# 2026 Estate Planning Forum

Community Foundation
OF SOUTHEAST KANSAS


**Topics**

- Holistic Estate Planning
- Long-Term Care Planning with Farm & Ranch Scenario
- Blended Family Estate Planning


Kansas Legislative Update for 2026

Trust Accounts in Kansas: Clicking Your Heels Won't Fix Bad Decisions

# Welcome

Welcome to the 2026 Estate Planning Forum! We're always excited to host this event for local attorneys, CPAs, insurance professionals, and other professional advisors, and we're glad you've joined us. Here's what you can expect from today's Forum:

- **Learn about common estate-planning problems from long-time practitioners:** The thing about simple wills, holistic estate planning, farm & ranch, blended families and more.
- **Hear some of the latest from the Kansas Legislature:** What's going on in Topeka and what does that mean for our clients.
- **For lawyers: an hour of ethics CLE with a course on trust accounts.**
- **Enjoy complimentary The Balkan coffee, snacks, and lunch from The Blue Spoon.**
- **Enjoy the company of your fellow professionals:** Say hello to old friends or make new ones during the breaks between sessions!

## About us

The Community Foundation exists to encourage charitable giving that improves the quality of life in Southeast Kansas. Thanks to the generosity of our donors—people like your clients, who want to leave a legacy or make a difference in their community—we've awarded over $27 million in grants and scholarships to local nonprofits and students since 2001.

We'll have more to say about the Community Foundation during today's lunch break. Until then, thank you for joining us, and we hope you enjoy today's lessons!

Community Foundation
OF SOUTHEAST KANSAS

# AGENDA

**8:30 – 9:00**
Registration

**9:00 – 9:50**
Trust Accounts in Kansas: Clicking Your Heels Won't Fix Bad Decisions
*Presented by Kathleen Selzler-Lippert*

**10:00 – 10:50**
Holistic Estate Planning
*Presented by Tim O'Sullivan*

**11:00 – 11:50**
Holistic Estate Planning Continued
*Presented by Tim O'Sullivan*

**11:50 – 1:00**
Lunch break

**1:00 – 1:50**
Kansas 2026 Legislative Update
*Presented by Joseph Molina*

**2:00 – 2:50**
Long-Term Care Planning with Farm & Ranch Scenario
*Presented by Tim O'Sullivan*

**3:00 – 3:50**
Blended Family Estate Planning
*Presented by Tim O'Sullivan*

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# Contact

**Timothy P. O'Sullivan**
Senior Counsel
Wheeler & Michelson Chartered
319 N. Broadway
Pittsburg, KS 66762
T: 620-231-4650
E: tosullivan@wm-law.com

**Joseph N. Molina III**
Kansas Bar Association
Robert L. Gernon Law Center
1200 SW Harrison St
Topeka, KS 66612-1806
T: 785-234-5696
E: jmolina@ksbar.org

**Kathleen J. Selzler Lippert**
Office of the Disciplinary Administrator
701 SW Jackson St - First Floor
Topeka, KS 66603-3729
T: 785-435-8200 | F: 785-783-8385
E: Kathleen.Lippert@kscourts.gov

# CONTACT

**Community Foundation of Southeast Kansas**
100 S Broadway St, Ste 100
Pittsburg, KS 66762
T: 620-231-8897 | F: 620-231-0292
E: info@southeastkansas.org
SoutheastKansas.org

# Trust Accounts in Kansas: Clicking Your Heels Won't Fix Bad Decisions

# About Kathleen

Kathleen J. Selzler Lippert, JD, is a graduate of Drake Law School who has dedicated her entire 30-year legal career to public service. She began her career as a prosecutor, initially for a drug task force, and later as an Assistant District Attorney in Shawnee County where she prosecuted felony domestic violence cases, including homicides. She then practiced administrative law for over a decade by serving in a variety of roles for the Kansas State Board of Healing Arts, including Executive Director.

Since December 2019, Kathleen has served as a Deputy Disciplinary Administrator with the Office of the Disciplinary Administrator. She is a wife and mother of three young men who are now embarking on the adventures of adulthood.

**BIOS:**

Kathleen J. Selzler Lippert, JD, joined the Office of the Disciplinary Administrator in 2019 following a 30-year legal career in public service. She began her career as a prosecutor working in both Atchison County and later as an Assistant District Attorney in Shawnee County where she prosecuted felony domestic violence cases, including homicides. She then practiced administrative law for over a decade by serving in a variety of roles for the Kansas State Board of Healing Arts, including Executive Director. She is a wife and mother of three young men who are now embarking on the adventures of adulthood.

**Presentation Title:** Trust Accounts in Kansas: Clicking Your Heels Won't Fix Bad Decisions

**Presentation Description:** Every state has professional rules governing fees and safekeeping of property belonging to clients or others. While the state rules have some similarities, they are often a little or a lot different depending on the jurisdiction. This CLE is only about Kansas rules related to fees (KRPC 1.5) and safekeeping (KRPC 1.15). It is critical to know the specific rules for the jurisdiction where you practice.

**Presentation Outline:**

1. Why it is important.
2. Know the rules.
3. IOLTA vs. Non-IOLTA
4. Characterizing Funds.
5. Record Keeping
6. Avoiding Discipline
7. Quiz

**Learning objectives – By the end of this presentation, participants will be able to:**

1. Recognize how small missteps – neglect, poor communication, sloppy trust accounting – can escalate into serious disciplinary consequences.
2. Identify best practices to protect clients and your practice.
3. Recognize the red flags in your practice before the Board does.

Trust Accounts in Kansas: Clicking Your Heels Won't Fix Bad Decisions

1. Why it is important.
   a. Duty, protection (for you and client), avoid discipline.
2. Know the rules.
   a. The Kansas Supreme Court requires lawyers to certify client trust account compliance on their annual licensing registration KRPC 1.15(e).
   b. KRPC 1.5 (fees) sets forth factors to be considered in determining whether a fee is reasonable, contingent fee requirements and prohibitions, and other duties as it relates to fees.
   c. KRPC 1.15 (safekeeping) sets forth requirements for record keeping, prompt notice and delivery requirements, defines IOLTA and other trust accounts.
   d. Five caretaker duties: (1) Segregation, (2) Prompt Notification, (3) Prompt Payment or Delivery, (4) Safeguarding, and (5) Accounting. Helpful Tips.
   e. Scammer Warning.
   f. The materials include an overview of disciplinary decisions related to KRPC 1.15.
3. IOLTA vs. Non-IOLTA
   a. IOLTA: Pooled interest-bearing account, interest earnings to be paid to the Kansas Bar Foundation under the IOLTA program (Interest on Lawyer Trust Account).
   b. Non-IOLTA: Interest Bearing, Pooled Interest Bearing, or Pooled non-interest bearing.
4. Characterizing Funds.
   a. Every dollar in IOLTA or Trust account belongs to a client or third party. Commingling funds of others with lawyer's funds is prohibited.
   b. Know what funds are and where they go.
5. Record Keeping
   a. Document, document, document.
   b. Always provide receipts, deposit funds promptly, no "cashing out" or cash withdrawals, and wait for funds to clear before disbursement.
   c. Keep (1) client ledgers, (2) Check journal, (3) Monthly bank statements, (4) Receipts / disbursements, and (5) Do monthly 3-way reconciliations.
6. Avoiding Discipline
   a. Conduct that will invite discipline: commingling, conversion, sloppy records, disbursing too early, failure to reconcile, not recording in real time, using trust account as an operating account, disbursement before clearance.
7. Quiz

# Materials Ks. Trust Accts: Clicking Heels

## Categories of Summarized Cases[1]

- Attorneys are expected to know the rules
- Misappropriation of client funds is serious
- Record keeping
- Commingling, Earned upon receipt, & Unearned fees in operating account
- Promptly deliver funds or property
- Non-refundable fees
- Flat fees
- Rounding up
- Overdraft
- Improper use of trust account
- Misappropriation of firm or partner funds

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## Attorneys Are Expected to Know the Rules

### In re Ruther, 285 Kan. 808, 175 P.3d 251 (2008)

Discussed and summarized in more detail below in the "Earned Upon Receipt" section. Significantly, the Court held:

The Kansas Supreme Court has consistently held that **it is incumbent upon every attorney to know the disciplinary rules regulating the profession**, and failure to cite specific rules does not excuse misconduct. {Emphasis added]. *[See: In re Farmer, 242 Kan. 296, 300 (1987), In re Turner, 217 Kan. 574, 579 (1975), quoting State v. Alvey, 215 Kan. 460, 464 (1974), and State v. Nelson, 206 Kan. 154, 157 (1970)]*

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[1] Rarely does a disciplinary case involve a single rule violation. Most disciplinary cases involve multiple rule violations and could be placed in several 'categories'. Thus, the category designation is representative of only one violation in the case.

# Misappropriation of Client Funds Is Serious

## In re Shumway, 269 Kan. 796, 8 P.3d 735 (2000)

The respondent was contacted regarding a potential paternity action on behalf of a father. Respondent advised the client that a paternity action could be brought prior to the birth of a child, which was contrary to Kansas law. After not responding to the client, the client filed a complaint. Respondent failed to respond to multiple requests from the disciplinary office for a written response. At the formal hearing, respondent asserted that she was not able to respond because of her severe depression and argued she could not comply with the duty to cooperate.

The Court stated that her clinical depression was serious; however, there was nothing to suggest she was physically incapacitated. She could have telephoned the disciplinary administrator or the investigator to inform the office of her situation.

In determining the appropriate sanction, the Court said, "[m]isappropriating client funds is one of the gravest offenses against the public trust a lawyer can commit. Suspension is an appropriate discipline."

The respondent violated KRPC 1.1 (competence), 1.15(d)(2)(iv) (safekeeping - promptly deliver), 1.16(d) (termination - surrender papers, property, return unearned fees), and 8.4(g) (misconduct - conduct adversely reflecting on fitness). The Court imposed a one-year suspension with conditions.

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## In re Buckner, 308 Kan. 427, 421 P.3d 226 (2018)

This case arose when respondent was retained to defend clients in a pending mortgage foreclosure action. Respondent's fee agreement provided for a $500 "monthly flat fee." The background of the case is described in more detail below in the "Flat Fee" section. The Kansas Supreme Court stated:

"Kansas disciplinary cases have consistently recognized that misappropriation of clients' funds is one of the most serious offenses an attorney can commit, and the sanction generally imposed has been disbarment."

*Citing In re Veith, 252 Kan. 266, 272 (1992).*

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# Record Keeping

## In re Black, 283 Kan. 862, 156 P.3d 641 (2007)

Respondent, an elected county attorney, was responsible for handling diversion funds. The established process required defendants to submit two checks: one for court costs and one for the law enforcement training fund. Some defendants submitted a single check instead. Respondent cashed these checks, stored the money in his desk drawer labeled with a sticky note, and periodically distributed funds to the clerk and county treasurer. Respondent failed to obtain receipts, maintain a ledger, or reconcile funds.

The Court found a violation of KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate) and imposed public censure.

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## In re Corrin, 286 Kan. 421, 184 P.3d 923 (2008)

The initial complaints related to diligence and communication. During the course of the investigation, information came to light concerning respondent's trust account practices. The investigation uncovered evidence that respondent failed to disburse funds from his client trust account to numerous clients.

Respondent was directed to provide an accounting of trust account funds and identify which funds should be disbursed to clients. Respondent was unable to identify client ownership of the funds, blamed his computer software, and asserted that his computer had "crashed." Respondent had very few records available during the trust account audit.

