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Malpractice Issues and The Uniform Trust Code

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A considerable amount of discussion and concern has arisen regarding potential malpractice issues associated with the Uniform Trust Code ("UTC"). Most of the UTC malpractice issues involve the failure to disclose the potential decrease in asset protection available to beneficiaries in jurisdictions that adopt the UTC. This malpractice discussion has primarily focused on issues of the settlor suing the drafting attorney, a beneficiary suing the drafting attorney, a beneficiary suing the trustee, and the obligation of an attorney to inform clients of safer alternative forums.

I. Background

Prior to the passage of the UTC, the common law and most state laws provided relatively similar asset protection for beneficiaries of non-self-settled trusts, which included a discretionary-support dichotomy and spendthrift protection. Exceptions to spendthrift provisions ("exception creditors"), if any, were limited to relatively small classes: (1) alimony and child support; (2) necessary expenses of a beneficiary; and (3) governmental claims.[1] In addition, a trustee could pay a debtor beneficiary's expenses to a service provider for the benefit of a beneficiary rather than paying distributions directly to the beneficiary, thereby avoiding potential taking by a beneficiary's creditor.

Several articles have discussed in detail the significantly decreased asset protection available following changes to the common law by the UTC and Restatement (Third) of Trusts ("Restatement Third").[2] Some of the concerns addressed by these publications are as follows:

- The UTC and Restatement Third abolish the 125-year common law distinction between a discretionary trust and a support trust.[3] By abolishing the common law distinction, discretionary trusts must now rely on spendthrift protection for their asset

protection value. Two types of trusts owe their existence to the discretionary trust/support trust dichotomy. Traditionally, special needs trusts were trusts created for children with physical or emotional handicaps. Further, many high net worth trusts have relied on the discretionary trust–support trust dichotomy as an integral part of wealth preservation planning.

- Increased remedies would be available to an exception creditor preventing a trustee from directly paying the expenses of the beneficiary and permitting an exception creditor, and <u>possibly any creditor</u>, to attach a beneficial interest in the trust itself. The creditor could then wait for future distributions to satisfy the claim.[4]

- The increased UTC remedies would allow for the judicial foreclosure sale of all beneficial interests by exception creditors.[5] This would include current distribution interests (i.e., income interests) as well as remainder interest from both discretionary and support trusts.

- The UTC most likely creates a property interest in all current beneficial interests[6] as well as remainder interests.[7] In many states, consequentially, beneficial interests will be classified as marital property and distributed as part of marital property in a divorce and, further, may be used to impute trust income for the purpose of child support or alimony computations.[8]

- Under the UTC and Restatement Third, a spouse has the ability to force a distribution to satisfy a claim for child support or alimony from all discretionary trusts as well as support trusts.[9] Further, the spouse may seek the payment of legal fees directly from the trust.[10]

- Depending upon how a special needs trust is drafted, the creation of a property interest or a sufficient enforceable right may result in a third-party special needs trust being classified as an available resource. This may well result in beneficiary disqualification from governmental aid.[11]

- A bankruptcy trustee, standing in the shoes of a debtor/beneficiary, may be able to force a distribution from the trust on behalf of all creditors due to the creation of a property interest or a sufficient enforceable right.[12]

- The UTC treats inter vivos general powers of appointment as the equivalent of ownership, permitting any creditor to attach and exercise the general power of appointment.[13]

II. The Alternative – A Non-UTC State

Fortunately, the UTC does not mandate that clients create trusts in their own state.[14] Settlors have the ability to create a trust in a jurisdiction with more favorable trust laws than those of a UTC state. In other words, a client has the ability to forum shop. This being the case, from an asset protection perspective, would a client end up in a better position by creating a trust in a non-UTC jurisdiction?

If the case went as far as the U.S. Supreme Court, many commentators have expressed different views regarding what law would be applicable under conflict of law principles.[15] However, principals of conflict of laws are not the primary issue in the mind of the settlor or beneficiary when a malpractice claim is brought. The issue is whether the attorney had adequately informed the settlor or beneficiary of the costs and benefits of using a non-UTC state and whether more of the beneficiary's interest would have been preserved using a non-UTC jurisdiction. Unfortunately, for the estate planner or trustee who fails to disclose or resolve these issues, there is little doubt that a settlor or a beneficiary could easily find an expert witness who would testify in the affirmative.

III. The Claim

In order to see the magnitude of the issues involved, this article analyzes the following typical situations that occur with a trust.

- A beneficial interest is deemed marital property and divided between divorcing spouses, or income is imputed from a beneficial interest to determine the amount of child support or alimony due from a beneficiary.
- Child sues mom for discretionary distributions from a family trust.
- A court on behalf of an exception creditor allows a judicial foreclosure sale of a beneficiary's interest.

