator typically bequeaths to the GST Trust an amount equal to the testator's remaining GST exemption. If the personal representative of the estate funds the GST Trust with cash equal to the amount of the testator's remaining GST exemption (and all of that GST exemption is allocated to the GST Trust), the numerator and the denominator of the applicable fraction are the same, resulting in an applicable fraction of 1 and an inclusion ratio of zero (the same as described in the example above). Treas. Reg. § 26.2642-2(b)(2)(i). If, however, the personal representative of an estate satisfies the pecuniary gift to the GST Trust with property other than cash, Treas. Reg. § 26.2642-2(b)(2)(i) provides that

> the denominator of the applicable fraction is the pecuniary amount only if payment must be made with property on the basis of the value of the property on—
>
> (A) The date of distribution; or
>
> (B) A date other than the date of distribution, but only if the pecuniary payment must be satisfied on a basis that fairly reflects net appreciation and depreciation (occurring between the valuation date and the date of distribution) in all of the assets from which the distribution could have been made.

The language quoted in clause (A) above typically is referred to as "true worth" or "date-of-distribution funding." The language quoted in clause (B) above typically is referred to as "fairly representative funding."

To summarize, if the personal representative of the estate satisfies a pecuniary gift to a GST Trust with assets other than cash, the personal representative must be required to comply either with true worth or fairly representative funding for the denominator of the applicable fraction to equal the pecuniary amount of the gift. In such a situation, the resulting GST Trust effectively should be exempt from the GST Tax because both the numerator and denominator of the applicable fraction should be equal to the pecuniary amount of the gift, resulting in an applicable fraction of 1 and an inclusion ratio of zero.

If the personal representative of the estate is not required to comply with true worth or fairly representative funding when satisfying a pecuniary gift to a GST Trust with property other than cash, the denominator of the applicable fraction is the date of distribution value of the property. Treas. Reg. § 26.2642-2(b)(2)(ii). For example, assume the will provides for a pecuniary gift to the GST Trust of an amount equal to the testator's remaining GST exemption, to be funded based on federal estate tax values. Assume also that the testator's remaining GST exemption is $5 million. If the personal representative of the estate satisfied the gift with property other than cash that had a federal estate tax value of $5 million, but was worth $10 million as of the date of the distribution, the numerator of the applicable fraction is $5 million (the amount of GST exemption available to be allocated to the trust), but the denominator is $10 million (the value of the assets as of the date of distribution). Thus, the applicable fraction is ½ ($5 million divided by $10 million), and the trust's inclusion ratio also is ½ (1 minus the applicable fraction of ½), meaning the GST Trust is not fully exempt from the GST Tax.

State law may prevent the situation described in the preceding paragraph from occurring unless the will explicitly authorized the personal representative to use something other than true worth or fairly representative funding when satisfying a pecuniary gift with property other than cash. For example, Texas law requires either true worth or fairly representative funding when satisfying pecuniary bequests with property other than cash, unless the will provides otherwise. The default rule under Texas law for using property other than cash to satisfy a pecuniary bequest intended to qualify for the federal estate tax marital deduction is fairly representative funding. Tex. Est. Code § 124.052. The default rule under Texas law for using property other than cash to satisfy any other pecuniary bequest is true worth funding. Tex. Est. Code § 124.051. Thus, whether default Texas law would direct the personal representative of an estate to use true worth or fairly representative funding when satisfying a pecuniary bequest to a GST Trust with property other than cash would depend on whether that bequest also is intended to qualify for the federal estate tax marital deduction. Any discussion of other states' laws is beyond the scope of this article.

**True Worth vs. Fairly Representative Funding**

To better compare the results obtained under the funding requirements discussed above, true worth and fairly representative funding are applied below to an expanded version of our earlier hypothetical example.

**Hypothetical Example.** Suppose the facts set forth in Table 2.

**TABLE 2**

| | Values | |
|---|---|---|
| Estate Assets | Date of Death | Dist. Date |
| Cash | $3,000,000 | $6,000,000 |
| Blackacre | $3,000,000 | N/A (sold) |
| Redacre | $4,000,000 | $3,000,000 |
| Partnership Int. | $5,000,000 | $11,000,000 |
| Gross Value | $15,000,000 | $20,000,000 |
| Less DET | ($5,000,000) | N/A (paid) |
| Net Value | $10,000,000 | $20,000,000 |
| Pecuniary Gift to GST Trust | | $5,000,000 |

The hypothetical facts set forth above assume that, other than income from the sale of Blackacre, no income was earned during the estate administration, and Blackacre was sold for $8 million, resulting in $6 million of cash on the date of distribution ($3 million starting cash, plus $8 million proceeds from sale of Blackacre, less $5 million debts, expenses, and taxes).

Under the facts set forth above, the net value of the estate doubled during the period of administration.

**True Worth Funding Results.** If the personal representative of the estate is required to comply with true worth funding, the gift to the GST Trust can be satisfied in a number of different ways.

*True Worth Funding with Depreciated Assets***.** The personal representative can fund the GST Trust with all of Redacre, valued at $3 million on the date of distribution, plus $2 million cash, resulting in assets with an aggregate value of $5 million on the date of distribution being funded to the GST Trust. Under this scenario, the personal representative would use assets with a basis of $6 million ($2 million cash, plus Redacre's basis of $4 million) to satisfy a pecuniary gift of $5 million, which is analogous to the personal representative selling assets with basis of $6 million in exchange for $5 million. Thus, the personal representative of the estate would need to consider the potential income tax consequences of funding with depreciated assets.

*True Worth Funding with Appreciated Assets.* Alternatively, the personal representative could fund the GST Trust with 45.5% of the partnership interest, which would be analogous to the personal representative's selling assets with a basis of approximately $2.3 million (45.5% of the total basis of the partnership interest) in exchange for $5 million. In that situation, funding would result in capital gain.