Eventually, respondent delivered his computer to ODA investigators, who were able to determine ownership of more than $30,000 belonging to clients. During the formal hearing, the panel issued an interim order directing respondent to distribute client funds. Respondent distributed some, but not all, of the funds and failed to fully comply with the order. The Supreme Court found that respondent's failure to comply was a knowing violation.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), and 8.4(g) (misconduct - conduct adversely reflecting on fitness to practice law). The Court imposed an indefinite suspension and additional requirements.

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## In re Quinn, 286 Kan. 301, 184 P.3d 235 (2008)

This matter arose from a complaint alleging fraudulent endorsement of an insurance check, which led to an audit of respondent's trust account. The account was overdrawn and commingled with personal funds. Respondent failed to supervise her assistant, who improperly endorsed and deposited checks. Respondent had a very casual approach to trust account transactions and recordkeeping; despite being admonished in a prior disciplinary hearing to get help to ensure appropriate maintenance of her trust account.

Respondent admitted she maintained no deposit slips, ledgers, reconciliations, or transaction journals. The Court rejected respondent's argument that wrongful intent was required to establish misrepresentation.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), 5.3(b) (supervision of nonlawyer assistance), and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court imposed a one-year suspension, with a minority favoring a more severe sanction.

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## In re Harrington, 305 Kan. 643, 385 P.3d 905 (2016)

This disciplinary case involved two separate matters. In the first, respondent misused a durable power of attorney to withdraw funds from a client's account, including after the client's death, and made false statements to the probate court regarding his authority and fees. Respondent paid himself more than $30,000 for a simple estate, later refunding $10,000. His remaining fees were still unreasonable.

In a second matter, respondent paid himself more than the amount approved by the court, retained an heir's funds in trust, and ultimately converted approximately $25,000 for personal use. When ordered to remit the funds to the Kansas State Treasurer as unclaimed property, respondent obtained a personal loan to replenish the trust account. Respondent failed to maintain proper trust records and made misleading statements during the investigation.

The respondent argued his due process was violated because the ODA initially learned of the misconduct through an informal conversation with another attorney who died before the panel hearing. The respondent contended that the other attorney had an impure motive and the absence of a written formal complaint was a due process violation. Additionally, the respondent argued that his restitution negated any harm.

The Court rejected respondent's due process arguments and his claim that restitution negated harm, reiterating that "no harm, no foul" arguments are consistently repudiated in disciplinary cases. The Court stated the ODA can investigate all possible misconduct "whether called to his or her attention by complaint or otherwise." The absence of a written complaint did not prejudice the respondent in any manner. The ODA developed the evidence through investigation and established violations through independently obtained evidence and rendered the motive of the other attorney irrelevant. The Court rejected his claim that restitution negated harm, reiterating that "no harm, no foul" arguments are consistently repudiated in disciplinary cases.

The respondent violated KRPC 1.5 (fees - reasonable), 1.8(b) (conflict special rules - prohibit use of client information to disadvantage of client), 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(d)(2)(v) (safekeeping - produce trust account records for examination), 3.3(a)(1) (candor toward tribunal – prohibit false statement), 8.1(b) (disciplinary matters - correct misapprehension, must respond to ODA request for information), 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation), and 8.4(d) (misconduct - prejudicial to administration of justice). The Court ordered disbarment.

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# Commingling, Earned Upon Receipt, & Unearned Fees in Operating Accounts

*This section addresses fees treated as earned upon receipt when, under Kansas law, they were required to be held in trust until earned.*

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### In re Kellogg, 274 Kan. 281, 50 P.3d 57 (2002)

In one matter, a client paid respondent $2,000 and terminated the representation days later. Respondent failed to deposit the unearned fees into her trust account and did not provide an accounting. In a second matter, a client paid $20,000 for representation in a criminal case. Respondent again failed to deposit unearned fees into trust and was later terminated.

Respondent kept no contemporaneous time records and directed staff to bill in fixed increments regardless of time spent, intentionally padding bills to limit refunds. A refund check issued to the client was returned for insufficient funds.

The hearing panel considered the issue of reasonable fees and cited to Davis v. Miller, 269 Kan. 732 (2000), which held, "… [f]ees which are not supported by 'meticulous, contemporaneous time records' that show the specific task being billed should not be allowed."

The respondent violated KRPC 1.5 (fees - reasonable), 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), 1.15(d)(1) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling), 1.15(d)(2)(iii) (safekeeping - maintain complete records) and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court imposed an indefinite suspension with additional requirements.

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## In re Ruther, 285 Kan. 808, 175 P.3d 251 (2008)

This disciplinary case stemmed from an audit of respondent's trust account. Respondent opened an interest-bearing account, commingled personal funds with client funds, and retained interest earned on client money. Respondent falsely certified compliance with KRPC 1.15(e) on his attorney registration form. [See also, *In re Leon*, 314 Kan. 419 (2021)].

The respondent violated KRPC 1.15(d)(1) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling), 1.15(d)(3)(iii) (safekeeping - interest earnings credited proportionately to the client or third party for the benefit of whom the funds are held or IOLTA to the Kansas Bar Foundation, Inc.), and 1.15(e) (safekeeping - certify compliance on attorney registration). The Court imposed an indefinite suspension.

The Kansas Supreme Court has consistently held that it is incumbent upon every attorney to know the disciplinary rules regulating the profession, and failure to cite specific rules does not excuse misconduct. *[See: In re Farmer, 242 Kan. 296, 300 (1987), In re Turner, 217 Kan. 574, 579 (1975), quoting State v. Alvey, 215 Kan. 460, 464 (1974), and State v. Nelson, 206 Kan. 154, 157 (1970)]*

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## In re Holmes, 293 Kan. 478, 264 P.3d 423 (2011)

This disciplinary matter arose from several client complaints involving a divorce, a simple estate, a conservatorship and guardianship, a family land dispute, and a contested conservatorship. Respondent charged unreasonable fees in the estate matter, increased fees without prior agreement, failed to provide itemized statements upon request, and filed a garnishment order against a client despite a settlement agreement.

Respondent mishandled probate matters by failing to file required inventories and delaying the establishment of a conservatorship for a minor heir. Respondent billed an estate for time spent responding to a disciplinary complaint and advanced unearned fees to himself from conservatorship funds without court approval. Respondent commingled and converted client funds for personal use.

In another matter, respondent received unearned fees, failed to deposit them into a trust account, and converted those funds for personal use. It is no defense to conversion that, later, the fees were earned.

The respondent violated KRPC 1.5 (fees - reasonable), 1.15(a) (safekeeping - maintain complete records and hold property separate) and 1.15(d) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling), and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court ordered disbarment.

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## In re Haitbrink, 304 Kan. 531, 375 P.3d 296 (2016)

Respondent represented 15 Washington residents in negotiations with mortgage companies concerning delinquent or underwater mortgages. The State of Washington charged respondent with violations of the Mortgage Broker Practices Act, and respondent agreed to pay restitution. Respondent failed to inform the Kansas Office of the Disciplinary Administrator (ODA) of the Washington charges.

Respondent's fee agreements included hold-harmless provisions that violated the requirement that clients be represented by independent counsel before entering into such agreements. Respondent treated client fees as earned upon receipt, even though the work had not yet been completed. As a result, the fees should have been deposited into a trust account rather than the operating account.

The respondent violated KRPC 1.8(h)(1) (conflict special rules - prohibit agreement to prospectively limit liability), 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.16(d) (termination - surrender papers, property, return unearned fees), and 8.3(a) (duty to report misconduct by self or others). The Court imposed a public censure.

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## In re Hult, 307 Kan. 479, 410 P.3d 879 (2018)

Respondent maintained an immigration practice while licensed in Kansas and practicing federal immigration law in Iowa. Iowa rules required respondent to maintain a trust account, file annual statements, and pay fees. Respondent disclosed to Iowa authorities that he did not maintain a trust account and deposited flat fees into his operating account because he believed the fees were earned upon receipt. Iowa publicly reprimanded respondent, and the matter was referred to Kansas. Respondent failed to report the Iowa discipline to Kansas.

Kansas ODA also received multiple client complaints regarding lack of communication, diligence, and competence. In one case, respondent failed to respond to a malpractice action, resulting in a default judgment, and later failed to appear in a collection proceeding. In the subsequent garnishment action, respondent provided the bank account number where he deposited unearned client funds. Then he opened a new account and transferred all monies from the prior account to avoid garnishment. The Court issued a temporary suspension pending the final disciplinary hearing.

During disciplinary proceedings, respondent testified that he did not understand what a trust account was, had no reliable billing or timekeeping system, lacked office management support, and did not understand basic procedural requirements. Despite accepting funds for work not yet completed, respondent continued to operate without a trust account.

The hearing panel found violations of KRPC 1.5 (fees - reasonable), 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.16(d) (termination - surrender papers, property, return unearned fees), and 8.3 (duty to report misconduct by self or others). The Court imposed an indefinite suspension.

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## In re Leon, 314 Kan. 419, 499 P.3d 467 (2021)

This matter arose from multiple client complaints. Respondent maintained a trust account but routinely failed to deposit unearned fees into it, instead using client funds for personal expenses. Respondent charged nonrefundable fees, which are per se unreasonable, failed to maintain complete trust account records, and failed to provide documents to the investigator.

Respondent certified on attorney registration forms that he was familiar with and compliant with KRPC 1.15. When questioned, respondent testified he believed he was compliant merely because he had a trust account, even though he rarely used it. [See also, *In re Ruther*, 285 Kan. 808 (2008) (violation of KRPC 1.15(e) (safekeeping - certify compliance on attorney registration)].

The respondent violated KRPC 1.5 (fees - reasonable), 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(d)(1) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling), 1.15(d)(2)(iii) (safekeeping - maintain complete records), and 1.15(d)(2)(v) (safekeeping - produce trust account records for examination). The Court imposed an indefinite suspension.

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### In re McVey, 317 Kan. 266, 527 P.3d 900 (2023)

The respondent, an associate in a law firm, had an agreement to purchase a ninety-five percent stock ownership interest. Respondent made annual payments, but the firm did not assign any stock to him. Respondent believed the firm violated the agreement but never pressed the partner on the issue. In one client matter, respondent took a $1,000 advance fee but did not deposit it into the firm trust account. Rather, he placed it his desk drawer. The advance fee was commingled with other funds and deposited elsewhere. Respondent testified, "…frankly, I don't know for sure where it went."

In another matter, respondent ran a rental management business out of the law office for a client's rental property. Respondent would list the properties, locate tenants, collect rent, and do other work. Respondent also served as escrow agent when the client sold a building, collecting payments made by the buyer. Respondent opened a checking account for the rental management business in his and his wife's name – it was not a trust account. Respondent did not notify the client when rent or escrow funds were received and did not promptly disburse funds to the client. Bank records for the personal account demonstrated the balance fell below amounts the client was owed and the account was used to pay for personal expenses. Additionally, respondent failed to provide complete accounting information to the ODA pursuant to the investigator's request.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), 1.15(d) (safekeeping – preserve identity of funds by deposit in trust/IOLA), 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation), and S. Ct. R. 210 (duty to respond and cooperate). The Court imposed a one-year suspension and required a reinstatement hearing.

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## Promptly Deliver Funds or Property

*These cases focus on the duty to promptly notify clients or third persons of receipt of funds or property and to promptly deliver what they are entitled to receive.*

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### In re Jenkins, 258 Kan. 779, 907 P.2d 825 (1995)

Respondent represented a husband in a divorce action. Following trial, the opposing party (the ex-wife) delivered personal property to respondent for return to his client. Respondent failed to inventory, receipt, or safeguard the items and stored them in a garage at his wife's home. Respondent's client received some items but claimed that other items were not returned to him.