Estranged Son or Daughter-in-Law

Daughter marries. Subsequently, in order to save estate tax, parent's estate planner advises them to create a standard QTIP and credit shelter trust. The parents noted that during the daughter's marriage, the son-in-law did not have a job and the daughter provided most of the financial support for the family. Since the parents have a negative opinion of the son-in-law, the estate planner advised that the credit shelter trust be a discretionary trust. Several years later, mom passed away and the trustee funded the QTIP and the credit shelter trusts. A bank was appointed trustee, an independent trustee within the meaning of IRC § 672(c). Several years later, the state legislature passes the UTC. This scenario presents several ethical questions. Does either the estate planner or the trustee have an affirmative obligation to notify Dad or the beneficiaries of the decreased asset protection when the UTC becomes effective and suggest the possible alternative of moving the trust to a non-UTC state to preserve trust assets for the daughter as originally intended?

Assuming the estate planner and the trustee were unaware of the issues involved with the UTC, neither one affirmatively notifies the client of these issues. Eight years later, the value of the QTIP has grown from a half million dollars to $1 million dollars and the value of the credit shelter trust has grown from $1.5 million dollars to $3 million dollars. The daughter and son-in-law begin divorce proceedings. The estranged son-in-

law advances the following legal arguments in the divorce: Under the newly created theory of a continuum of discretionary trusts, the daughter has a property interest in the current beneficial trusts interest.[16] The daughter has a property interest in the remainder.[17] The daughter should have income imputed from the trust for the purpose of calculating child support and alimony.[18]

Under the daughter's applicable state law, inheritance is not marital property. However, the increase in value of any inheritance is marital property. Therefore, the son-in-law claims that half of the increase in value of the remainder interest as well as half of the increase in value of the discretionary interest are both marital property. Finally, to add insult to injury, the estranged son-in-law claims that his legal fees incurred to challenge the trust, should be properly reimbursed by the trust under UTC §503(b).

The court determines that the current distribution interest lies somewhere on the undefined continuum of discretionary trusts. By placing it somewhere on this undefined continuum, the court then decides how much the beneficiary has an enforceable right to demand a distribution each year. This becomes the annual imputed distribution amount. The court then determines the estimated return on the trust assets, the anticipated period of time that the daughter should receive the annuity distribution, and then applies a present value factor to this discount stream. The present value of the discretionary distribution amount is divided between the separate and marital property components. The marital property component of the estimated value of the annuity stream is then eligible in the division of marital property.

The court then decides to follow the minority line of cases that a remainder interest is a property interest eligible for division. While the UTC and Restatement Third did not start this growing minority trend, the positions taken in these pronouncements strengthen such a position.[19] As such, the court determines that the remainder interest is a property interest under state law, and that under state law such property interest is considered marital property.

In the trial court's equitable discretion, the court concludes that the trusts are making $200,000 a year, and that the daughter had a right to demand $50,000 a year from the by-pass trust for the purpose of alimony and child support. The court concludes that in addition to using the $50,000 to determine the marital property value of the current distribution interest, the $50,000 imputed distribution amount should also be used to compute child support. As such, the daughter's share of child support is increased by approximately 1/4 for $12,500 a year.

A summary of the amounts attributable to the marital property interests under the UTC are as follows:

- $30,000 in attorney fees;
- $12,500 a year child support;
- $217,000 present value of the current distribution interest
- $1 million present value of the remainder interest.

Does the beneficiary have a malpractice claim against the drafting estate planning attorney or trustee for failing to advise the beneficiary of the possible better outcome by simply using a non-UTC state? Since the court held the daughter had an enforceable right (i.e., a property interest) to demand $50,000, if she does not exercise the right is such non-exercise the release of a general power of appointment, which would be subject to gift tax? If the daughter passes away, is the non-exercise of the right to demand $50,000 a general power of appointment included in the daughter's estate for estate tax purposes? What if the trustee had made a $100,000 distribution to the daughter before the divorce, is the distribution applied on a FIFO (i.e., first in, first out), LIFO (last in, last out), or weighted average basis between marital and non-marital components of the trust?

Child Sues Mom For Distributions From a Family Trust

Mom and dad have two children. One of the children is able to manage his own affairs, but one son has an alcohol dependency problem and also has problems getting along with mom. Mom and dad have a net worth of approximately two million dollars and most of the assets are highly appreciated. Approximately $1.5 million of these assets are in dad's name. Dad contracts cancer and is expected to pass away in the next year. Due to the problems with the one son, the estate planner recommends a discretionary distribution standard in the bypass trust created by dad's will. Dad passes away and the bypass trust is created and funded with dad's $1.5 million of assets. A couple of years later the UTC passes. Due to the notice requirements contained in the UTC and the trust,[20] mom must notify the troublesome son regarding his interest. Upon consultation with an attorney, the son realizes that he now has an enforceable right in a discretionary trust to sue the trustee and demand a distribution pursuant to the distribution standard. The trust now incurs the legal fees to defend against the troublesome son. The trust may also be liable for the son's legal fees under UTC §503(b). A judge awards the troublesome son a distribution amount of $2,000 a month based on the discretionary trust language.[21] The judge makes this determination by computing the trust income as a 5% return and dividing by the number of beneficiaries, giving a slight preference to mom's current distribution interest.[22] When the will was created, Mom was advised that the purpose of creating the family trust was to save estate taxes. Mom was not advised that one of her children could sue her over what she viewed as her marital assets. Does mom have a malpractice claim against the drafting attorney for failing to advise her of the problems associated with the UTC and the possibly better results that might be obtained in a non-UTC state?