*True Worth Funding with Cash.* Note that the personal representative could fund the GST Trust with $5 million cash, which would not trigger gain or loss.

*True Worth Funding Summary.* There are multiple ways in which the personal representative might choose to comply with true worth funding in the hypothetical example presented above. The income tax consequences may vary depending on the assets the personal representative selects to fund the GST

Trust, but the GST Trust always must receive assets with a value, as of the date of distribution, of $5 million.

**Fairly Representative Funding Results.**

*No Official "How-to" Examples.* Neither the Treasury Regulations nor any cases provide examples illustrating how a personal representative should fund on a "basis that fairly reflects net appreciation and depreciation (occurring between the valuation date and the date of distribution) in all of the assets from which the distribution could have been made." Treas. Reg. § 26.2642-2(b)(2)(i).

*Historical Insight*. The fairly representative funding requirement in Treas. Reg. § 26.2642-2(b)(2)(i) is based on an earlier version of the fairly representative funding requirement found in Rev. Proc. 64-19. Although there are some minor differences between the wording of the fairly representative funding requirements in Treas. Reg. § 26.2642-2(b)(2)(i) and Rev. Proc. 64-19, the substance essentially is the same. Rev. Proc. 64-19, 1964-1 C.B. 682 ("the fiduciary must distribute assets, including cash, fairly representative of appreciation or depreciation in the value of all property thus available for distribution in satisfaction of such pecuniary bequest or transfer"). Therefore, understanding the rationale behind Rev. Proc. 64-19 can be instructive in formulating a funding plan designed to comply with fairly representative funding.

Rev. Proc. 64-19 represented a compromise between Treasury officials and the taxpayers' representatives in response to Treasury's concerns regarding the funding of marital gifts with assets valued at estate tax values. See Stanley M. Johanson, *Marital Deduction Planning* 161, 231–32, Ctr. for Am. and Int'l Law Estate Planning Course (Apr. 28–30, 2010). The reason for Treasury's concerns can be illustrated by assuming a marital deduction pecuniary gift of $5 million that the taxpayer decides to fund with $1 million cash and the Redacre property referenced in the hypothetical example above (as noted above, Redacre has a $4 million federal estate tax value but is worth only $3 million as of the date of distribution). Under these hypothetical facts, the marital gift has received assets with an estate tax value of $5 million but a fair market value on the date of distribution of only $4 million. As noted by Prof. Johanson, "the result would be instant depreciation in the value of the marital deduction amount," thereby reducing the value subject to estate tax on the death of the surviving spouse. Id. In this example, the marital gift depreciated by 20% despite the fact that the overall estate doubled in size.

These same concerns are present in the funding of a pecuniary gift to a GST Trust, but in reverse. In that situation, the concern is that the taxpayer would fund the gift with appreciated assets, thereby increasing the value of trust assets that are intended to be exempt from the federal estate tax for so long as they remain in trust.

The concerns that led to Rev. Proc. 64-19 and, later, Treas. Reg. § 26.2642-2(b)(2)(i) suggest that the focus in a fairly representative funding should be to make the increase or decrease in the value of the pecuniary gift from date of death to date of distribution mirror the increase or decrease in the overall value of the estate.

*Indirect Support from Case Law*. Although no cases directly address the proper method for complying with fairly representative funding, three cases indirectly support the theory that fairly representative funding requires the increase or decrease in the value of the pecuniary gift from date of funding to date of distribution to mirror the increase or decrease in the overall value of the estate.

In *Jacob v. Davis*, the Court of Special Appeals of Maryland held that a trustee under a will was required to account for his failure to fund a marital trust when the will called for fairly representative funding and the marital trust would have been funded with over $80,000 if funding had occurred on the testator's date of death (the pecuniary amount of the gift to the bypass trust was $600,000). *Jacob v. Davis*, 738 A.2d 904, 915–16 (Md. Ct. Spec. App. 1999). The trustee ultimately failed, however, to fund the marital trust. The trustee in *Jacobs* explained his failure to fund the marital trust by stating that the total assets available on the date of funding did not exceed $600,000 (the amount of the testator's credit against estate and gift taxes), and the trial court accepted the trustee's explanation.

On appeal, the *Jacob* court held that, under the fairly representative funding method, if the assets of the estate depreciate, "the Marital Trust would be diminished on a pro rata basis with the Family Trust and would absorb no more than its pro rata share of such decrease." Id. The court continued, "In light of this mandatory directive we do not see how the Marital Trust could be legitimately 'wiped out' by a decrease in overall value, when the Family Trust bequest remained intact." Id. The *Jacob* court held that the trial court should not have accepted the trustee's failure to fund the marital trust without a better explanation. The court reserved making a decision, however, on whether the marital trust ultimately should have been funded until the trustee could provide a full accounting.

In *Estate of Goutmanovitch* and *Estate of De St. Aubin v. Commissioner*, a New York Surrogate's Court and the U.S. Tax Court, respectively, opined in dicta that fairly representative funding effectively "converts a pecuniary legacy to a fractional one." *Estate of Goutmanovitch*, 432 N.Y.S.2d 768, 773 (Sur. Ct. 1980); *Estate of De St. Aubin v. Commissioner*, 76 T.C.M. (CCH) 409, 417–18 (1998). If that is true, then under the hypothetical example presented above, fairly representative funding would result in the GST Trust receiving assets that had doubled in value from the date of death to the date of funding, just as occurred in the hypothetical example presented in the section above discussing fractional shares. Both *Goutmanovitch* and *De St. Aubin* were focused, however, on interpreting and applying the requirements of minimum worth formula clauses in cases in which a beneficiary argued that it was entitled to a share of appreciation. Thus, the courts discussed fairly representative funding in each case only for comparative or historical purposes.