The hearing panel emphasized and the Supreme Court affirmed that KRPC 1.15 applies to tangible personal property as well as funds and requires attorneys to act as professional fiduciaries. KRPC 1.15, Comment [1] provides that all property which is the property of clients or third persons should be kept separate from the lawyer's business and personal property and an attorney must hold property with the care required of a professional fiduciary.

Respondent violated KRPC 1.15 (safekeeping). The Court imposed an indefinite suspension, concurrent with a prior suspension.

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**In re Potter, 279 Kan. 937, 112 P.3d 216 (2005)**

Respondent accepted fees from multiple clients, performed little or no work, deposited unearned fees into his operating account, and failed to communicate. When clients requested return of fees and files, respondent failed to comply.

Respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate) and 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request). The Court imposed an indefinite suspension.

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**In re Rathbun, 280 Kan. 672, 124 P.3d 1 (2005)**

Respondent's divorce client gave mail addressed to the client's ex-spouse, the opposing party, to respondent. Respondent retained the mail addressed to the ex-spouse for more than two years without notifying opposing counsel or forwarding the mail. The opposing party had a clear interest in receiving the correspondence.

The Court found respondent violated KRPC 1.15(b) (safekeeping - promptly notify and deliver funds and property, and render full accounting upon request). Because the misconduct occurred before respondent was placed on probation in a prior disciplinary case, the Court extended probation by one year.

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## In re Dowell, 287 Kan. 501, 196 P.3d 915 (2008)

Respondent represented several clients in bankruptcy matters and repeatedly failed to file required documents, communicate with clients, or take necessary action. Respondent received numerous orders to show cause and failed to notify clients when he ceased practicing law.

While assisting respondent with a move, a client discovered original bankruptcy documents and personal property discarded as trash, including tax returns and credit cards. Respondent instructed the client to dispose of the materials.

The respondent violated KRPC 1.15 (safekeeping) by improperly disposing of client property. The Court imposed an indefinite suspension.

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## In re Hawkins, 304 Kan. 97, 373 P.3d 718 (2016)

This disciplinary case arose from four client complaints. In one client matter, the hearing panel found that after the client terminated respondent and obtained new counsel, respondent failed to timely provide a psychological report and police reports to the client's new counsel, knowing that the new counsel only had 10 days to file objections. Additionally, despite the client terminating the respondent and asking for a refund of earned fees, the respondent failed to timely refund unearned fees.

Respondent explained that after the client requested a refund, she told the client she would provide a full refund after respondent completed a full accounting. Respondent took three months to provide the refund. The Court noted respondent could not explain why a full accounting would take so long and concluded the three-month delay in providing a refund violated KRPC 1.16(d).

Respondent suggested in her brief to the Court that though she may not have provided information to the investigator in a timely fashion, she ultimately complied. The Court concluded that respondent's failure to provide a timely response to a disciplinary complaint can constitute a violation of KRPC 8.1(b) (disciplinary matters – timely response to a disciplinary complaint).

The respondent violated KRPC 1.16(d) (termination – surrender papers, property, return unearned fees), 3.2 (expediting litigation), 3.3(a)(1) (candor toward tribunal – prohibit false statement), 3.4(d) (fairness to opposing party – frivolous discovery request or fail to comply with discovery), 8.1(b) (disciplinary matters – must respond to ODA request for information), 8.4(c) (misconduct – dishonesty, fraud, deceit, or misrepresentation), and 8.4(d) (misconduct – conduct adversely reflecting on fitness to practice law). The Court imposed an 18 month suspension and required a reinstatement hearing.

## In re Biscanin, 305 Kan. 1212, 390 P.3d 886 (2017)

This disciplinary matter arose from a contested and complex probate case involving competing wills and intestate heir claims. After settlement, respondent's client received a significant distribution. At the client's request, respondent agreed to "hold" $10,000. Respondent did not deposit the funds into his trust account, instead placing the money in a safe in his office and later returned it to the client when it was requested.

The client later provided the funds to respondent to "hold" a second time. The client testified that respondent asked to borrow the money to invest in a bar and promised to pay interest. Respondent claimed a promissory note existed but was unable to produce it. The hearing panel found respondent's explanation not credible.

One issue before the hearing panel was whether the respondent promptly returned the funds after the client asked respondent to hold them the second time. The respondent argued he first learned of the client's demand for the funds when he received the disciplinary complaint and returned the funds to the client within approximately 6 weeks. Respondent argued this was "prompt". The disciplinary administrator argued the evidence showed the return took 8 months. Arguably, the 8-month time frame required an assessment of credibility of the client and respondent's testimony.

The Count framed the question as whether a 6-week delivery period constituted a "prompt" delivery of the client's funds. The Court found a delay of 10 months to be a violation in McPherson. [*In re McPherson*, 287 Kan. 434, 440 (2008) (10-month delay in returning retain after divorce client notified the attorney of the couple's reconciliation)]. The Supreme Court analyzed the delay and did not accept respondent's argument. The Court discussed the meaning of "prompt delivery" as required by KRPC 1.15(b) and 1.15(d)(iv) and said that "[w]hether one acts on time and without delay will often be determined by the particular circumstances of a transaction."

The Court determined the arrangement constituted a business transaction with a client and that respondent failed to comply with KRPC 1.8(a) (conflicts special rules - limits on business transactions with clients). Respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), KRPC 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), 1.15(d)(1) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling) by failing to deposit funds into trust, and 1.15(d)(2) (safekeeping – maintain complete records and promptly deliver). The Court imposed a 2-year suspension, stayed after 6 months, and placed on supervised probation for 2 years.

## In re Owens, 309 Kan. 80, 431 P.3d 832 (2018)

This disciplinary case arose from two client complaints. The first client complaint alleged respondent failed to advise him of the statute of limitations, failed to timely file suit, and failed to communicate with the client. The second client complaint asserted respondent was hired to amend a birth certificate and paid $2,000. The second client complaint alleged respondent did not file the necessary documents, failed to return calls or emails, and did not return the funds.

Initially, respondent did not respond to the investigator or cooperate with the investigation. At some point, respondent did provide information to the investigator. Respondent stipulated to violating the rules prior to the formal hearing. Respondent stipulated violating 1.1 (competence), 1.3 (diligence), 1.4(a) (communication), 8.1(b) (cooperation) and 8.4(d) (prejudicial to administration of justice). Additionally, respondent stipulated to violating 1.15(b) (safekeeping – promptly notify and deliver funds and render a full accounting upon request) and 1.16(d) (termination – surrender papers, property, return unearned fees). Despite stipulating before the hearing panel to violating 1.15(b) and 1.16(d), respondent later filed exceptions to the hearing panel report and disputed that she violated either 1.15(b) or 1.16(d).

Respondent suggested to the Kansas Supreme Court they should ignore the five-month or more delay in her giving a full accounting because eight days after she signed the stipulation and just days before the hearing she refunded the full fee. In response, the Kansas Supreme Court said,

> While the repayment acts as a mitigating factor relating to the sanction we impose, the belated payment does not erase the fact Owens violated KRPC 1.15(b). She provided no billing statement or accounting and did not refund the money from July 2015 when P.Z. advanced the funds until the refund on May 12, 2017. Although Owens did ultimately return the money to P.Z., she did not do so *promptly*, especially when we consider the fact she had not done anything to advance the case for well over a year and A.R. and P.Z. had essentially stopped communicating with Owens in October 2016. And P.Z. filed a disciplinary complaint in December 2016, complaining about the lack of action on the case and lack of communication. Owens was promptly advised of the complaint. (*Owens*, at 89).

The Court cited to their holding in Hawkins where the respondent violated 1.15(b) when she delayed refunding the balance of the retainer for three months. [In re Hawkins, 304 Kan. 97 (2016)].

The respondent violated KRPC 1.1 (competence), 1.3 (diligence), 1.4(a) (communication), 8.1(b) (cooperation) and 8.4(d) (prejudicial to administration of justice). Additionally, respondent stipulated to violating 1.15(b) (safekeeping – promptly notify and deliver funds and render a full accounting upon request) and 1.16(d) (termination – surrender papers, property, return unearned fees).. The Court imposed a six month suspension and required a reinstatement hearing.

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### In re Crow-Johnson, 319 Kan. 192, 553 P.3d 328 (2024)

Respondent was responsible for administering a trust while employed at a law firm. After leaving the firm for other employment, respondent retained possession of the trust matter. Respondent ceased communicating with the beneficiary, who hired new counsel.

Despite extensive efforts, successor counsel was unable to obtain the trust file. A court order directed respondent to return the file or face contempt. Respondent failed to fully comply and retained trust records and client property at her home, commingling client records with personal property. In a separate matter, respondent failed to promptly deliver client tax documents despite repeated requests.

Although many Rule 1.15 cases involve funds, the Court emphasized that the rule also applies to client papers and property. In addition to many other rule violations, Respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate) and 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request). The Court ordered disbarment.

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## Non-Refundable Fees

*These cases address advance fees labeled as non-refundable and the distinction between true retainers and fees to be earned by future services.*

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### In re Scimeca, 265 Kan. 742, 962 P.2d 1080 (1998)

Respondent’s fee agreements designated advance payments as non-refundable minimum fees owed upon receipt. At the time payment was made, respondent had performed no services for which the client owed a fee. The Court held that absent clear language establishing a true retainer paid solely to secure the attorney’s availability, advance fees remain client property until earned and must be held in trust. Respondent refused to return advance payments of unearned fees, endorsed checks so as to attempt to make an improper agreement prospectively limiting his liability.

The better view is to resolve the question based upon the agreement between the parties. If the contract or agreement between the attorney and the client clearly states that the fee advanced is paid as a nonrefundable retainer to commit the attorney to represent the client and not as a fee to be earned by future services, then it is earned by the attorney when paid and is the attorney's money. If, on the other hand, the retainer is to be earned by future services performed by the attorney, then it remains the client's money and subject to Rule 1.15.

The Court explained that if a fee is to be earned by future services, it is subject to the requirements of KRPC 1.15. Additionally, respondent billed time in minimum .25-hour increments, resulting in charges for time not actually spent on client matters, which constitutes improper billing. It is a violation to bill for time not spent on client matters.

The respondent violated KRPC 1.5(a) (fees - reasonable), 1.8(h) (conflict special rules - prohibit agreement to prospectively limit liability), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), 1.16(d) (termination - surrender papers, property, return unearned fees), 8.2(a) (judicial officials - statement that is false), and 8.4(a) (misconduct – prohibit attempt to violate), 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation), and 8.4(d) (misconduct -prejudicial to administration of justice). The Court imposed an indefinite suspension.

[See also, ABA Formal Opinion 505 (defining a 'true' retainer "…it is solely to reserve the lawyer's availability.")].

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## In re Angst, 275 Kan. 388, 64 P.3d 350 (2003)

This disciplinary case arose from a contested probate matter. The written fee agreement provided for a $2,500 retainer plus hourly billing at $95 per hour, along with costs. During the representation, the client paid a total of $4,743, and the probate court later awarded respondent $475 in fees, bringing the total amount received to $5,218.30. The client requested a refund of $1,000 and a detailed accounting.

Respondent failed to refund any unearned fees and refused to provide an accounting unless the client agreed to allow respondent to bill for the effort of preparing it. The hearing panel, citing *In re Scimeca*, [discussed above] determined that the $2,500 portion of the retainer was treated as non-refundable without the required language, rendering it unreasonable. The respondent must have earned the retainer at his hourly rate in order to retain it.

The Court held in *Scimeca* that absent clear language that unless a retainer is paid solely to secure the attorney's availability and not for future services, the fee remains refundable. Respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), and 1.16(d) (termination - surrender papers, property, return unearned fees). The Court imposed a public censure.