Judicial Foreclosure Sale of a Beneficiary's Interest

The comment to UTC §501 allows for a judicial foreclosure sale of a beneficiary's current distribution interest or the remainder interest by an exception creditor. Under UTC §503(c) an exception creditor includes any federal claim to the extent provided by a future statute. Assume the federal government passes a statute stating that all federal claims are exception creditors under UTC §503(c). Further,

assume that a child has both a current distribution interest and a remainder interest based upon age vesting. The client is the only beneficiary of the trust and the amount of trust property is $2 million. The child is twenty-five years old, and the vesting schedule provides that one-third of the trust property shall vest at age 30, one-half of the remaining trust property at age 35, and the balance at age 40. Pursuant to the terms of the trust, the trustee has the power to change the governing law of the trust. The child purchases a house and later learns of a $1million environmental liability on the property. The court orders the judicial foreclosure sale of both the current distribution interest and the remainder interest. The purchaser at the judicial foreclosure sale buys both trust interests for $500,000. Does the child have a malpractice claim against the trustee for $1.5 million for the trustee failing to move the trust to a non-UTC state where the beneficiary may well have had a more favorable result?

IV. The Motive For Non-Disclosure of Non-UTC States

With all of the asset protection issues associated with the UTC, one might easily conclude that all estate planners will spend an hour or two discussing these issues with the client and discuss the more favorable alternatives available in non-UTC states. Some estate planners will even create a disclosure form and have each client sign the form indicating that the client was advised about the relevant issues under the UTC. While some attorneys might think this will provide them some degree of protection in a perfect world, others will likely conclude that some significant exposure still exists, and still others will have no idea of their malpractice exposure. Consider the following:

- Many attorneys are only part time estate planners, will not have read the literature regarding the UTC's changes to common law, and will be completely unaware of the issues;

- Many clients will be unwilling to pay for an hour or two of an attorney's time to explain the multitude of problems under the UTC as they affect the client's interests;

- Most estate planners are licensed in only one state and will be reluctant to either forego their fees or share fees on a co-counsel basis with an attorney in a non-UTC jurisdiction;

- The estate planning attorney will ruin valuable referral relationships by advising the client to move the trust and underlying liquid assets to a non-UTC state; and

- A corporate trustee will not want to lose trustee fees by referring a client to an out-of-state trustee in a non-UTC state.

With regard to the first issue, the UTC and Restatement Third change over a century of common law with regard to the discretionary-support trust distinction and over

four centuries of common law with regard to settlor intent in a discretionary trust. Since the promoters of the UTC have been professing that the UTC is the common law, many estate planners will be completely unaware of the issues until it is too late. The estate planners will only discover later at their peril that the UTC is not the same as the common law.

Regarding the second issue, most clients are fee sensitive. Further, they are more interested in paying for viable solutions and advice as to why something works as contrasted with why something does not work. Therefore, when explaining how trust law works under a UTC state, many clients may decide not to use a trust or to forego the additional expense of learning the bad news regarding trusts in UTC states.

Third, some estate planners have learned how to "value" bill and to negotiate value, but not price. In this respect, there are a wide range of fees between those who have learned to market to the higher end of the market and those who sell at the low end of the market. However, the majority of the estate planners will be in the middle of the market. Generally, the average price for many types of estate planning trusts may be between $4,000 and $7,000. How much room is available in these fees for a co-counsel arrangement with an attorney in another jurisdiction if such a co-counsel arrangement is permitted under the attorney rules of ethics in both states? In determining whether there is any room to share estate planning fees, one must remember that most estate planners draft with quite a few different drafting options for the same client fact pattern. In this respect, there is a significant increase in the amount of time spent by the two attorneys while various tax, administrative, family and jurisdictional issues are reconciled between co-counsel. In many, if not most cases, there just will not be enough "fat" within the standard estate planning fee to make it economically feasible to co-counsel the estate planning engagement.

With these facts in mind, the estate planner should realize that there well may be a significant decrease in revenue when forum shopping and using the laws of a different state. However, a client is not concerned with an estate planner's bad motive or lack of profit for failing to advise the client about more favorable trust laws. The client is concerned with how much the client or a beneficiary potentially loses by being in a UTC jurisdiction compared to the outcome in a non-UTC state.

However, the most problematic of the above five scenarios is that an estate planner does not advise a client about potentially more favorable forums, because he or she will lose referral relationships and future business by recommending that the client situs the trust as well as the liquid assets outside of UTC states. A law review article has been published regarding the malpractice issues associated with attorneys who failed to advise high net worth trusts to move to more favorable income tax-free jurisdictions.[23] The law review article is titled, *South Dakota Trust Amendments and Economic Development: The Tort of Negligent Trust Situs.* The article states that the choice of a state in which to establish a trust is as critical as the decision to create the trust. This leads to the unavoidable question: Can or should estate planners, lawyers, institutional trustees and money managers be liable for avoidable costs incurred by a trust because of

its situs when they knew or should have known that such costs were attendant to the selection of a situs? The article explores the common situation of the attorney who refused to forego trust preparation compensation by sending the trust business out of state to a state that did not impose any state income tax on trust property. The article then posed the question - at what point does the attorney or advisor become exposed to a claim for professional negligence for failure to refer?