Each of these three cases suggests that fairly representative funding should operate in a manner similar to fractional share funding. But, because of the limited application of fairly representative funding to the facts in each opinion, it is not clear to what degree these courts would expect fairly representative funding to produce a result similar to that obtained in fractional share funding. Still, these cases do provide indirect support for a conclusion that the increase or decrease in the value of the pecuniary gift from the date of funding to the date of distribution should mirror the increase or decrease in the overall value of the estate.

*Hypothetical Non-Pro Rata Funding Example.* For purposes of making a true comparison to the true worth funding examples illustrated above, this funding example uses the same hypothetical facts, which are set forth in Table 3.

| TABLE 3 | | |
|---|---|---|
| | Values | |
| Estate Assets | Date of Death | Dist. Date |
| Cash | $3,000,000 | $6,000,000 |
| Blackacre | $3,000,000 | N/A (sold) |
| Redacre | $4,000,000 | $3,000,000 |
| Partnership Int. | $5,000,000 | $11,000,000 |
| Gross Value | $15,000,000 | $20,000,000 |
| Less DET | ($5,000,000) | N/A (paid) |
| Net Value | $10,000,000 | $20,000,000 |
| Pecuniary Gift to GST Trust | | $5,000,000 |

These hypothetical facts assume that, other than income from the sale of Blackacre, no income was earned during the estate administration and Blackacre was sold for $8 million, resulting in $6 million of cash on the date of distribution ($3 million starting cash, plus $8 million proceeds from sale of Blackacre, less $5 million of debts, expenses, and taxes).

In the hypothetical example above, the net value of the estate's assets doubled in value during the estate administration (from $10 million to $20 million). Thus, if the increase in the value of the GST Trust from the date of death to the date of distribution should mirror the overall increase in the value of the estate assets, the personal representative should fund the GST Trust with assets having a value, as of date of distribution, of $10 million (that is, double the amount of the pecuniary gift).

As is the case under a true worth funding regime, the personal representative of the estate has multiple options available for satisfying the pecuniary gift to the GST Trust with assets having a fair market value of $10 million. But, unlike in a true worth funding situation, the personal representative tasked with complying with fairly representative funding requirements also may be required to fund the pecuniary gift to the GST Trust with assets having an aggregate estate tax value equal to the amount of the pecuniary gift. See Rev. Proc. 64-19, 1964-1 C.B. 682 (requiring minimum worth or fairly representative funding only when the will provides that a pecuniary gift may be satisfied by distributing assets in kind that are "valued at their values as finally determined for Federal estate tax purposes"). Alternatively, to avoid recognizing gain or loss on funding, the will might require the personal representative to fund the pecuniary gift to the GST Trust with assets having an aggregate income tax basis equal to the amount of the gift (estate tax value and income tax basis are not always the same, as discussed further below). The remainder of this article, however, assumes that the will in question requires the personal representative to value each asset distributed in kind to the GST Trust at its federal estate tax value or, if the asset was acquired after date of death, at its income tax basis (an asset's federal estate tax value or income tax basis, as applicable, is referred to as "Tax Value" below).

In the hypothetical example above, it would be possible to fund the pecuniary gift to the GST Trust with assets having an aggregate Tax Value of $5 million and an aggregate fair market value, as of the date of distribution, of $10 million by funding the GST Trust with approximately 17.3% of Redacre and approximately 86.2% of the Partnership Interest, in Table 4.

| TABLE 4 | | |
|---|---|---|
| GST Trust receives | Tax Value | Dist. Date FMV |
| 17.3% Redacre | $690,000 | $518,000 |
| 86.2% P'ship Int. | $4,310,000 | $9,482,000 |
| Total | $5,000,000 | $10,000,000 |

Although Table 4 above illustrates a funding in which all funding requirements are met, sometimes the fairly representative funding and the Tax Value "funding requirement" may be in conflict. The remainder of this section discusses that issue, as well as issues relating to income tax basis, fair market value of fractional interests, and other fractional interest funding issues.

(i) Tax Value. It may not always be possible to satisfy both fairly representative funding and the Tax Value "funding requirement." For example, assume that the personal representative in the hypothetical example above sold all of the estate's assets in exchange for stock in ABC, Inc. one day before the date of funding. That stock would have both a fair market value and a Tax Value of $20 million (because the stock was acquired after date of death, its Tax Value is its income tax basis). Therefore, it would be impossible to fund the GST Trust with stock having a Tax Value of $5 million and a fair market value as of the date of distribution of $10 million. Instead, the personal representative would be forced to fund the GST Trust either with stock valued at $5 million on the distribution date or stock valued at $10 million on the distribution date. Fortunately, this problem would not arise under Treas. Reg. § 26.2642-2(b) in a situation in which the personal representative sells assets for cash because Treas. Reg. § 26.2642-2(b) would allow the personal representative to satisfy a pecuniary gift to a GST Trust with cash. If a conflict does arise between the Tax Value requirement and fairly representative funding, however, the personal representative will need to carefully consider the best way to resolve the conflict.

As a first step, the personal representative might consider whether the two funding requirements are so closely interrelated that the Tax Value requirement must be satisfied to comply with fairly representative funding. Despite the fact that fairly representative funding arose because of estate Tax Value funding formulas, Treas. Reg. § 26.2642-2(b)(2)(i) does not require that pecuniary gifts be funded on the basis of estate Tax Value to satisfy fairly representative funding. Instead, Treas. Reg. § 26.2642-2(b)(2)(i) requires fairly representative funding if satisfaction of a pecuniary amount "must be made with property on the basis of the value of the property on . . . [a] date other than the date of distribution." This suggests that fairly representative funding may be satisfied even if properties are not distributed on a Tax Value basis. At least one commentator agrees, stating that "[b]ecause it may not be possible or prudent to have date-of-death value of the distribution equal to the amount of marital deduction *and also* have date-of-distribution value fairly represent the appreciation or depreciation in the estate, the latter requirement will be followed even if the former is not." See Elliott M. Friedman, *Choosing the Property Formula Marital Bequest (What We Don't Know Might Hurt Us)*, 58 Taxes (CCH) 632, 640, Sept. 1980.