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### In re Crandall, 308 Kan. 1526, 430 P.3d 902 (2018)

Although this case did not involve a direct violation of KRPC 1.15, it provides extensive discussion relevant to trust-account issues and reasonable fees. The matter involved competing expert testimony regarding the reasonableness of fees under the eight factors set forth in KRPC 1.5(a).

Respondent proposed a fee agreement that included an advance non-refundable fee to be earned by future services. Respondent argued the provision was irrelevant because it was not selected by the client. The hearing panel rejected that argument, emphasizing that non-refundable fees are strictly prohibited in Kansas.

The Court also noted respondent's time records were not prepared contemporaneously, and the lack of detail undermined the credibility of the claimed fees. Further, the Court discussed the difference between a flat fee and retainer for future services.

The respondent violated KRPC 1.5(a) (fees - reasonable). The Court imposed a six-month suspension and required a reinstatement hearing.

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## Flat Fees

*These cases address the treatment of flat fees, including when such fees are earned, the requirement to deposit them into trust until earned, and the consequences of failing to maintain adequate records or provide accountings.*

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### In re Carson, 268 Kan. 134, 991 P.2d 896 (1999)

This case includes a fairly comprehensive analysis of flat fees. The Court ultimately did not find the flat fee to violate Rule 1.5; but did provide important cautions when flat fees are the basis of a fee agreement.

Respondent quoted the client a flat fee of $800 to handle a child support matter and the client signed a promissory note for that amount. The client made periodic payments totaling $360 and was billed an additional $460. While handling the child support matter, the client decided to seek a change in child custody and visitation and agreed to pay an additional fee for that work, but no fee was agreed upon. Respondent filed small claims suit to collect an $800 fee from his client, allegedly for additional work on the support matter, but his ledger reflected no additional work was performed. Later, respondent settled his small claims suit with the former client which included a provision prospectively limiting his liability to the client for malpractice without first advising in writing that independent representation is appropriate.

The hearing panel concluded that respondent's flat fee was not in fact a flat fee but rather a fee that could be raised based solely upon respondent's judgment as to how much work was performed by the attorney.

The Court found it troubling that the flat fee could be raised by respondent but declined to find a violation of KRPC 1.5, likely because respondent and his client had agreed upon additional work to be performed beyond that work agreed covered by the quoted flat fee. In discussing the issue, the Court said:

> The problem with respondent's fee setting is not that it is a flat fee, as such would obviously be within the rule. Rather, the problem is that respondent has reserved the right to set a fee higher than the flat fee whenever, in his estimation, the time spent on the case is more than usual. This information does little to inform the client of the basis of the fee. (*Carson*, at 141).

Neither this case (*Carson*) nor KRPC 1.5 can be read as authorizing an attorney unilaterally to increase a quoted flat fee if the attorney decided time had been spent beyond what was anticipated would be required when the fee agreement was made.

Respondent violated KRPC 1.8(h) (conflict special rules - prohibit agreement to prospectively limit liability). The Court imposed a public censure.

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## In re Thurston, 304 Kan. 146, 371 P.3d 879 (2016)

Respondent represented a client in a criminal case for a flat fee but failed to deposit the unearned fee into a trust account. Respondent withdrew after the preliminary hearing and failed to provide an accounting upon termination.

Because respondent failed to maintain complete time records, it was difficult to determine what portion of the fee had been earned. The Court reiterated that flat fees must be deposited into trust and remain there until earned, unless the lawyer and client agree to partial withdrawals tied to completion of specified tasks.

> A lawyer may charge a flat fee to a client for a specific task to be undertaken. When the flat fee is paid to the lawyer, it must be deposited into the lawyer's trust account and the fee cannot be withdrawn until it is earned. Since a flat fee is not earned until completion of the task, the entire flat fee must remain in the lawyer's trust account until that task is completed unless the lawyer and client otherwise agree to partial withdrawals based upon the amount earned for completion of specified subtasks unless the lawyer and client otherwise agree to partial withdrawals based upon the amount earned for completion of specified subtasks. (*Thurston*, at 149).

Respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate) and 1.16(d) (termination - surrender papers, property, return unearned fees). The Court imposed a public censure.

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## In re Knox, 305 Kan. 628, 385 P.3d 500 (2016)

Respondent represented a client in multiple matters, charged a non-refundable flat fee, and failed to deposit the fee into a trust account. Respondent did not withdraw after being discharged, failed to refund unearned fees, failed to appear at a hearing, and delayed forwarding evidence to a prosecutor.

During the disciplinary hearing, respondent falsely testified regarding the client's instructions, the date of termination, and alleged the theft of his laptop. Respondent also failed to cooperate with the disciplinary investigation by failing to provide requested documents.

Respondent violated KRPC 1.5 (fees - reasonable), 1.15(a) (safekeeping - maintain complete records and hold property separate)1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), 1.15(d) (safekeeping – preserve identity of funds by deposit in trust/IOLA), 1.16(a)(3) (termination – shall withdraw when discharged), 1.16(d) (termination - surrender papers, property, return unearned fees), 8.1(b) (failure to disclose fact necessary to correct a misapprehension known by respondent), 8.4(d) (misconduct - prejudicial to administration of justice). S. Ct. R. 207(b) (failure to cooperate in disciplinary investigation), and S. Ct. R. 211(b) (failure to file answer in a disciplinary proceeding). The Court imposed a one-year suspension and required a reinstatement hearing.

## In re Buckner, 308 Kan. 427, 421 P.3d 226 (2018)

Respondent was retained to represent a client in a mortgage foreclosure action and to file a counterclaim. The fee agreement provided for a $500 "monthly flat fee" and stated respondent would maintain contemporaneous time records. Respondent did not maintain contemporaneous time records.

A dispute arose regarding settlement proceeds. Respondent failed to place the proceeds in a trust account, failed to provide a full accounting, and treated the matter inconsistently as both a flat fee and contingency fee arrangement. Respondent failed to reduce any contingency agreement to writing and did not advise the client of the right to court review.

Because a dispute existed regarding entitlement to funds, respondent was required to keep the disputed funds separate until resolution. Instead, respondent withdrew funds and deposited them into an operating account at a financial institution not approved by the ODA. Respondent admitted he was unaware of the requirement that trust accounts be maintained at approved institutions.

Additionally, respondent provided documents which purported to be billing statements at the disciplinary hearing. However, he testified that he prepared the finished draft of his time in 2017, for work performed in 2014 and 2015; the hearing panel found this to be deceptive. Further, respondent failed to cooperate with the investigation, and failed to provide a written response.

The respondent violated numerous provisions, including KRPC 1.5(d) (fees – contingent fee, deduct expenses before contingent fee is calculated, and advise the client of the right to have fee reviewed by court), and 1.5(e) (fees - all fee contracts subject to court review and approval). Additionally, he violated 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), 1.15(c) (safekeeping - funds in dispute kept separate until resolved), 1.15(d)(1)(ii) (safekeeping - disputed portion kept separate until resolved), 1.15(d)(3) (safekeeping - trust accounts maintained in approved institution), and 1.15(f) (safekeeping - approved institution must report overdraft). Further, he violated 1.16(d) (termination - surrender papers, property, return unearned fees), 8.1(b) (disciplinary matters - correct misapprehension, must respond to ODA request for information), and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court ordered disbarment.

## In re Borich, 316 Kan. 257, 514 P.3d 352 (2022)

Respondent represented a client in a home construction defect matter. The initial fee agreement was a contingency agreement. The litigation was complex and extended for more than ten years. During the representation, the client performed substantial legal work, including drafting pleadings, to assist respondent.

Respondent amended the original contingency agreement to require a $1,000 payment and $500 monthly payments. The amendment also stated respondent would "not return any attorney's fees if we are not successful." Respondent later demanded and accepted two additional $5,000 payments. Respondent failed to deposit the monthly fees and additional payments into a trust account.

The amended agreement did not specify when the monthly payments would be earned, and respondent failed to maintain contemporaneous time records. When the client requested an accounting and return of unearned fees, respondent failed to comply. Respondent falsely told the client that an arbitration award of $3,500 had been obtained and issued a check from the trust account, depositing personal funds to cover the payment.

Respondent violated KRPC 1.5(a) (fees - reasonable) and 1.5(d) (fees – contingent fee, deduct expenses before contingent fee is calculated, and advise the client of the right to have fee reviewed by court). Additionally, he violated 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), and 1.15(d) (safekeeping - deposit in trust/IOLA). Further, he violated 1.16(a) (termination - shall withdraw), and 1.16(d) (termination - surrender papers, property, return unearned fees), and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court imposed a one-year suspension with conditions and criticized respondent for minimizing responsibility and blaming the complainants.

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## In re Maughan, 318 Kan. 890, 549 P.3d 1134 (2024)

Respondent represented multiple clients in a criminal matter, creating conflicts of interest. Respondent accepted a $30,000 flat fee and deposited it into his operating account, testifying that he considered the fee earned upon receipt.

The hearing panel, citing *In re Thurston*, found the fee had not been earned when deposited and that respondent commingled the flat fee with personal funds.

Respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate). The Court imposed a one-year suspension and required a reinstatement hearing.

## Rounding Up

*These cases address improper billing practices, including rounding up time entries and charging for time not actually expended, which can render fees unreasonable and implicate trust-account obligations.*

### In re Scimeca, 265 Kan. 742, 962 P.2d 1080 (1998)

Summarized above.

### In re Davis, 296 Kan. 531, 303 P.3d 250 (2013)

The respondent was a law firm partner responsible for administering a large trust for an elderly client. In that role, the respondent hired his wife to serve as the client's health care advocate. The trust was billed for the wife's services over several years, and her fees were repeatedly increased. Ultimately, the trust paid nearly $500,000 to the respondent's wife.

The respondent opened a separate trust account at a different bank and deposited client trust funds into that account. Those funds were then used to pay the respondent's personal taxes. The respondent also engaged in dishonest billing practices by rounding up billing entries and charging for time not actually spent on client matters. KRPC 1.15 requires attorneys to charge reasonable fees. Rounding up time constitutes billing for work not performed. Billing for work not performed is per se unreasonable.

The misconduct was discovered during a law firm audit. The respondent was not fully candid with either the law firm or the Office of the Disciplinary Administrator regarding the scope of his misconduct. The law firm ultimately reimbursed the trust more than $400,000 in excessive fees.

The respondent violated KRPC 1.5 (fees - reasonable), 1.15 (safekeeping), 8.4(b) (misconduct - criminal act), 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation), and 8.4(d) (misconduct - prejudicial to administration of justice). The Court ordered disbarment.

# Overdraft

*These cases involve overdrafts of attorney trust accounts and the resulting disciplinary consequences, including failure to maintain required records, commingling, and conversion of client funds.*

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### In re Craig, 272 Kan. 299, 32 P.3d 1174 (2001)

The respondent operated a high-volume, low-cost uncontested divorce practice known as the "Divorce Clinic." The disciplinary case involved five client matters and multiple trust account violations.

The respondent maintained three successive trust accounts. The first was closed after six checks were returned for insufficient funds and had a negative balance exceeding $900 at closure. The second account had four checks returned for insufficient funds. A third trust account was then opened.

The respondent failed to maintain complete trust account records. He and his wife, who served as office manager, deposited personal funds into the trust account to avoid creditors and the IRS. The respondent testified that his practice operated on a cash basis. His wife testified that cash—including unearned fees—were kept in envelopes and used to pay filing fees.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.16(d) (termination - surrender papers, property, return unearned fees), 5.3 (supervision of nonlawyer assistance), and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court imposed a one-year suspension, restitution, additional CLE requirements, and a reinstatement hearing.