For example, if the trust property is valued at $10 million and the trust terms provide that all income be accumulated, the taxable income is 4%, and the state income tax 5%, the annual unnecessary state income tax each year would be $20,000. Over a ten-year period, the state income tax savings resulting from moving a trust to a non-taxable jurisdiction would compound to approximately $250,000. Many of us would conclude that a quarter of a million dollars might well be large enough so that the threshold for a claim for negligent trust situs has been reached. However, if the trust held $50 million, the state income tax savings over ten years would be close to $1.25 million. At this point, most of us would agree that the threshold for a claim of negligent trust situs has been reached. This was the point of the article. At some point, the trust assets have been unnecessarily depleted. Liability should exist for the unnecessary depletion. The conclusion is based in part upon an examination of the Model Rules and other materials.[24]

A minor extension of the trust state income tax "tort of negligent trust situs" would be to apply the rule to a situation where the underlying trust corpus is lost in a lawsuit because the trust had a situs in a UTC state.[25] All estate planners realize that certain jurisdictions have income tax advantages. If the failure to properly situs a large trust in a low tax or no tax jurisdiction could create liability, then the failure to properly situs the trust in a jurisdiction that has legislation that will protect the trust assets (i.e. a non UTC state) should create an even greater liability. The loss of the underlying asset is of a far greater concern than is the payment of state income taxes on income earned by the same assets. Tax attorneys and estate planners have long wrestled with the concept of trust situs and taxation,[26] but the use of a trust situs to protect the attorney from liability against claims of future trust beneficiaries is a different and far broader concern.

Unfortunately, while the estate-planning attorney is interested in assisting the client accomplish their estate planning goals, they are seldom interested to the point where they will forego their own income by recommending that their affluent clients select another law firm in a non-UTC jurisdiction. Further, there is a second real concern at issue. Let us say that an attorney is willing to co-counsel and forego some of the legal fees. However, the referral came from a local bank that has a trust department or from a financial planner who is looking to manage the investment assets. If the attorney advises the client of a better jurisdiction from an asset protection perspective, the attorney will most likely never receive another referral from the referral source. On the other hand, the attorney faces liability should the attorney not zealously represent the client by failing to inform the client of possibly better asset protection alternatives.

V. Cost to the Client to Move to a Non-UTC Jurisdiction

An estate planner may conclude that the cost to pay a corporate trustee is too high when compared to the asset protection benefit. For this reason the estate planner did not advise the client of the relevant issues. Unfortunately, this is not a decision the estate planner should be making. Rather, the client should be making the decision after the client has been adequately informed[27]. In apprising the client of the relevant costs, there may be an increase in the trust fee of a few thousand dollars, depending on whether the trustee is already a corporate trustee. However, a client does not necessarily need to pay an annual trustee fee based on a percentage of assets. Rather, many trustees will agree to manage a passive interest such as a limited partnership interest or member interest for an annual fee of approximately $2,000 to $5,000 a year. In this sense, the annual cost to receive a more favorable asset protection result in a non-UTC state is quite small compared with the potential loss in a UTC state.

VI. Malpractice Claims

When a client is dissatisfied with the legal advisor advice or services, the client has the right to file a malpractice claim against the attorney whose services were believed to fall short of the applicable standard of care. This claim could be based on many theories, including providing improper legal services, professional negligence, incompetence, the failure to properly advise the client of the uncertainty of law or anticipated results, or as addressed in this Article, the improper selection of law to accomplish the client's desired estate planning or creditor protection goals.

The majority of malpractice claims contain counts based on professional negligence or breach of contract. In order to prevail on a professional negligence claim, the client must prove that (1) a duty existed to use such skill, prudence and diligence as other members of the legal community would commonly have and utilize; (2) the attorney breached this duty; (3) a causal connection exists between the negligence and the injury claimed; and (4) the injury claimed caused actual damages to the client. Claims based on breach of contract have been upheld because of an implied duty in the contract of engagement to exercise reasonable skill, care and diligence even without privity of contract having been extended to third party beneficiaries.[28]

During the last thirty years, the number of suits alleging attorney malpractice in estate planning has skyrocketed.[29] Every year over twenty percent of lawyers in private practice face legal malpractice exposure.[30] When an act such as the UTC radically changes 125 years of established law,[31] claims against attorneys engaged in the drafting of trusts governed by the UTC are expected to increase as the clients or their intended beneficiaries find that planning goals have been frustrated, impaired and possibly ruined. Further, more claims will originate as legal practitioners find it increasingly more difficult to monitor the changing laws, effects of new legislation, legal developments, court decisions and, in addition, fully understanding the consequences of these laws in jurisdictions outside their normal practice area. These changes can affect tax benefits,

creditor protection, administration efficiencies, and differences in trustee's powers, investment powers, principal and income allocation, division and merger of trusts,[32] as well as beneficiary notice provisions.