As a next step, the personal representative should consider the consequences of not complying with either requirement. If the personal representative does not comply with fairly representative funding, the denominator of the GST Trust's applicable fraction will be the aggregate value of the trust property as of the date of distribution. The personal representative needs to consider the potential GST Tax consequences of such a result and weigh those consequences against income tax issues and fairness to the beneficiaries under the will.

(ii) Income Tax Basis. The funding illustrated in Table 4 funds the pecuniary gift with assets having an aggregate income tax basis equal to the amount of the gift. Courts and commentators have acknowledged that fairly representative pecuniary bequests do not result in taxable gain or loss on funding "because the basis of the assets distributed equals the value of the obligation satisfied." *Estate of De St. Aubin*, 76 T.C.M. at 417; see, e.g., Richard B. Covey, *The Marital Deduction and the Use of Formula Provisions* 100 (2d ed. 1978). Of course, such statements may assume that the basis and Tax Value of the assets distributed are the same, which may not be the case. For example, if the partnership in which the estate held an interest earned income that was allocated to the estate without corresponding distributions, the basis of the partnership interest might exceed its Tax Value.

(iii) Fair Market Value of Fractional Interests. Table 4 illustrates a funding that results in the pecuniary gift to the GST Trust receiving assets with a fair market value, as of the date of distribution, of $10 million, but this assumes that a fractional share of Redacre has a value that is proportional to the value of Redacre as a whole. This may not be the case. Often, the value of a partial interest in real property will be worth less than a pro rata share of the property as a whole because of the nature of a fractional interest.

In contrast, one advantage to funding with a limited partner interest is that the value of a portion of the limited partner interest probably is proportional to the value of the interest as a whole, particularly if the holder of a 99% limited partner interest has no more control over the partnership than the holder of a 1% limited partner interest.

(iv) Other Fractional Interest Funding Issues. Another point raised by funding with fractional interests relates to the nature of the assets. By its nature, a partnership is designed to be owned by multiple parties. Splitting a partnership interest formerly held by one party into multiple interests should not result in some of the difficulties that occur when multiple parties own undivided fractional interests in real estate. These issues, along with other issues that arise in the transfer of assets (for example, admission of assignees to a partnership or possible rights of first refusal in the case of real estate or partnership interests) all need to be analyzed by the personal representative before funding.

*Pro Rata Fairly Representative Funding Example*. As an alternative to the non-pro rata approach, the personal representative could fund the pecuniary gift to the GST Trust with assets valued at $10 million by means of a pro rata distribution (that is, distributing to the GST Trust one-half of each asset held in the estate on the date of distribution), which would result in the GST Trust being funded as in Table 5.

**TABLE 5**

| GST Trust receives | Tax Value | Dist. Date FMV |
|---|---|---|
| ½ Cash | $3,000,000 | $3,000,000 |
| ½ Redacre | $2,000,000 | $1,500,000 |
| ½ P'ship Int. | $2,500,000 | $5,500,000 |
| Total | $7,500,000 | $10,000,000 |

Under this example, the overall increase in the value of the pecuniary gift from the date of death to the date of distribution mirrors the overall increase in the value of the estate (doubling), but the GST Trust receives assets with a Tax Value in excess of the pecuniary amount.

In this hypothetical example, a pro rata distribution will never fund the GST Trust with assets that have a Tax Value equal to the amount of the gift *and* fund the GST Trust with assets that mirror the overall increase in the value of the estate. The reason relates to the sale of Blackacre. The sale of Blackacre increased the amount of cash in the estate, which increased the Tax Value of the assets available for distribution.

If the facts of the hypothetical example were altered to eliminate the need for a sale of assets to satisfy debts, expenses, and taxes, a pro rata funding would have satisfied both the Tax Value requirement and fairly representative funding. For example, consider the modified example presented in Table 6.

If the GST Trust had received 50% of the assets available for distribution, the result would have been as in Table 7.

**TABLE 6**

| | Values | |
|---|---|---|
| **Estate Assets** | **Date of Death** | **Dist. Date** |
| Cash | $5,000,000 | $0 |
| Blackacre | $1,000,000 | $6,000,000 |
| Redacre | $4,000,000 | $3,000,000 |
| Partnership Int. | $5,000,000 | $11,000,000 |
| Gross Value | $15,000,000 | $20,000,000 |
| Less DET | ($5,000,000) | N/A (paid) |
| Net Value | $10,000,000 | $20,000,000 |
| Pecuniary Gift to GST Trust | | $5,000,000 |

This shows that, absent a sale of appreciated or depreciated assets, a pro rata funding can satisfy both the Tax Value requirement and fairly representative funding. Indeed, commentators generally recognize that fairly representative funding may be satisfied by a pro rata funding, which is referred to by some as the easy way to satisfy fairly representative funding. Jeffrey N. Pennell, 843-2nd T.M., *Estate Tax Marital Deduction* A-138; see also Johanson, supra, at 233. Commentators also generally agree that a pro rata distribution under fairly representative funding should be "functionally the same as a fractional share of the residue bequest." Pennell, supra, at A-138; see John T. Sheets, Assistant Chief, Estate and Gift Tax Branch, Tax Rulings Division, Internal Revenue Service, *Determination of the Interest in Property Passing to the Surviving Spouse by Section 2056 of the Internal Revenue Code of 1954 and Revenue Procedure 64-19*, Speech at Chicago Bar Ass'n, at 26 (Dec. 1, 1964) ("The construction adopted by Rev. Proc. 64-19 treats bequests covered by its provisions as bequests of fractional shares."). It may be that these commentators were focusing only on the fairly representative funding requirements and not considering the fact that the will also might contain a Tax Value requirement. Alternatively, perhaps the commentators were not considering a situation in which estate assets were sold during the period of estate administration at a gain or loss.