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### In re Collins, 295 Kan. 1084, 288 P.3d 847 (2012)

This disciplinary matter arose from two complaints: (1) multiple overdrafts on the respondent's attorney trust account and failure to cooperate with the disciplinary investigation, and (2) failure to prepare and file tax returns for a client.

In 2010, the Office of the Disciplinary Administrator was notified that the respondent overdrew his attorney trust account on six occasions. Three of the overdrafts resulted from the respondent using the trust account to pay expenses associated with maintaining his law license, including CLE and registration fees. The ODA sent letters in June, July, and August 2010 requesting a written explanation for the overdrafts. The respondent failed to respond and did not provide a written explanation until December 2010, approximately six months after the initial request. The respondent testified that no client funds were held in the trust account at the time and that the account contained only personal funds.

The second complaint involved the respondent's failure to prepare and file tax returns for a client. As a result, the Kansas Department of Revenue seized the client's personal property, and the client lost refunds because the returns were filed more than three years late.

The respondent argued that he did not violate KRPC 1.15 because he held no client funds in the trust account and therefore did not commingle funds. He further asserted that, absent a KRPC 1.15 violation, he had no duty to respond to the ODA and therefore did not violate KRPC 8.1(b).

The Supreme Court rejected these arguments, holding that Kansas rules generally prohibit maintaining personal funds in a trust account, subject only to limited exceptions that did not apply. The Court also emphasized that the duty to cooperate with disciplinary investigations is independent of any underlying rule violation.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate) and 1.15(d)(1) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling). Additionally, he violated 8.1(b) (disciplinary matters - correct misapprehension, must respond to ODA request for information), and 8.4(g) (misconduct - conduct adversely reflecting on fitness to practice law). The Court imposed a one-year suspension with a reinstatement hearing.

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# Improper Use of Trust Account

## In re Lund, 270 Kan. 865, 19 P.3d 110 (2001)

The respondent was delinquent on child support and medical expenses for his child. He deposited personal funds into the trust account to conceal them and made child support payments directly from his IOLTA account. When enforcement efforts began, he falsely represented that funds in his trust account were not subject to garnishment. While client funds are not subject to garnishment, his personal funds, concealed in the trust account, were subject to garnishment.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(d)(1) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling), 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation), 8.4(d) (misconduct - prejudicial to administration of justice), and 8.4(g) (misconduct -

conduct adversely reflecting on fitness to practice law). The Court imposed a one-year suspension.

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## In re Rausch, 272 Kan. 308, 32 P.3d 1181 (2001)

The respondent used his trust account as a “mere conduit” to pass investment funds to his company in connection with an investment scheme. Although no attorney-client relationship existed, the respondent served as trustee for the investors. A federal civil judgment found the respondent liable for fraud and breach of contract.

The respondent acknowledged his conduct “appears to be negligent and careless” and contended he was “duped, and did not knowingly or intentionally defraud or deceive anyone”. Responded disputed that he acted “knowingly” or that conduct “seriously adversely reflects on fitness. The respondent urged the Court to impose a public censure as was done in *Kershner*. [*In re Kershner*, 250 Kan. 383 (1992) (convicted of four felony violations of Kansas Securities Act, panel recommended disbarment and the Supreme Court imposed public censure)].

The Court dismissed respondent’s analysis. The Court cited to *Lucas* which imposed a two-year suspension as appropriate for an attorney who misrepresented closure of trust account and used it to deposit fees. [*In re Lucas*, 269 Kan. 785 (2000)]. The Court, citing to *In re Shumway*, 269 Kan. 796 (2000), said, “Misappropriating client funds is one of the gravest offenses against the public trust a lawyer can commit.” Here, the victims were not clients, but respondent was trustee for victims, placed their funds into his IOLTA account, transferred funds to another and the money was lost.

The opinion includes an extensive discussion of the purpose of IOLTA accounts. There was also a discussion on the evidentiary effect of civil judgments in disciplinary proceedings and whether a civil judgment is deemed ‘conclusive’ or ‘prima facie evidence’ and the standard of proof applied in the underlying judgment. The opinion has a discussion of whether a criminal conviction can form the basis of both a violation of KRPC 8.4(b) (misconduct - criminal act) and (g) (misconduct - adversely reflecting on fitness to practice law).

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), 4.1(b) (truthfulness in statements to others), 8.4(b) (misconduct - criminal act), 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation), and 8.4(d) (misconduct - prejudicial to administration of justice). The Court imposed a two-year suspension.

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## In re Conwell, 275 Kan. 902, 69 P.3d 589 (2003)

This case involved the respondent's handling of advance due-diligence fees paid by prospective borrowers through a consulting business associated with the respondent's law partner. The consulting corporation advertised its ability to obtain financing for large projects and required prospective clients to pay a $25,000 advance due-diligence fee, which was deposited into the law firm's trust account.

Written contracts and oral representations stated that the due-diligence fee would be refunded if financing was not obtained. Shortly after deposit, however, the funds were transferred from the trust account to the consulting firm's account and then converted to personal use. None of the due-diligence fees were refunded.

The consulting firm was never registered as a loan broker with the Kansas Securities Commissioner as required by K.S.A. 50-1001 et seq. By acting as unregistered loan brokers, both the consulting business and the law firm violated Kansas law.

The respondent violated KRPC 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request) and 1.15(c) (safekeeping - funds in dispute kept separate until resolved). Additionally, he violated 5.1(c)(2) (responsibilities of partners, managers, and supervisory lawyers - lawyer shall be responsible for misconduct of other lawyer in specific circumstances), and 8.4(a) (misconduct - attempt to violate). The Court imposed a two-year suspension, stayed, with two years of probation under specific conditions.

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## In re Mandelbaum, 304 Kan. 67, 373 P.3d 710 (2016)

This matter involved multiple client representations. The respondent borrowed nearly $10,000 from client funds, advanced living expenses to clients, and used trust funds to assist with a client's motorcycle purchase by temporarily using other clients' funds. The respondent also intentionally maintained personal funds in his trust account to avoid tax levies.

The respondent violated KRPC 1.8(a) (conflicts special rules - limits on business transactions with clients) and 1.8(e) (conflict special rules - limits on financial assistance to client), 1.15(a) (safekeeping - maintain complete records and hold property separate) and 1.15(d) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling). The Court imposed an indefinite suspension, stayed, with supervised probation.

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## In re Odo, 304 Kan. 844, 375 P.3d 320 (2016)

The respondent used his trust account as an operating account and commingled personal and client funds. He recommended that financially distressed personal injury clients obtain litigation loans from a corporation he controlled, charging excessive interest and imposing burdensome terms without advising clients to seek independent counsel.

The respondent later represented a medical provider who sued one of his former clients, creating additional conflicts.

The respondent violated KRPC 1.7(a)(2) (conflicts), 1.8(a) (conflicts special rules - limits on business transactions with clients) and 1.8(e) (conflict special rules - limits on financial assistance to client), 1.9(a) (duty to former client), 1.15(d) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling), and 8.4(d) (misconduct - prejudicial to administration of justice). The Court imposed a one-year suspension with a reinstatement hearing.

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## In re Hawkins, 310 Kan. 988, 453 P.3d 295 (2019)

The respondent failed to diligently represent multiple clients, including failing to file required briefs and continuing to practice after suspension. She also improperly used her attorney trust account for personal purposes.

The respondent deposited retirement funds into her trust account, paid personal credit cards and attorney fees from the account, and failed to promptly return client funds. She did not cooperate with the disciplinary investigation and failed to appear at the hearing.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), 1.16(d) (termination - surrender papers, property, return unearned fees), and 8.1(b) (disciplinary matters - correct misapprehension, must respond to ODA request for information). The Court ordered disbarment.

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## In re Fulcher, 319 Kan. 105, 552 P.3d 1255 (2024)

The respondent was disciplined by the Missouri Supreme Court after an audit revealed a variety of problems. The respondent had a personal injury practice. The audit revealed he provided financial assistance to a client in the amount of $500 and did not comply with KRPC 1.8(e)(1). The respondent routinely failed to keep funds belonging to clients or third parties in his trust account. He paid funds to his firm from the trust account without properly accounting that the amount was correct and represented earned fees. Respondent failed to promptly deliver funds to clients or third parties. Additionally, he failed to notify clients or others that he had received funds on their behalf. In several cases, he did not deliver payments owed until the Missouri disciplinary office inquired about the missing payments.

The respondent violated KRPC 1.8(e) (conflict special rules - limits on financial assistance to client), 1.15(a) (safekeeping - maintain complete records and hold property separate) and 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request). The Court imposed a two-year suspension, stayed, and two years' probation.

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# Misappropriation of Firm or Partner Funds

### In re Lucas, 269 Kan. 785, 7 P.3d 1186 (2000)

The respondent failed to close firm trust accounts as required by the agreement with the firm partners and continued to use the former firm trust accounts to conceal client revenue from other attorneys in the firm. He falsely represented that the accounts had been closed, hid bank statements, and redirected mail to conceal the accounts.

The respondent violated KRPC 1.15 (safekeeping) and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court imposed a two-year suspension.

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### In re Wright, 276 Kan. 357, 76 P.3d 1018 (2003)

The respondent misappropriated funds from his elderly aunt while acting under a power of attorney and failed to pay the elderly aunt's nursing home bill for approximately three years. The nursing home notified respondent that his elderly aunt faced removal. The investigation revealed he had "borrowed" over $86,000 from his elderly aunt without authorization. Additionally, the respondent converted funds from a social club for which he served as secretary/treasurer.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate). Additionally, he violated 8.4(a) (misconduct – prohibit attempt to violate rules), 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation), 8.4(d) (misconduct - prejudicial to administration of justice), and 8.4(g) (misconduct - conduct adversely reflecting on fitness to practice law). The Court ordered disbarment.

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## In re Johnson, 276 Kan. 904, 80 P.3d 32 (2003)

The respondent accepted a representation, received an unearned fee, failed to deposit it into the firm's trust account, and converted it to personal use. When confronted, the respondent asked the client to characterize the payment as a loan and not disclose the misconduct.

The respondent violated KRPC 1.15(d)(1) (safekeeping - deposit in trust/IOLA, two limited exceptions, prohibit commingling), 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation), and 8.4(g) (misconduct - conduct adversely reflecting on fitness to practice law). The Court imposed an indefinite suspension.

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## In re Christian, 281 Kan. 1203, 135 P.3d 1062 (2006)

While employed at a law firm, the respondent repeatedly converted firm funds by accepting attorney fees from clients and failing to remit those fees to the firm. In more than seven matters, the respondent converted more than $36,000. The firm incurred substantial fees investigating the misconduct.

The respondent failed to provide settlement statements to several clients and made misrepresentations to both clients and the firm regarding fees collected.

The respondent violated KRPC 1.5(d) (fees – contingent fee, deduct expenses before contingent fee is calculated, and advise the client of the right to have fee reviewed by court), 1.15(b) (safekeeping - promptly notify and deliver funds and render full accounting upon request), 4.1 (truthfulness in statements to others), and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court ordered disbarment.

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## In re Purinton, 283 Kan. 880, 156 P.3d 660 (2007)

After termination from his firm, it was discovered that the respondent had cashed a client's fee check for personal use. The respondent initially denied wrongdoing before admitting the misconduct.

The respondent violated KRPC 1.15(a) (safekeeping - maintain complete records and hold property separate) and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court imposed an indefinite suspension.