Client against the Estate Planner

The failure properly to advise a client or to draft a client's documents has resulted in liability for attorneys to their clients. These types of claims are quite common in all areas of law such as the failure to incorporate a business,[33] failure to preserve bankruptcy exemptions,[34]and the failure to advise clients concerning disclaiming property[35] which can be used to protect property from creditor claims but not taxes due the government.[36] However, for this article only, estate planning, asset protection planning or tax claims are the focus of concern.

With the advent of the UTC, additional concerns are presented, as the legal advisor must now consider whether the:

- Failure to inform the client of unfavorable trust law is actionable;
- The UTC will adversely affect the client, the client's spouse, children or other contingent beneficiaries;
- The UTC will permit access (directly or through imputed income theories)[37] to discretionary trusts defeating the rights of other beneficiaries or perhaps resulting in the loss of trust corpus;
- The purpose of multi-generational dynastic trusts will be defeated upon the adoption of a UTC Act in the settlors or trustees jurisdiction;
- If the attorney fails to disclose less favorable local laws; will the attorney be liable for drafting an ineffective plan to someone other than the settlor?
- Choice of law will encourage creditor claims; and
- Trust corpus should also be moved out of the UTC state to avoid the possible application of the UTC's most significant relationship conflict of law rule.[38]

It will become more important than ever to document the client's intentions and preferences as well as the attorney's recommendations. The law continues to evolve in the area of multi-jurisdictional practices. The multi-jurisdictional practices increase the legal advisor's ability to select a more favorable jurisdiction to govern a given situation. The failure to act or to advise the client of the differences in law may create as large of a liability as undertaking the representation and negligently failing to complete the same.

An attorney has a duty to research the law and protect his client's interests.[39] When dealing with unsettled areas of the law, the attorney assumes an obligation to undertake necessary research in order to make informed decisions on how best to implement the client's objectives. The attorney's immunity from malpractice liability is contingent upon the attorney's ability to analyze the law after completion of adequate research of the applicable legal principles and then to properly advise the client or draft the proper

documents to obtain the desired benefits. Failure to conduct research into the law, not just of the state where the attorney is located, but also the more favorable law available in other jurisdictions, will result in increased claims by the beneficiaries against the attorney. Research includes investigating alternatives that other attorneys in the community are using.

According to an Illinois court, it is the duty of every attorney to inform a client of available options for alternative legal solutions, as well as to explain the foreseeable risks and benefits of each. The purpose of such a rule is to enable the client to make an informed decision as to whether the foreseeable risks of a proposed legal course of action are justified by its potential benefits when compared to other alternative courses of action.[40] While this case was in the bankruptcy context, the duty to inform a client of alternatives applies to all areas where an attorney renders advice – including estate planning.

Beneficiary against the Estate Planner

Recent court decisions have eroded the traditional defenses to attorney malpractice claims, including especially the defenses of privity of contract and the statute of limitations.[41] In his law review article, *First Let's Sue All The Lawyers - - What Will We Get: Damages for Estate Planning Malpractice*,[42] Professor Begleiter noted that only six states retained a rule of absolute privity prohibiting will beneficiaries from bringing action against drafting attorneys. The trend away from the requirement of privity of contract has broadened the pool of eligible plaintiffs. Courts have permitted third-party non-clients to sue attorneys for malpractice when the risk of injury was foreseeable. The test in many jurisdictions for determining whether the non-client is entitled to bring a malpractice action are such that that a court will almost always allow a beneficiary under a person's will or trust to pursue such a claim.[43] The beneficiary will hold the attorney responsible for undertaking preparation of estate-planning documents as well as for advise on the finer points of estate, tax or trust law, regardless of his or her own degree of expertise.[44] "The risk of liability for an estate planner is compounded by the relative ease with which a harmed beneficiary often can prove causation and damages"[45] In most beneficiary estate planning malpractice claims, causation and damages are readily provable … proximate cause is obvious and damages are established by the value of the legacy that would have been received."[46]

When considering that errors in the estate plan are not discoverable for many years, the cost of remedying the error or the additional tax consequences may be substantially increased or may be remedial.[47] The estate-planning attorney will be responsible for work far longer than attorneys practicing in other areas of law that contain shorter statute of limitation periods. The person discovering the error will most likely not be the client with whom the attorney had a long and trusting relationship. The aggrieved party will likely be a more distant and frustrated beneficiary who believes the attorney's actions were negligent and adversely reduced the amount available to the beneficiary. The failure could be due to a creditor appropriating an inheritance, additional payment of income or estate taxes, the invasion of discretionary or support trusts and loss of trust

corpus. Mistakes and omissions in the estate-planning area are far more treacherous for legal advisors because many different areas of the law are involved. The greater the complexity facing the planner, the higher is the risk of making a mistake and committing malpractice.[48]