Interestingly, in *Ellis Estate*, the court declined to hold that "the *necessary effect* of [fairly representative funding] is to wipe out the use of pecuniary formulas and replace them all with fractional share formulas." *Ellis Estate*, 7 Pa. D. & C. 3d 42, 48 (Pa. Ct. Com. Pl. 1977) (emphasis added). In *Ellis Estate*, the court was asked to determine whether a pre-residuary gift of a pecuniary amount to a marital trust was transformed into a residuary gift of a fractional share by reason of the fairly representative funding requirement contained in the will, thereby increasing the pool of assets available to satisfy the marital gift and reducing the value of assets that would pass to charity. In that case, the court declined to do so, but the court's holding did not rule out the possibility that, in the right circumstances, a pro rata fairly representative funding might function the same as fractional share funding.

If pro rata funding may be used to satisfy fairly representative funding, one advantage is that revaluation of the assets on the date of distribution should not be necessary. In the hypothetical example above, the net value of the estate assets doubled between the date of death and the date of distribution. But, even if the net value of the estate assets had tripled in value or decreased by 75%, satisfying the pecuniary gift to the GST Trust with one-half of each asset available for distribution would cause the change in the value of the pecuniary gift to the GST Trust to mirror the overall change in the net value of the estate assets. Therefore, if a personal representative wishes to avoid re-valuing estate assets on the date of distribution, the personal representative instead might give the pecuniary gift to the GST Trust a fractional share of each asset available for distribution, with the fraction to be determined by dividing the amount of the pecuniary gift by the net value of the estate assets on the decedent's date of death (or alternative valuation date, if applicable).

### Funding Summary

Under a fractional share formula, the value of the assets received by each share increases or decreases proportionately to the value of the estate overall, and funding should not result in gain or loss. In the hypothetical example above, this resulted in the gift to the GST Trust being funded with assets having a fair market value, as of the date of distribution, equal to $10 million.

In contrast, under true worth funding, the pecuniary gift is guaranteed to receive assets with a value, as of the date of distribution, equal to the amount of the gift, but funding may trigger gain or loss (depending on the value and basis of the assets used to fund the gift). In the hypothetical

**TABLE 7**

| GST Trust receives | Tax Value | Dist. Date FMV |
|---|---|---|
| ½ Blackacre | $500,000 | $3,000,000 |
| ½ Redacre | $2,000,000 | $1,500,000 |
| ½ P'ship Int. | $2,500,000 | $5,500,000 |
| Total | $5,000,000 | $10,000,000 |

example above, the GST Trust was funded with assets valued at $5 million under a true worth funding, as opposed to the $10 million received by the GST Trust under a fractional share approach. Of course, if the overall value of the estate had decreased from the date of death to the date of funding, the GST Trust would have received assets valued at *less* than $5 million as of the date of distribution under a fractional share approach. Under the true worth funding, the value of the assets passing to the GST Trust would not decrease below $5 million unless the net value of the entire estate decreased below $5 million.

The results under fairly representative funding were the same as those under the fractional share approach in terms of value (that is, in the hypothetical example, the GST Trust received assets with a value, as of the date of distribution, equal to $10 million). The income tax consequences, however, are not entirely clear when the pecuniary gift is funded with assets that have an income tax basis that differs from the amount of the gift. In addition, a will that requires fairly representative funding also may impose a Tax Value requirement, which might prevent the personal representative from making a pro rata distribution of assets, which should not be the case under a fractional share approach.

## Timing

### Don't Fund Until Asset Values Are Finally Determined (and Any Estate Taxes Are Paid)

**Final Determination of Asset Values.** As illustrated by the above examples, it is not uncommon for a testator to provide for the residuary estate to be divided among multiple beneficiaries based on the amount that can be sheltered from the federal estate tax or the testator's remaining GST exemption amount under IRC § 2631. In such a situation, the amount of the non-exempt gifts would depend on the overall value of the testator's estate. Thus, the personal representative would not be able to determine the relative amounts of the gifts under the will until a final determination has been made regarding the value of estate assets.

Further, if the personal representative wishes to satisfy a gift with assets in kind before a final determination of the value of those assets, the personal representative runs the risk that the IRS might disagree on the value of the assets used to fund the gift. Although the focus of the IRS in an estate tax audit is the value of the assets as of the decedent's date of death (or alternative valuation date, if applicable), if the IRS objects to the method used to value the assets for estate tax purposes, the personal representative (and beneficiaries) may have concerns if the assets used to fund a gift on a later date are valued using that same method.

**Personal Liability.** "Personal liability" is a two-word phrase that always seems to catch the attention of clients. Section 3713(b) of 31 U.S.C. provides that "[a] representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government." If an estate has ample funds to pay all debts, expenses, and taxes, the personal representative may feel comfortable making a partial distribution to the beneficiaries, but any time that a distribution is made, the personal representative must determine the amount that should be paid to each beneficiary (assuming multiple beneficiaries), determine how this distribution might affect the calculations required in future distributions, consider whether to ask for releases and indemnities, and so on. The more distributions a personal representative makes, the more expense and hassle will be involved in the estate administration. Therefore, it would be better if the beneficiaries can wait until the personal representative can distribute all or substantially all of the estate assets in one fell swoop.

**Tax Controversy Expenses.** If the personal representative wishes to fund before knowing whether the IRS will audit the estate tax return or before a final settlement or court decision regarding the amount of any estate tax deficiency, the personal representative will have difficulty determining the amount of expenses that might be incurred in dealing with the IRS (let alone the other expenses that will be incurred during the course of the estate administration). If a personal representative decides to fund before resolving any potential dealings with the IRS, the personal representative will have to reserve an estimated amount for future expenses or enter into an agreement with the beneficiaries regarding the payment of future expenses. Unless the personal representative also is the beneficiary of the estate, the latter option likely will be undesirable to the personal representative. Under the former option, the more conservative approach would be to overestimate the amount of the reserve fund. A reserve that ends up being larger than the amount of expenses incurred will lead to multiple distributions from the estate, which will increase the hassle and expense of the estate administration.