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## In re Schnittker, 298 Kan. 89, 310 P.3d 399 (2013)

A law partner became concerned that respondent had not deposited earned fees into the firm's operating account. The respondent intentionally deposited firm funds into his personal account, constituting felony theft – albeit uncharged. The Court rejected the respondent's request for a public censure, which was based on the law partner's forgiveness, emphasizing the seriousness of the misconduct. The Court noted that respondent seemed to imply that a benevolent crime victim's wishes should somehow supersede the imposition of a sanction typically imposed and warranted for such serious flagrant misconduct.

The respondent violated KRPC 8.4(b) (misconduct - criminal act) and 8.4(c) (misconduct - dishonesty, fraud, deceit, or misrepresentation). The Court ordered disbarment.

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## In re Peloquin, 301 Kan. 1, 338 P.3d 568 (2014)

The respondent failed to properly supervise his office manager, who negotiated settlements without authorization and converted settlement funds to her personal use. The office manager took the respondent's computer when the misconduct was discovered. The respondent also failed to keep a master list of clients and failed to maintain proper trust account records.

The respondent violated KRPC 1.15 (safekeeping) and 5.3(b) (supervision of nonlawyer assistance). The Court imposed a three-month suspension and additional requirements.

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KANSAS BAR FOUNDATION
WWW.KSBAR.ORG

https://www.ksbar.org/


# IOLTA Enrollment is as easy as 1, 2, 3

## 1 — Download, print, and complete the IOLTA registration form

IOLTA Registration Form

## 2 — Take the registration to a KBF IOLTA approved bank or other financial institution.

Find an approved IOLTA bank.

If your bank has questions about becoming an approved financial institution, they should call the Office of the Disciplinary Administrator at (785) 435-8200 or at attydisc@kscourts.org.

## 3 — Contact the Kansas Bar Foundation at iolta@ksbar.org to receive a secure link to send your completed form. *(please include "IOLTA Registration" in the subject line)*

# Questions

Contact Us if you have any questions about IOLTA.

# For Firms in Kansas AND Missouri

If you practice in both Kansas and Missouri and you wish to participate in IOLTA in both states, you can set up an IOLTA account in the same bank if it has branches in both states. You will need to have two accounts and they need to be labeled for each state (one titled Kansas IOLTA and the other Missouri IOLTA). In Kansas, participating in IOLTA is still voluntary. If you wish to decline participation, you are required to send a letter or a declination form to Attorney Registration at registration@kscourts.gov.

# Notice of Declination

Notice of Declination Form

**Important** If you choose not to participate in IOLTA in Kansas and you have Kansas clients, you still must establish a non-IOLTA trust account in Kansas. Refer to Kansas Rules of Professional Conduct 1.15(d)(3)(iii).

## For Attorneys

- Financial Institutions approved for lawyer trust accounts
- Attorney Registration Form
- Notice of Declination
- Trust Account Handbook

## For Financial Institutions

- Bank Data and Update Form
- Become a Partner in Justice Bank
- KBF Electronic Remittance Guidelines for Financial Institutions
- Money of Others

# IOLTA REGISTRATION

**NOTICE TO KANSAS BAR FOUNDATION**

*Your bank can assist you in completing this form. Present it when opening the account. It is the attorney's responsibility to ensure the form is sent to the Kansas Bar Foundation (see below for procedure for sending).*

**Financial Institution Name:** ______________________________

**Address:** ______________________________

**City, State Zip:** ______________________________

**Telephone:** ______________________________

**Financial Institution Routing Number:** ______________________ **Date:** ____________

The undersigned elect(s) to participate in the interest bearing trust account program authorized by the Kansas Supreme Court (Rule No. 226 at Rule 1.15(d)(3)). *Please include the word "IOLTA" in the name of your account. For example: Anderson Law IOLTA Account.*

**Account Number:** ______________________________

**Account Name:** ______________________________

**Address:** *(Use your address. Do not use the KBF 1200 SW Harrison St. address.)*

______________________________

**City, State Zip:** ______________________________

**Telephone:** ______________________________

**Email Address** ______________________________

Interest on the average monthly balance in the account, or as otherwise computed in accordance with your standard accounting practice (net any service charges or fees), should be remitted at least quarterly to the Kansas Bar Foundation. The remittance of the interest can be done by check, automated clearinghouse, or any other method provided by the Federal Reserve System. The Foundation is a 501 (c) (3) charitable organization and the IRS does not require a Form 1099 for this program. If your financial institution does elect to send out a W-9 Form, it should reflect the Kansas Bar Foundation as the payee, should contain the Kansas Bar Foundation tax identification number (48-6116429), and should be sent to the Kansas Bar Foundation. The address on the IOLTA account should be your firm's address, not the Kansas Bar Foundation address.

The establishment of trust accounts by law firms, including professional corporations, to implement this program has been approved by the Federal Reserve System, the Federal Home Loan Bank Board, and the Federal Deposit Insurance Corporation.

Your cooperation and support for this important program benefiting the residents of Kansas is appreciated.

______________________________
Authorizing trust account signature-
(attorney's signature)

______________________________
Attorney printed name

Attorneys- Please contact the KBF to receive the procedure for sending your information securely.
IOLTA@ksbar.org (please put IOLTA Application in the subject line).

To: Office of Judicial Administration
Attention: Attorney Registration
301 SW 10th Avenue, Room 117, Topeka, KS 66612-1507
Email: registration@kscourts.gov

# NOTICE OF DECLINATION

Pursuant to the provisions of subsection (e) (1) Kansas Rule of Professional Conduct 1.15, adopted by the order of the Kansas Supreme Court, I elect to decline to maintain interest-bearing trust accounts for clients' funds which are nominal in amount or to be held for a short period of time for the public service purposes of the Kansas Bar Foundation in accordance with the procedures set forth in subsection (3) of KRPC 1.15.

Name of Lawyer (Please print or type): ______________________________________

Supreme Court Registration #: ______________________________

Name of Law Firm *(Please print or type)*: ___________________________________

Address: ______________________________________________________________

_______________________________________________________________________

Telephone: ______________________________

Signature: ______________________________________

________ day of ________________, 202__.

ATTORNEY TRUST ACCOUNT OVERDRAFT NOTIFICATION AGREEMENT

TO: Office of Disciplinary Administrator
701 S.W. Jackson Street
First Floor
Topeka, Kansas 66603

The undersigned, being a duly authorized officer of the named financial institution and the person or persons specifically authorized to enter into this agreement, hereby applies to be approved to receive attorney trust accounts. In consideration of the approval of the named financial institution by the Kansas Supreme Court, the institution agrees to comply with the reporting requirements for such institutions as set forth in Kansas Supreme Court Rule 240, Kansas Rule of Professional Conduct 1.15(f).

The named financial institution specifically agrees:

(1) To report to the Disciplinary Administrator's Office in the event any properly payable attorney trust account instrument is presented against insufficient funds, irrespective of whether or not the instrument is honored.

(2) That all such reports shall be substantially in the following format:

(a) In the case of a dishonored instrument, the report shall be identical to the overdraft notice customarily forwarded to the depositor.

(b) In the case of instruments that are presented against insufficient funds, but which are honored, the report shall identify the financial institution, the attorney or law firm, the account number, the date of the overdraft created thereby.

(3) That all such reports shall be made within the following time periods:

(a) In the case of a dishonored instrument - within the time provided by law for notice of dishonor.

(b) In the case of instruments that are presented against insufficient funds, but which are honored - within (five) 5 banking days of presentation for payments against insufficient funds.

(4) That as required by Supreme Court Rule 240, KRPC 1.15(f)(3), attorneys have given consent to the reporting and production requirements mandated by this rule.

This agreement shall apply to all branches of the named financial institution and shall not be canceled except upon thirty (30) days 'written notice to the Disciplinary Administrator’s Office, 701 SW Jackson Street, First Floor, Topeka, Kansas 66603.

Name, Address, and Web Address of Main Branch of Financial Institution (please type or print):

______________________________________________

______________________________________________

______________________________________________________________________________________
Website Address

______________________________________________________________________________________
Name of Chief Executive Officer or Authorized Representative (Please type or print) (Corporate Seal) | Signature | Date

STATE OF KANSAS

COUNTY OF____________________.

Personally, appeared before me, _______________________, a Notary Public in and for said County and State, the within named______________________________, Authorized Representative for the named financial institution, with whom I am personally acquainted, and who acknowledged execution of the Attorney Trust Overdraft Notification Agreement for the purposes therein contained, and further acknowledged authorization by the financial institution, as Chief Executive Officer or Authorized Representative, to execute the agreement on behalf of the financial institution.

On this___________day of____________________,________

_____________________________________
Notary Public

My Commission Expires:_______________________(Notary Seal)

## TRUST ACCOUNTING MAINTENANCE CHECKLIST

- If the trust account is an interest on lawyer trust account ("IOLTA"), that it is at a participating IOLTA financial institution.
- All unearned funds, whether client or third-party funds, are promptly deposited into the trust account.
- Individual client/third party ledgers are kept for each client/third party for whom funds are held with a running balance of funds held for the client/third party.
- A general ledger is maintained which records every transaction involving the trust account, and which has a running balance of all funds held in the trust account.
- Contemporaneous entries are made to the applicable client ledger and to the general ledger for every transaction involving the trust account.
- The trust account is reconciled monthly by ensuring that the general ledger running balance as of the day the reconciliation is performed is equal to the sum of the individual client ledgers that same day, and is equal to the trust account bank statement balance adjusted for uncleared deposits (+) and withdrawals or outstanding checks (-).
- Flat fees, if any, collected from the client before all of the work is completed are deposited into the trust account and earned incrementally, or by reasonable benchmarks agreed to with the client at the inception of the representation.
- Any unearned client funds held in the trust account at the termination of representation are refunded to the client, including any unearned flat fees
- Earned fees are deposited directly into the operating account if earned when paid or transferred from trust account into the operating account within a reasonable time after they are earned if previously held as unearned fees in the trust account.
- No "cushion" of lawyer funds is deposited or kept in the trust account. The only lawyer funds deposited to the trust account are for the sole purpose of paying bank service charges or other fees on the account and only in the amount necessary for that purpose. (Not more than $300.00 recommended).
- If a client disputes a transaction involving the trust account, the disputed funds are held in trust in the trust account pending resolution.
- Complete trust account records are kept in accordance with KRPC 1.15 for a minimum of five (5) years.

- Lawyers and non-lawyer staff have been trained, as appropriate, on proper trust accounting procedures adopted by the law firm.
- At least one lawyer is responsible for making or overseeing monthly reconciliations of the trust account, and responding to inquiries regarding the trust account from the Disciplinary Administrator's Office or other regulatory authorities.

Client Ledger

| **Client Name:** ________________________ | | | | | | |
|---|---|---|---|---|---|---|
| **Matter:** _____________________________ | | | | | | |
| **Reconciled?** | Type/Number | Date | Description of Transaction (Payor/Payee) | Debit (+) | Payment (-) | Balance |
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Bank Charges Ledger

| **Administrative: Bank Charges** | | | | | | |
|---|---|---|---|---|---|---|
| **Reconciled?** | Type/Number | Date | Description of Transaction (Payor/Payee) | Debit (+) | Payment (-) | Balance |
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Trust Account Ledger/Checkbook Register

| Trust Account Ledger | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Reconciled?** | Type/Number | Date | Matter | Description of Transaction<br><br>(Payor/Payee) | Debit (+) | Payment (-) | Balance |
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Trust Account Reconciliation Sheet

**Trust Account Reconciliation Report** Date: ____________

**General Information**

- Complete one form for *each* trust account
- Attach the following: (1) list of clients with corresponding balances, (2) copy of general ledger/checkbook register, (3) list of outstanding deposits, (4) list of outstanding checks, and (5) corresponding bank statement.