Once the client's lifetime and testamentary objectives have been frustrated, the intended beneficiaries will be consulting their own legal advisors looking for a way to claim against the attorney who was unable to advance the client's objectives. The attorney is responsible for doing all things reasonably necessary to fulfill the objective of employment, which requires the anticipation of reasonably foreseeable risks.[49] It seems logical to believe that every attorney is striving to carry out the client's intentions or they would not have accepted the engagement. However, the fact remains that an increasing number of lawsuits are based on the failure of an attorney to meet this objective.[50]

Beneficiary against the Trustee

The fiduciary duties of a trustee are of the highest "known to law.[51]" Further, "a trustee must discharge his or her duties in the interest of the beneficiaries, provide disinterested advice, avoid conflicts of interest, and disclose any potential conflicts of interest."[52] In addition to being liable under a breach of fiduciary duty for failing to disclose potential conflicts, a trustee may also be liable under negligent misrepresentation. In the context or a relationship of trust with a depository client，a bank was liable for failing to disclose to a client the financial condition of an entity having an account with the bank.[53] If a bank can be liable for failing to disclose financial condition without a special relationship, why would a corporate trustee not be liable for failing to disclose material issues to a client when there is such a special relationship? This would be the case particularly if a corporate trustee had multiple attorneys working in its trust department with years of trust experience. In such a case, it would be hard to argue the corporate trust department did not know or did not have reason to know that its state laws regarding the asset protection of beneficial interests was most likely inferior to almost all of the common law states.

The duty of a trustee to inform a beneficiary is a continuing duty. Therefore, where the estate planner may be able to argue that a statute of limitations has passed, such generally will not be the case for a trustee. Also, as between a corporate bank trustee and an estate planning attorney, which defendant has the much deeper pocket? In most cases, this will be the corporate trustee. Further, while the original estate-planning attorney may have used poor judgment in selection of the situs of the trust, in most estate planning documents, the trustee has the power to change the governing law or situs of the trust. In many cases, the failure of the trustee to act will be problematic. Does a trustee not have a fiduciary obligation to exercise this power on behalf of beneficiaries to protect their interests? While both the drafting estate-planning attorney and the trustee will be named as defendants in negligent situs types of cases, the corporate trustee appears to have greater financial exposure.

Trial attorneys can well be expected prey upon all trustees under the negligent situs type of arguments; unfortunately, in-state corporate trustees are most likely the prize trophy. All trustees have a duty to inform. All corporate trustees should know or have reason to know of the shortcomings of their local laws and the more favorable trust laws protecting beneficial interests in non-UTC states. However, it is the in-state corporate trustee, who may lose trust business by not disclosing the more favorable law that has a true conflict of interest. The in-state trust companies profits were made at the expense of the beneficiary's losses.

VII Conclusion

If the plan of a client or beneficiary has been impaired because of the passage of the UTC, unlike the state income tax issue, the situation is universal and does not apply only to high net-worth trusts. Rather, the situation applies to trusts of all sizes. As noted in the examples, the loss exposure to a client or a beneficiary is quite large. Further, the magnitude of a client's or a beneficiary's frustration will most likely increase when he or she learns that he or she may have received a much more favorable outcome under the laws of a non-UTC state. This is particularly true, when the annual cost of employing an out of state trustee to manage a passive interest may be as low as $2,000 to $5,000 a year.

At this point, the client or a beneficiary may now turn to one or both of the following persons to seek recovery for the possible new tort of negligent trust situs: (1) the estate planner; (2) the trustee. Even if the common law does not develop the name, "negligent trust situs," it is still relatively easy for a trial attorney to argue that a duty of care has been breached or argue for the negligence of the trustee or legal advisor. This creates a dilemma for the estate planner: Does the estate planner forego part of his or her attorney fees and risk irreparably damaging referral relationships from local bankers, local trust companies and financial planners by prudently disclosing the potential large decrease in asset protection in UTC states? In the case of multi-state bank, the multi-state bank may not actually have such a dilemma. The multi-state bank may merely send a written disclosure of the issues to the client, and then merely offer to change the situs of the trust and move the underlying investment assets to a non-UTC state. On the other hand, in-state corporate trustees face a much greater dilemma: How much business will an in-state corporate trustee lose by prudently disclosing the possible better asset protection for beneficiaries in non-UTC states? The damages under the possible new tort of negligent trust situs is compounded by the bad motives of estate planning attorneys and trustees not counselling a client and/or the beneficiaries about a more favorable outcome in non-UTC states.

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[1] The exception creditor for attorney fees for a beneficiary (or creditor standing the in the shoes of a beneficiary) bringing an action against the trust was not widely adopted at common law. However, it is codified by UTC §503(b).