Another issue with funding before knowing what expenses might be incurred in settling a tax controversy is that the amount of estate expenses might affect the personal representative's ability to determine the value of the properties that should be distributed to the beneficiaries under the will. This might be an issue when the will uses a fractional share formula or when the personal representative wishes to comply with fairly representative funding by distributing a pro rata share of each estate asset to the residuary beneficiaries. As illustrated above, fractional share formulas and satisfaction of fairly representative funding through a pro rata distribution of assets involve the creation of a fraction representing the share of the estate to which each beneficiary is entitled. Alan N. Polasky, *Marital Deduction Formula Clauses in Estate Planning: Estate and Income Tax Considerations*, 63 Mich. L. Rev. 809, 840–44 (1965); Jeffrey N. Pennell, 843-2nd T.M., *Estate Tax Marital Deduction* A-138 (comparing fairly representative funding to the funding of fractional shares). If estate expenses must be subtracted from the denominator of that fraction, the personal representative will need to know the amount of estate expenses to calculate those fractions.

### How Long Will It Take?

For the reasons set forth above, in an estate in which an estate tax return is due, if at all possible, the personal representative of a taxable estate should wait to fund until the federal estate tax return has been filed, a final determination of the amount of federal estate tax due has been made, and the tax (and interest, if applicable) has been paid. This means that, in these types of estates, funding may not occur for some time after the decedent's death. The federal estate tax return is not due until nine months after the decedent's death, and the due date may be extended automatically for an additional six months (and some estates will require the personal representative to use all 15 months to prepare the federal estate tax return!).

On top of this, the IRS might choose to audit the estate tax return. If the IRS does so, the time before funding is likely to be lengthy. If matters are going to be resolved at the audit stage, that resolution must occur within three years after the date the estate tax return is filed, but that already might be more than four years after the decedent died. If matters cannot be resolved at the audit stage, the process can be extended for years after that. Despite this daunting prospect, there are good reasons for waiting to have matters settled with the IRS before funding.

### Lag Time

Even after the personal representative of the estate is ready to fund, it is not unusual for there to be some time between the effective date of the funding and the actual distribution of assets. If there are multiple residuary beneficiaries, and the personal representative of the estate is not distributing a pro rata share of each asset to each of them, the personal representative likely will need to know the value of the assets on the date of funding. For estates holding a large number of assets or assets that are hard to value, it will not be possible for the personal representative of the estate to determine asset values in one day and then complete funding on that same day. Thus, it is typical for the personal representative and the beneficiaries to agree on a funding effective date (usually, to make accounting easier, the end of a month or a year). After the funding effective date, the personal representative can complete the valuation process and the logistical details necessary to complete the funding. The personal representative and the beneficiaries may wish to enter into a funding agreement to document the funding effective date and various other matters, some of which are discussed in the next section.

## Funding Agreements

### Reserves

**Expense Reserve.** No matter how close the personal representative is to wrapping up the estate administration, there will always be final estate expenses. For example, expenses will be incurred to file the final income tax return, to accomplish the distributions (for example, the preparation of transfer documents and possibly filing fees), and so on. The personal representative should review prior expenses and consult with an accountant, attorney, and other advisors to identify what expenses might arise post-funding and decide on an appropriate reserve amount.

**Debt Reserve.** The personal representative may need to retain a reserve for any debts that are not yet due or otherwise remain unpaid. For example, there may be an outstanding loan that prohibits pre-payment. If so, and if all other estate administration matters have been completed, the personal representative and the beneficiaries may agree that the personal representative should retain a reserve sufficient to allow the personal representative to satisfy those debts in the future.

As a side note, if there is outstanding debt, a distribution of all or substantially all of the assets of the estate may trigger consent rights of third parties or result in a default under the loan documents. Thus, it may be necessary to obtain the consent of the parties to whom the debt is owed if the debt will not be satisfied before funding.

### Assumption of Debts and Expenses

**Outstanding Debts.** If the personal representative does not wish to retain a reserve to satisfy any outstanding debt, the personal representative and the beneficiaries might agree to have one or more of the beneficiaries assume the outstanding debt, subject to approval by the parties to whom the debt is owed.

**Unknown Debts; Future Expenses.** The funding agreement should address the payment of any unknown debts and any expenses that might arise in the future that exceed any reserves retained by the personal representative. Under the funding agreement, such debts and expenses should be assumed by one or more of the beneficiaries. If more than one beneficiary assumes those debts and expenses, the funding agreement should address the manner in which the debts and expenses should be allocated between or among them. Even though the will or default state law provides for the apportionment of debts, expenses, and taxes, it is better to address the issues in a funding agreement to avoid questions of interpretation post-funding.

### Releases and Indemnities

**Releases.** Speak now or forever hold your peace! It is not uncommon at the end of an estate administration for the personal representative to ask the beneficiaries for a release from any liability relating to the administration. In asking for a release, the personal representative is attempting to achieve some finality for his or her responsibilities. In the absence of a release, it is hard for the personal representative to feel comfortable that finality has been achieved because there may be a claim relating to the estate that will need to be defended in the future. On the other hand, requesting a release may prompt a beneficiary to consider what claims the beneficiary might have, ask questions, or otherwise investigate how the estate was handled, and perhaps bring a claim that otherwise might not have been brought. On balance, however, if a beneficiary has some claim, the personal representative likely is in a better position to defend against that claim while memories are fresher, documents and other materials are easier to find, and the personal representative is still serving in that role. For those instances in which requesting a release is appropriate, sample release language is provided in the appendix on page 63.