---

**Reconciliation of Lawyer's Trust Account Records**

7. **Total of <u>positive</u> client ledger balances** as of ______________.........................$_____
   (Attach a list of clients with corresponding balances).

8. **Trust account ledger/checkbook register balance** as of___________ ..............$_____
   (Attach copy of general ledger/checkbook register).

---

**Bank Statement Reconciliation**

9. Account Balance as of ___________ (per appended bank statement) ...............$_____

   *Plus:* Deposits in transit (deposits made to the account through end of month yet not reflected on bank statement).......................................................+$___
   Number of deposits in transit .............................________
   (Attach list of outstanding deposits)

   *Less:* Outstanding (uncleared) checks (checks issued through end of month not reflected in bank statement) .......................................................................-$____
   Number of outstanding checks ...........................______
   (Attach list of outstanding checks)

10. ***Subtotal***.........................................................................................................=$___
11. ***Other Adjustments (describe and attach supporting documentation)***

    ______________________________________________________________

    ______________________________________________________________

12. ***Adjusted Trust Account Bank Balance*** (as of end of report month)...............$_____

---

Reconciliation prepared by: ________________________
Name and Position

Reconciliation reviewed by: ________________________
Lawyer Name

DATE

ATTORNEY NAME
Attorney at Law
ADDRESS
ADDRESS

Dear MR. OR MS. ATTORNEY:

You have been selected to have your client trust accounts examined pursuant to Supreme Court Rule 236 (2022 Kan. S. Ct. R. at 236) (compliance examinations by the disciplinary administrator). The purpose of the compliance examination is to determine if you or your law firm's records and accounts are being maintained in accordance with applicable Kansas Supreme Court Rules. The selection of you and/or your firm was made on a random basis and not as a result of any specific complaint made regarding your activities in connection with the safekeeping of property.

I am enclosing a document entitled Trust Account Data Form. You are requested to complete that form in connection with each bank account involving client funds in your custody and/or control during the previous twelve (12) month period. Please photocopy the form provided and prepare a separate form for each bank trust account and then return the forms to this office within ten (10) days from the date of this notification. You should have the necessary bank documents available at the start of the compliance examination.

Jeffry Baker, an employee of the Office of the Disciplinary Administrator, will conduct the examination. The examination may be conducted at your office or through remote means. If the examination is conducted at your office, please provide a place in your office where Mr. Baker may conduct the examination.

Mr. Baker will be in touch with you after the Trust Account Data Forms are returned to the Office of the Disciplinary Administrator to inform you what documents, in addition to the trust account bank documents, he will need to review and how you may provide him with the documents.

If you prefer, the examination may be, at least initially, conducted remotely, through correspondence, via U.S. mail and/or email, telephone, and Zoom or other form of internet communication. Correspondence examinations can be less time consuming; however, you must agree to provide all requested information in hardcopy or electronic format.

If the examination is conducted remotely, Mr. Baker will review the information you send and take one of the following actions:

1. Request additional information and/or continue the examination at your place of business; or

2. Submit his findings to the Disciplinary Administrator and issue a written report.

You can request a correspondence examination in writing when you return the Trust Account Data Form.

At the conclusion of the compliance examination, a written report containing the disciplinary administrator's findings will be provided to you pursuant to Rule 236 (e).

A copy of Supreme Court Rule 236 is enclosed for your information.

Sincerely,

Gayle B. Larkin
Disciplinary Administrator

GBL/XXX

Enclosures

TRUST ACCOUNT DATA FORM

1. Type of Account

   ( ) Client trust account
   ( ) Interest-bearing account pursuant to KRPC 1.15(d)(3)
   ( ) Probate account
   ( ) Custodial account

2. Name of Account:________________________________________

3. Bank:________________________________________

4. Account Number:________________________________________

5. Authorized signatures:________________________________________

   ________________________________________

   ________________________________________

6. Law Firm Street Address: ________________________________________

   ________________________________________

   ________________________________________

   ________________________________________

7. Law Firm Telephone Number: ________________________________________

8. Name of Lawyer to Contact: ________________________________________

9. Email Address of Contact Lawyer: ________________________________________

10. If your trust account, or your firm's trust account was previously audited by this office, please provide the date(s) and a brief explanation.

    ________________________________________

    ________________________________________

## Rule 236

## COMPLIANCE EXAMINATIONS BY THE DISCIPLINARY ADMINISTRATOR

**(a) Authority.** The disciplinary administrator may conduct a compliance examination of any trust account or other fiduciary account held by an attorney or the attorney's law firm.

**(b) Disciplinary Administrator's Duties.** In conducting a compliance examination, the disciplinary administrator has the following duties.

**(1)** The disciplinary administrator must determine whether the attorney's or law firm's records and accounts are being maintained in accordance with applicable rules.

**(2)** The disciplinary administrator must employ sampling techniques to examine selected accounts, unless a discrepancy is found that indicates a need for a more detailed examination. Selected accounts may include the following:

**(A)** money, securities, and other trust assets held by an attorney or law firm;
**(B)** a safe deposit box or similar device;
**(C)** deposit records;
**(D)** canceled checks and their equivalent; and
**(E)** any other record that pertains to a trust account transaction affecting an attorney's or a law firm's practice of law.

**(c) Cooperation.** The attorney or law firm must cooperate in a compliance examination by providing records and answering questions. Failure to cooperate in the examination is a violation of Rule 210 and Kansas Rule of Professional Conduct 8.1.

**(d) Investigative Subpoena.** The disciplinary administrator may issue an investigative subpoena to compel the production of pertinent books, papers, documents, records, and electronically stored data and information that relate to the account. The subpoena must state that it was issued under this rule.

**(e) Report.** At the conclusion of the compliance examination, the disciplinary administrator must prepare a written report containing the disciplinary administrator's findings. The disciplinary administrator must serve a copy of the report on the attorney or law firm.

**(f) Deficiencies.** If a compliance examination report specifies a deficiency in the attorney's or law firm's records or procedures, the following provisions apply.

**(1)** No later than 14 days after service of the report, the attorney or law firm must serve the disciplinary administrator with evidence that the alleged deficiency either is incorrect or has been corrected.

**(2)** If corrective action requires additional time, the attorney or law firm must apply for an extension of time to correct the deficiency.

**(g) Confidential.** Except as otherwise provided in subsection (h) and Rule 237, all records produced for a compliance examination are confidential.

**(h) Disclosure of Records.** The disciplinary administrator may disclose a record produced for a compliance examination as follows:

**(1)** to a court if disclosure is necessary to complete the examination;

**(2)** in a board proceeding; or

**(3)** as directed by the Supreme Court.

[**History**: New rule adopted effective January 1, 2021.]

**STATE OF KANSAS**
**OFFICE OF THE DISCIPLINARY ADMINISTRATOR**
***Investigations Unit***

***GAYLE B. LARKIN***
*Disciplinary Administrator*
***MATTHEW J. VOGELSBERG***
*Chief Deputy Disciplinary Administrator*
***CRYSTALYN M. ELLIS***
*Director of Investigations*

***KATIE M. MCAFEE***
*Assistant Disciplinary Administrator*
***ROYETTA F. RODEWALD***
***WILLIAM T. SCHILLING***
*Special Investigators*
***JEFFRY D. BAKER***
*Trust Account Auditor*

## PRE-EXAMINATION QUESTIONNAIRE

Date:

Name:

Firm:

Trust Account:

Response Due Date:

1. How long have you been admitted to practice in the State of Kansas?

2. Are you admitted to practice in any other state? If so, please list.

3. Have you always been with this firm? If not, where?

4. How many attorneys are in the firm?

5. In what type of practice does the firm engage (e.g., Family Law, Personal Injury)?

6. Has the firm ever established separate trust accounts for clients?

7. Do you maintain separate trust accounts for states you practice in besides Kansas? If so, list the states where you have separate trust accounts.

*701 Southwest Jackson Street, First Floor, Topeka, Kansas 66603-3729*

*785-435-8200 (phone) • 785-783-8285 (fax) • attydisc@kscourts.gov*

8. What type of fees do you charge *(flat, contingency, etc....)?*

9. Do you execute written fee agreements? If so, in what situations?

10. Are earned fees ever deposited into the trust account?

11. Are advanced fees or other client funds ever deposited into your operating account?

12. Are there instances when client fees are earned upon receipt?

13. Do you ever consider client fees to be nonrefundable?

14. Is the general (operating) account and trust account held in the same bank? If not, please identify the location of the operating account.

15. Has the law firm set aside some of its own money, as a reserve, in the trust account? If so, please identify the amount.

16. What accounting software, if any, do you use *(Quickbooks, Law-Specialty or In-house)?*

17. Are the books and records maintained by an employee in-house, or do you have an outside professional? Please list their name and job title or company name.

18. Do you maintain electronic or hardcopy records, or both?

19. If electronic records are maintained, do you regularly back-up the records? If so, is the back-up copy stored off-site?

20. Do you store any trust client hardcopy records off-site? If so, where?

21. Do you keep trust account records for at least five (5) years?

22. Have you purged any trust client records? If so, what is your procedure once the holding period has expired?

23. Does the firm follow certain internal controls, or a specific security policy, regarding the safekeeping of client property? If so, please describe. If not, please explain your particular procedure.

24. Please identify the individuals working in the firm and their job title who have access to and the authority to manipulate trust account and the client trust account information and records.

25. Are the trust account records allowed to leave the office, for any reason?

26. Do you receive trust account bank statements electronically or get hard copies?

27. Do you maintain a trust account general ledger or deposit and check register, listing each transaction chronologically with date, description, amount, and running balance?

28. Who has signature authority on the trust account?

29. Are there situations that require two signatures on a trust disbursement? If so, please describe.

30. Are trust bank deposits made daily? If not, then when, and where are client monies held pending the deposit?

31. Do trust bank deposit slips include the client's name and their check number?

32. Do you accept credit cards? If so, are the credit card transaction fees paid from the operating account or the trust account? Is the client ever charged the fee?

33. If you accept credit cards, who is your credit card processing company?

34. Do you accept cash from clients? If so, do you provide the client with a receipt?

35. Do you deposit all cash received?

36. Does the firm recognize a bank holding period until deposits have cleared? If so, how long?

37. Are you holding any client, including estates, non-cash property? If so, please identify.

38. Are trust checks pre-numbered and a different color than operating account checks?

39. In the past 12 months, have you paid a trust client with cash? If so, please explain the circumstances

40. Do you write any trust account checks to "cash"? If so, please explain the circumstances.

41. In the past 12 months, have you voided any trust account checks? If so, have you saved the voided check(s)?

42. In the past 12 months, have there been any unexplained breaks in the sequential order of trust account checks or any missing checks?

*43.* Currently, do you have any long-term outstanding checks? *(long-term for the compliance examination is six (6) months or longer)?*

44. Do you maintain Individual Client Trust Account Ledgers, listing the client's advanced fee deposits and earned fee or expense withdrawals chronologically with date, description, amount, and running balance? If not, what system do you use?

45. Do you maintain a Master or Summary Trust Account Ledger? If not, what system do you use?

46. Do you maintain a system to keep track of "Open" and "Closed" client cases? If not, how do you keep track of active/current cases and closed cases?

47. Do you reconcile your trust account bank statements each month to the trust account ledger and retain a copy? If not, please explain. If so, who reconciles the bank statement, an attorney or another employee? Provide their name and job title.

*48.* If you reconcile the trust account bank statement to the trust account ledger each month, do you then prepare a three-way reconciliation and reconcile to the total balance of all of the Individual Client Trust Account Ledgers each month and retain a copy? If not, please explain. If so, who does this three-way reconciliation?

*49.* Are the trust account bank statements, individual client ledgers, reconciliations, and other trust account records reviewed by an attorney in the firm? If so, how often?