[2] Merric and Oshins, *The Effect of the Uniform Trust Code on Spendthrift Trusts,* Estate Planning, August, September, and October of 2004, Volume 31, No. 8, 9, & 10; Merric,

Stein, and Freeman, *The Uniform Trust Code and Asset Protection in Non-Self Settled Trusts,* Leimberg Listee, September 20, 2004; Merric, Stevens, and Freeman, *The Uniform Trust Code – A Divorce Attorney's Dream,* The Journal of Estate Planning, October/November 2004; Merric and Stein, *The Effect of the UTC on Special Needs Trusts,* Trusts & Estates, November 2004; Merric, Stevens, Freeman, Gillen, Sullivan, Harowitz, and Stein, *The Uniform Trust Code – What Does it Really Do?*- outline at www.InternationalCounselor.com.

[3] *Uniform Trust Code*, §504 and the first comment thereunder; *Restatement (Third) of Trusts*, §60, comment a.

[4] *Uniform Trust Code*, §501.

[5] *Uniform Trust Code*, §501, comment, paragraph two, last sentence.

[6] While *Comins v. Comins,* 595 N.E.2d 804 (Mass. App. 1992) was decided before the UTC and Restatement Third, both the UTC and Restatement Third provide the legal fame work to hold that a current distribution interest is a property interest eligible for division in a divorce. Absent the new continuum of discretionary trust theory, the holding in *Commins*, had little, if any, legal support.

[7] Merric, Stevens, and Freeman, *The Uniform Trust Code – A Divorce Attorney's Dream,* The Journal of Estate Planning, October/November 2004.

[8] *Dwight v. Dwight,* 756 N.E. 2d 17 (Mass. Ct. of App. 2001).

[9] *Uniform Trust Code*, §504(c)(1).

[10] *Uniform Trust Code*, §503(b).

[11] Merric and Stein, *The Effect of the UTC on Special Needs Trusts,* Trusts & Estates, November 2004;

[12] Upon the filing of a bankruptcy, the bankruptcy estate receives all of the assets of the debtor. 11 U.S.C. §541. Due to the decrease in the threshold of the judicial standard of review to good faith, all beneficiaries of a discretionary trust have an enforceable right may well hold a property interest under state law. This property interest would become part of the bankruptcy estate. Also under §541, the bankruptcy trustee stands in the shoes of the bankrupt for all purposes. Does the recognized right in UTC §504(d) combined with the creation of a property interest by lowering the judicial standard of review to good faith mean that the bankruptcy trustee may now exercise the beneficiary's rights to force a distribution on behalf of all creditors?

[13] Taking a distinctly minority view, the UTC provides that an inter vivos GPA is the equivalency of ownership. Under the definitions of §103(10), an inter vivos GPA is classified as a "power of withdrawal." Pursuant to §603(a), to the extent a person holds a power of withdrawal, he or she is classified as the settlor. A settlor has no spendthrift protection. Finally, pursuant to §505(b)(1), a creditor of the power holder may reach any property subject to an inter vivos GPA.

[14] While the UTC does not mandate that the client create trusts in the state where the settlor resides, the UTC does present some portability problems should a client wish to move the trust after the UTC is effective. Under UTC §107(d)(5), all beneficiaries must consent.

[15] Gideon Rothschild, Daniel S. Rubin, Jonathan G. Blattmachr, *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Whole Bunch?*, 32 Vand. L. Rev. 763 (1979).

[16] *Comins v. Comins,* 595 N.E.2d 804 (Mass. App. 1992).

[17] *Balanson v. Balanson,* 25 P.3d 28 (Colo. 2001).

[18] *Dwight v. Dwight,* 761 N.E.2d 964 (Mass. 2001). *Dwight v. Dwight* is one of the first cases to reference to the Restatement Third in this area. Although poorly written, the case did come to the correct conclusion based on this new theory of trust law – a discretionary interest is no longer merely an expectancy and a judge could impute the amount that the beneficiary should be receiving, regardless of whether the beneficiary received a dime.

[19] The UTC and Restatement Third create enforceable rights that will be classified as a property interest in all most all beneficial interests, current distribution interests and remainder interests. Further, all beneficial interests, current distribution interests and remainder interests, may be sold at a judicial foreclosure sale, and the UTC and the Restatement Third for the most part dispense with the contingent and indefinite sale of remainder interest rule under the Restatement (Second) of Trusts § 161.

[20] In many states, by statute there may already be a notification requirement prior to the adaptation of the UTC.

[21] The Restatement Third suggests that a court when looking at the purpose of the trust should give preference for a surviving spouse over the other beneficiaries. While the Restatement Third states a judge should give preference, it does not say how much preference. Further, the legal costs to defend an action have already been born by the parties and the trust to determine how much each judge would allocate and under which circumstances. Finally, the UTC does not mention any such preference for a surviving parent.

[22] As applied to this example, *Restatement Third,* §50, comment g(1) specifically states that a court should give preference to Mom in tax motivated situations. However, if it were not for the UTC and the Restatement Third creating the "continuum of discretionary trusts," the unruly son would have never had standing in the first place. In this sense as well as many others, the continuum of discretionary trusts" is much more likely a "continuum of continuing litigation."

[23] *South Dakota Trust Amendments and Economic Development: The Tort of "Negligent Trust Situs" At It's Incipient Stage?* Michael J. Myers and Rollyn H. Samp, South Dakota Law Review 1998/1999 44 S.D.L.Rev. 662.