**Indemnities.** The personal representative may request that the beneficiaries indemnify the personal representative for any claims relating to the estate administration. The personal representative may be particularly interested in obtaining indemnities when some of the beneficiaries are minors or when estate assets will pass to trusts of which some of the beneficiaries may be unknown at the time of the distribution. An attorney representing a beneficiary might seek to limit the scope of the indemnity (for example, to claims brought by the beneficiary or the beneficiary's descendants) or might advise a beneficiary to decline to give an indemnity altogether. Sample indemnity language also is included in the appendix.

**Involvement of Independent Counsel.** Although sample release and indemnity language is provided, any release or indemnity needs to be customized to reflect the specific circumstances of the estate administration. Often, the release and indemnity language is negotiated by the attorneys representing the interested parties. Although the personal representative cannot force the beneficiaries to obtain independent counsel before giving a release or indemnity, the personal representative should encourage the beneficiaries to do so. It should be harder for a beneficiary represented by counsel to claim that the release and indemnity provided by a beneficiary is unenforceable. The agreement itself can recite whether the beneficiary was represented and, if not, that the beneficiary was encouraged to obtain independent counsel. The agreement also can provide that the agreement should not be construed against any particular party merely because that party's attorney drafted the agreement. Sample language relating to this issue and other representations that the parties may wish to include in agreements containing releases and indemnities is provided in the appendix.

**Disclosure.** The personal representative and the beneficiaries should discuss the information to be provided to the beneficiaries before the


**The agreement containing the releases and indemnities should make reference to the consideration.**

beneficiaries provide any releases or indemnities. The agreement containing the releases and indemnities should include a provision under which the beneficiaries agree that they have been provided with full and adequate information. The agreement also should state that the beneficiary has received full access to the books and records of the estate and waives any further disclosure. Including this language may prompt the beneficiary to request additional information, which is easier to provide at this point instead of years later in the context of defending a claim. The thought here is to get everything on the table and have it dealt with now instead of later. Sample language relating to the provision of information to the beneficiaries is included in the appendix.

**Consideration.** The agreement containing the releases and indemnities should make reference to the consideration. The consideration for the releases and indemnities will vary depending on the circumstances of the estate administration. One common form of consideration, however, is for the personal representative to forgo obtaining a judicial release unless in defense of a claim relating to the estate administration or unless required to do so by a court of competent jurisdiction. Forgoing a judicial release can end the estate administration sooner and save expenses that otherwise would reduce the value of the assets passing to the estate beneficiaries.

### Documenting Division of Assets

Documenting the manner in which the funding complied with the provisions of the will and applicable state and federal laws is important for a number of reasons. As discussed above, an estate administration may be a lengthy process. A lot can happen during that process, and questions regarding funding may not arise until years later (particularly when the beneficiaries of the estate are trusts that are designed to last for as long as possible under state law). In that situation, it may be helpful to have a road map to help answer those questions. In fact, depending on when the questions arise, the personal representative and other parties who were involved in the funding may no longer be available to answer questions, which could make a funding agreement documenting the manner in which the funding occurred the only place to go to for answers.

In addition, the process of writing down the manner in which the funding complies with the provisions of the will and applicable state and federal laws can help to identify issues that otherwise might have been overlooked or to highlight better methods of achieving the desired goals. In fact, if the personal representative and beneficiaries choose not to enter into a funding agreement, the personal representative still may wish to document the manner in which the funding complied with the provisions of the will and applicable law in a memorandum. If so, it would be best for the personal representative's attorney to draft the memorandum and send it to the personal representative. The attorney may need help from the personal representative's accountant or others in preparing a funding memorandum, but issues related to the attorney-client privilege should be considered when doing so.

## Conclusion

From the date of death to the date of funding, the personal representative will have many issues to face and many decisions to make. Waiting to fund until the amount of estate tax due has been settled can make some of those issues and decisions easier and the estate administration more efficient. Once it is time to fund, however, the personal representative and the beneficiaries should consider entering into a funding agreement.

Debts and expenses always need to be addressed in a funding agreement, whether by way of reserves, assumption of debts and expenses, or the effect on the value of the properties received by the beneficiaries.

Releases and indemnities may or may not be included in a funding agreement, but, if they are included, it is desirable for both the personal representative of the estate and the beneficiaries of the estate to have independent counsel representing them in the negotiation of those releases and indemnities.

Finally, the funding agreement also should document the manner in which the personal representative complied with funding requirements contained in the will and applicable state and federal law, whether those funding requirements are in the context of a fractional share formula, true worth funding, fairly representative funding, or some other funding regime. The manner in which the personal representative chooses to satisfy those funding requirements will depend on a number of factors, some of which have been addressed above. ■

## APPENDIX

### Sample Release Language

The Releasing Parties hereby release, acquit, and discharge [name(s) of personal representative], individually and as Personal Representative and all persons acting for or on behalf of Personal Representative (collectively, the "Released Parties" and each a "Released Party"), with respect to any and all rights, claims, demands, liabilities, and causes of action (INCLUDING, WITHOUT LIMITATION, ANY CLAIM FOR NEGLIGENCE OR GROSS NEGLIGENCE), whether now known or unknown, in connection with, arising from, or attributable to the administration of the Estate and [insert other specific matters if desired] (collectively, the "Matters"), and for all other acts and omissions, if any, of any of the Released Parties regarding the Matters.

### Sample Indemnity Language

The Releasing Parties hereby agree to indemnify each Released Party from any and all claims, demands, liabilities, and causes of action (INCLUDING, WITHOUT LIMITATION, ANY CLAIM FOR NEGLIGENCE OR GROSS NEGLIGENCE) [brought by the Releasing Parties, or anyone claiming by, through, or under any of the Releasing Parties], whether now known or unknown, in connection with, arising from, or attributable to the Matters, including attorney's fees and costs incurred in defending against any such claim, demand, or cause of action that is threatened or brought against any of the Released Parties.

### Sample Language Regarding Scope of Releases and Indemnities

The full and complete releases and indemnities provided for in this Agreement shall survive and be binding upon the Releasing Parties and each such Releasing Party's heirs, beneficiaries, personal representatives, administrators, executors, trustees, successors, and assigns, as applicable, and shall inure to the benefit of the Released Parties and each Released Party's heirs, personal representatives, successors, or assigns, as applicable. Further, the releases and indemnities provided for in this Agreement are intended to provide the broadest protection possible to the Released Parties, and, in the event of any dispute, shall be interpreted in a manner designed to achieve that intent.

### Sample Representations

[Insert name] acknowledges that he/she/it has been represented by [insert name of law firm]. [Repeat first sentence as necessary for each party.] Further, each Party represents and agrees that (i) before executing this Agreement, such Party read this Agreement, (ii) such Party has entered into this Agreement freely and voluntarily, (iii) such Party desires to be bound by this Agreement, (iv) such Party has fully informed himself or itself of the terms, conditions, and effects of this Agreement, (v) such Party has not relied on any other Party for advice regarding the consequences of this Agreement, and (vi) such Party has full capacity and is not acting under fraud or duress. Each Party further agrees that, in the event of any dispute regarding this Agreement, this Agreement shall not be construed against any Party merely because of the involvement of that Party's counsel in the preparation and negotiation of this Agreement. Each of the Parties acknowledges that that Party's independent legal counsel has explained to the Party the meaning and legal consequences of executing this Agreement and specifically the releases and indemnifications and the legal rights the Party may be waiving or releasing by executing this Agreement and that the Party is not relying upon any other Party to explain those consequences.

### Sample Language Regarding Information Provided to Beneficiaries

The Releasing Parties acknowledge and agree that each of them (i) has received full access to the books and records of the Estate; (ii) has obtained sufficient and full information, including financial, accounting and legal advice, upon which to enter into this Agreement; (iii) has reviewed such information to the extent desired by that Party; (iv) has made such investigation as that Party deems necessary to enter into this Agreement; (v) has received all information requested by such Party; and (vi) waives any further disclosure.

# Norm's Rules of Practicing Law, Negotiating, and Drafting

In over 40 years of practice, I have learned, and incorporated into my practice, a number of concepts and beliefs, many learned from others and all learned from experience. Here are some of my favorites.

1. Treat your clients like your loved ones. To plan for spending the correct amount of time on a project, ask yourself whether you would charge your loved one "full boat" for what you are doing and the approach you expect to take. If you can't answer "yes," re-evaluate your approach—you may be overworking the project. When negotiating a point, consider the time involved and the importance of the issue, and again ask yourself if your loved one really cares and would pay for you to continue negotiating.

2. Keep your client informed on a current basis. This includes copying your client on substantive correspondence and e-mails. Think of it this way: if you weren't feeling well, went to your doctor, had some lab work done, and then didn't hear from your physician with the results, would you assume that everything was okay; or would you be concerned (and angry) that you didn't know and had not heard? To a client, you are the physician.

3. Focus first on what the client needs, then on what the client wants. If you don't get what the client needs, the "wants" generally are irrelevant.

4. If you don't understand why you are doing something or why your client needs it done, you won't negotiate properly or successfully. As a corollary, remember the adage—if you "ass u me" that you know the "why," then you will likely make an "ass" out of "u" and "me."

5. The only really stupid question is one that is not asked. All other questions are varying degrees of good.

6. When dealing with someone in government, always ask the individual if he or she can help you find a solution. If you tell the official the solution you expect, without first asking the official for help and possible solutions, the official likely will tell you that you are wrong.

7. Don't argue with me when I have agreed with you; otherwise, I may change my mind.

8. If you can't reply substantively to someone immediately, consider replying briefly, with a time when they can expect your substantive response.

9. When you have a big pile of things to do and all of these things have equal priority, find the things that you can do quickly and do some of those first—the pile will be smaller, and you will feel better.

10. When you have a big pile of things to do and all of these things have equal priority, first tackle what you least like to do. Everything after that will be more interesting.

11. If you leave what you like to do least for later, you may never get to it.

12. Teach individuals; train pets and other animals.

13. If someone says that something you drafted is unclear or ambiguous, he is right—change it.

14. Write a memorandum like a reporter writes an article—put the important points in the first three paragraphs; otherwise they may not be read.

15. Every draft of a document should represent your best effort. If you are planning to "clean it up later," it will take more time and probably not be as good as it would have been if you had given it your best effort in the first place.

16. When you have completed your first draft of a document, try to extrapolate an outline from it. If the outline has a logical order, move on; if not, reorganize the draft until you can extrapolate a logical outline.

17. Unless you are drafting a will or trust, it doesn't really matter if you use "will" or "shall"—just be consistent throughout the document.

18. In drafting avoid, whenever possible, the use of "ee" and "or" such as lessee and lessor, mortgagee and mortgagor, or grantee and grantor. Instead use terms that are less likely to be inadvertently interchanged, such as landlord and tenant, lender and borrower, owner and purchaser, or even the party's respective names.

19. It doesn't matter if you draft using "Landlord" or "the Landlord," "Tenant" or "the Tenant," "Seller or "the Seller," and so on—just be consistent.

20. Unless it is a substantive issue, resist correcting the opposing counsel's drafting. At best, you may embarrass him or her; at worst, he or she may view you as trying to show that you are smarter or a better lawyer and fight harder or argue more to prove you wrong.

21. Don't "reply all" to an e-mail from the other lawyer if the other lawyer's client was copied, unless you have express permission, preferably in writing, from the lawyer to communicate with the lawyer's client directly. Instead, at the very least, delete the other lawyer's client from your reply. Otherwise, you are likely violating a variety of ethical rules by having contact with the other side's client without express permission.

22. Never forget: The only thing better than a happy client is a happy client that talks about you, and the only thing worse than an unhappy client is an unhappy client that talks about you. ■

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