[24] *Asset Protection Strategies, Volume II*, Alexander A. Bove, Jr., editor, Robert D. Gillen, Author Chapter 17, Attorney Liability for Assisting in Asset Protection, to be published by the American Bar Association.

[25] It should be noted that do to the many material changes to the pure UTC, the word "uniform" is beginning to lose its meaning. This article addresses the pure UTC. Each practitioner will need to determine how much his or her state version of the UTC has potentially exposed beneficial interests to creditor attack.

[26] Max Gutierrez, Jr.'s presentation at the 36th Heckerling Institute entitled "The State Income Taxation of Multi-Jurisdictional Trusts - The New Playing Field" reviewing how much nexus a trust must have with a state for that state to constitutionally impose a tax.

[27] See *Williams v. Ely*, 668 N.E.2d 799 (Mass. 1996).

[28] *Lucas v. Hamm*, 56 Cal.2d 583,588 (1961); *Morales* v. *Field, DeGoff, Huppert & MacGowan* (1979) 99 Cal.App.3d 307, 316.

[29] Martin D. Beglieter, "*Attorney Malpractice in Estate Planning - You've Got to know When to Hold Up, Know When to Fold Up*", 38 Kan. L. Rev. 193, 193 (1990).

[30] Manuel R. Ramos, "*Legal Malpractice: The Profession's Dirty Little Secret*", 47 Vand. L. Rev. 1657, 1667 (1994).

[31] *Uniform Trust Code*, §504; see also the first comment thereunder; *Restatement (Third) of Trusts*, §60, comment a.

[32] *Uniform Trust Code,* §417 requires that notice be given to qualified beneficiaries for even such an essential action as dividing generation skipping trusts to produce inclusion rations of one or zero.

[33] See *Gunn V. Mahoney*, 95 Misc. 2d 943, 408 NYS2d (1978).

[34] *In Re Swift*, 129 F3d 792 (5th Cir. 1997). An action for negligence can be maintained for damages.

[35] *Kramer v. Belfi*, 106 App. Div. 2d 615, 482 NYS2d 898 (1984).

[36] *Drye v. United States*, 120 S.Ct. 474 (1999). The U.S. Supreme Court restricted the use of disclaimers as an asset protection device for estate beneficiaries by finding that tax-delinquent beneficiaries to avoid pre-existing tax liens may not use disclaimers. Drye owed the IRS $325,000 and all of his property was subject to IRS tax liens at the time his mother died intestate with Drye as her sole heir. Drye executed a valid disclaimer in his mother's probate case and the property then passed by intestacy to Drye's daughter who used the proceeds to fund a trust with herself and her parents as beneficiaries. The disclaimer was not successful in that it did not avoid the attachment of the pre-existing federal tax lien.

[37] Merric, Stevens, and Freeman, *The Uniform Trust Code – A Divorce Attorney's Dream,* Journal of Practical Estate Planning, October/November 2004; Merric and Stein, *The Uniform Trust Codes Effect on Special Needs Trusts,* Trust and Estates, November 2004.

[38] *Uniform Trust Code*, §107 provides the general rule that the choice of law is governed by the trust instrument. However, a court may ignore the general rule by merely claiming the most significant relationship is in the forum state under an undefined "strong public policy" argument. The more relationships that are outside the UTC state, the more likelihood the Supreme Court will hold that the law of the non-UTC state should govern the trust.

[39] *Niziolek v. Chicago Transit Authority*, 251 Ill. App. 537, 620 N.E.2d 1097, 1103 (1993).

[40] *Metrick v. Chatz*, 266 Ill. App.3d 649, 639 N.E.2d 198, 201 (1994).

[41] Roy M. Adams, David A. Herpe, Thomas W. Abendroth, "*Malpractice and Professional Responsibility Issues*", 133 Tr. & Est. 36, 36 (July 1994).

[42] 51 Hastings L.J., 325 (2000).

[43] Adams, et.al., *supra* note 41 at 37.

[44] Adams, et.al., *supra* note 41 at 37.

[45] Adams, et.al., *supra* note 41 at 41.

[46] Gerald P. Johnston, "*Avoiding Malpractice Claims That Arise Out of Common Situations*", Taxes 780, 782 (November 1985).

[47] Johnston, *supra* note 46 at 783.

[48] Johnston, *supra* note 46 at 780.

[49] Ronald E. Mallen & Jeffrey M. Smith, "*Legal Malpractice*" §8.2 at 408 (4th ed. 1996).

[50] Johnston, *supra* note 46 at 794.

[51] *Sassen v. Tanglegrove Townhouse,* 877 S.W.2d 489 (Tex. App. 1994).

[52] Campisi and Crandall, *Representing the Beneficiary in Claims Against Trustees and Corporate Fudiciaries*, ALI June 29, 2000.

[53] *Constance Katz Golber v. Baybank Valley Trust Company*, 704 N.E.2d 1191 (Mass. App. 1999).