*50.* How often do you bill your trust clients? Is your billing period consistent (*at month-end, mid-month, etc.*)?

*51.* What software do you use to prepare your billing statements?

*52.* Does your billing statement show the amount of client funds held in the trust account?

*53.* What are your procedures and timeframe regarding client notification and accounting after a transaction occurred affecting the client's trust balance?

*54.* In the past 12 months, have you had any trust client money disputes? If so, please explain and how was the dispute resolved?

*55.* Do you promptly withdraw earned fees from the trust account? If so, how do you withdraw the fees? (*Electronic Fund Transfers, check made payable to Operating Account, cash withdrawal*)

*56.* Are the earned fee payments/transfers from the trust account individual client fee payment amounts or grouped fee payments of several clients?

*57.* See questions 43-48 above. What reports, by name, if any, does your system produce for evaluation and substantiation of client trust account balances?

**73-SEP J. Kan. B.A. 6**

**Journal of the Kansas Bar Association**
September, 2004

**Item of Interest**
Philip Ridenour [a1]



# ATTORNEY FEES: WHERE ARE WE IN KANSAS?

If properly structured, Kansas lawyers are ethically permitted to charge clients nonrefundable, flat, minimum, and retainer fees. However, if the fee agreement contemplates future services to be performed by the lawyer, the "up front" payments do not belong to the lawyer until the services are rendered, and, upon completion of the assignment or termination of the representation, any unused portion of the fee must be refunded to the client.

"A lawyer's fee shall be reasonable." Thus begins Rule 1.5 Fees, of the Kansas Rules of Professional Conduct (KRPC), which then proceeds to enumerate eight nonexclusive factors that may be considered in determining the reasonableness of a fee.

Rule 1.5 is silent about nonrefundable, flat, minimum, or retainer fees, but the Kansas Comment to Rule 1.5 states,

> *Terms of Payment*
>
> A lawyer may require advance payment of a fee, but is obligated to return any unearned portion. See Rule 1.16(d).

Additionally, KRPC 1.16 states as follows:

> (d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee that has not been earned. ...

***7** From these two provisions it is abundantly clear that if a lawyer has been paid a fee in advance then, upon the conclusion of the representation, the lawyer must return any unused or unearned portion of the advance fee. But, what about written fee agreements? Is it permissible for a lawyer to contract with a client to receive a flat fee, nonrefundable advance fee, or a minimum fee that the lawyer may permissibly and ethically retain regardless of the amount of work or the services performed by the lawyer? The KRPC contain no specific provisions or guidelines that address these issues, but Kansas case law drawn from lawyer disciplinary cases supplies most of the answers.

### Flat or Fixed Fees

The "flat" fee is also known as a "fixed" or "task-based" fee. The lawyer agrees to do a specific task in exchange for the payment by the client of a specified fee.

**Example I**: Able Lawyer agrees, for the flat fee of $1,250, to draft the articles of incorporation for a new corporation and file them with the secretary of state, meet with the incorporators and prospective shareholders, and discuss how the corporation will operate; draft the by-laws and initial meeting minutes, which will include a banking resolution, medical reimbursement plan, and buy-sell agreement; prepare the opening balance sheet; and issue the stock.

Under the flat fee arrangement, the lawyer assumes the risk for the task consuming more time than estimated. The flat fee, like all fees, must also be reasonable under the requirements of KRPC 1.5. As long as the fee remains reasonable, then the lawyer reaps the benefit of streamlining the process and office efficiencies used in providing the service. [1]

The KRPC, following the American Bar Association's (ABA) Model Rules of Professional Conduct (MRPC), specifically approves of fixed or flat fees as one of the eight factors under KRPC 1.5 that may be considered in determining whether a fee is reasonable:

The factors to be considered in determining the reasonableness of a fee include the following:

(8) Whether the fee is fixed or contingent. [2]

In its only ethics opinion to consider flat fees, the ABA has approved fixed or flat fees in the areas of legal work on tax matters and tax litigation:

There is nothing improper in a lawyer charging and being paid a fixed fee in advance for legal work on tax matters or litigation before the Tax Court if the client and the lawyer choose to do so and it is fully understood that the fixed fee embraces all work to be done, whether it be relatively simple and of short duration, or complex and protracted. [3]

The Kansas comment to KRPC 1.5 clearly approves flat or fixed fees:

It is sufficient, for example, to state that the basic rate is an hourly charge or a *fixed* amount, or an estimated amount, or to identify the factors that may be taken into account in finally fixing the fee. [Emphasis added. [4]

Flat or fixed fees have been discussed on several occasions by the Kansas Supreme Court. *In re Rathbun* [5] involved two flat fees, one being a “minimum” flat fee while the other was a flat fee in a custody matter. The Court was not troubled by the flat fee as such, but found a violation of (1) KRPC 1.5 when the attorney deposited the flat fee into his operating account instead of his trust account prior to rendering the services covered by the fee and (2) KRPC 1.15 when the lawyer failed to return the portion of unearned flat “minimum” fee when his representation was terminated early. The Court has heard several other disciplinary cases in which the respondent attorney charged a “flat” fee. While the Court has found violations in the manner in which the flat fee was handled, including lack of communication regarding the fee, depositing the fee to the operating account instead of the trust account until the fee was earned, and failure to refund the unearned portion of the fee when the lawyer was discharged before completion of the services covered by the flat fee, none of the cases disapprove of the flat fee as such. [6]

Perhaps the most comprehensive analysis of flat fees is found in *In re Carson*, [7] where the attorney quoted the client a flat fee of $800 to handle a child support matter and the client signed a promissory note for that amount. The client made periodic payments totaling $360 and was billed an additional $460. While handling the child support matter, the client decided to seek a change in child custody and visitation and agreed to pay an additional fee for that work, but no fee was agreed upon. Respondent filed suit to collect an $800 fee from his client, allegedly for additional work on the support matter, but his ledger reflected no additional work was performed.

The hearing panel of the Kansas Board of Discipline of Attorneys concluded that respondent's flat fee was not in fact a flat fee but rather a fee that could be raised based solely upon respondent's judgment as to how much work was performed by the attorney. The Court found it troubling that the flat fee could be raised by respondent but declined to find a violation of ***8** KRPC 1.5, doubtlessly because respondent and his client had agreed upon additional work to be performed beyond that work agreed covered by the quoted flat fee. Nevertheless, the importance of *Carson* is its specific approval by the Court of a flat fee:

> The problem with respondent's fee setting is not that it is a flat fee, as such would obviously be within the rule. Rather, the problem is that respondent has reserved the right to set a fee higher than the flat fee whenever, in his estimation, the time spent on the case is more than usual. [8]

Despite the peculiar facts in *Carson*, neither it nor KRPC 1.5 can be read as authorizing an attorney unilaterally to increase a quoted flat fee if the attorney decided time had been spent beyond what was anticipated would be required when the fee agreement was made. Also, as discussed below, KRCP 1.16(d) requires the lawyer to return any unsecured portion of the flat fee if representation is terminated before the tasks are completed. [9]

> **Example II:** Shirley Wright is approached by a client accused of embezzlement of an employer's money. Shirley agrees to represent the client at the preliminary hearing through any trial that might result for the flat fee of $10,000 to be paid up front before representation begins. The client pays the $10,000, which Shirley properly deposits into her escrow account.

**First Scenario:** Client terminates Shirley's representation after the preliminary hearing; Shirley must refund to the client the unused portion of the fee, with the amount to be retained by Shirley calculated at her usual hourly rate or on some other reasonable basis as may be agreed upon with the client.

**Second Scenario:** The preparation for trial proves to be far more time consuming than Shirley anticipated: Shirley cannot ethically seek additional fees from the client and must perform the services agreed upon pursuant to the flat fee agreement.

Flat or fixed fees, whereby an attorney agrees to handle a matter and provide the required services, are proper in Kansas--as they seem to be in most other jurisdictions [10] --subject to the requirements that they are reasonable and, if the attorney is discharged before rendering the services contracted, the unearned portion must be refunded.

### Nonrefundable Advance Payments and Retainer Fees

There is perhaps more confusion among members of the bar regarding nonrefundable advance payments or nonrefundable retainer fees than any other issue regarding fees. Much of the confusion is caused by the lack of generally acknowledged definitions. For analysis, nonrefundable advance payments and retainer fees must be separated into two categories: "engagement fees" and "minimum" or "nonrefundable retainers," which are discussed below.

#### 1. Engagement Retainer Fees





 

The Restatement of the Law Governing Lawyers (1998) (Restatement), defines an "engagement retainer fee" [11] as follows:

> As used in this Restatement, an "engagement retainer fee" is a fee paid, apart from any other compensation, to ensure that a lawyer will be available for the client if required. An engagement retainer must be distinguished from a lump sum fee constituting the entire payment for a lawyer's service in a matter and from an advance payment from which fees will be subtracted (see § 38, Comment g). A fee is an engagement retainer only if the lawyer is to be additionally compensated for actual work, if any, performed. In some jurisdictions, an engagement retainer is referred to as a "general" or "special" retainer.

Since "engagement retainer fee" is the term used by the Restatement, that term will be used here. If properly handled, engagement retainers are permissible in Kansas. [12]

Although the term "engagement retainer fee" has not been used by the Kansas courts, it seems more descriptive of the arrangement and less confusing than some of the other terms that have been used to describe it, including "general retainer," "minimum fee," or "nonrefundable retainer." A good example of the confusion that can occur in this area is *In re Jackson*. [13] While the facts in that case are not entirely free from doubt, it appears that the respondent attorney received an engagement retainer, which was not required to be placed in the lawyer's trust account and, since earned upon receipt by the lawyer, not subject to refund upon termination of the representation. The Court, however, referred to the fee as a "minimum fee." If the fee is regarded as an engagement retainer, then the case appears to have reached the correct result.

Nationally, the engagement retainer has lost favor with the courts and commentators. [14] Courts critical of the engagement retainer have noted that lawyers are not business people entitled to charge what the traffic will bear, the engagement retainer robs the client of the ability to discharge the attorney and recover unearned fees, and engagement retainers are inconsistent with the fiduciary duties incumbent on the attorney in the attorney-client privilege. [15]

***36** One of the leading cases to deal with nonrefundable retainers is *Matter of Cooperman*, [16] wherein a lawyer routinely had clients sign retainer agreements providing for minimum fee nonrefundable retainers regardless of "how much or how little work I do in this case" and "even if you decide prior to my completion of the investigation that you wish to discontinue the use of my services for any reason whatsoever." [17] The New York Court of Appeals found the retainer agreements violative of the Code of Professional Responsibility then in effect and contrary to public policy "essentially because these fee agreements compromise the client's absolute right to terminate the unique fiduciary attorney-client relationship."

*Cooperman* can be read broadly as prohibiting every kind of nonrefundable retainer, including the engagement retainer. However, professor Hazard [18] urges a narrow construction of *Cooperman* and suggests that engagement retainers (unfortunately referred to by Hazard as a "substantial nonrefundable fee" or a "minimum fee") ought to be permitted:

> On the facts of the case, the *Cooperman* decision seems right. The matter undertaken for the client was apparently routine, the nonrefundable retainer fee was large, and the discharge of the lawyer was effected before any significant services had been rendered. Thus, the court could easily have justified imposing discipline solely on the alternate basis that the fee was unreasonably large in light of the limited services actually provided.
>
> The suggestion in *Cooperman* that nonrefundable fees are per se unreasonable, however, seems wrong. Several situations may be imagined in which a substantial nonrefundable fee--better understood as a minimum fee-- might be justified. For example, a client might wish to prevent anyone else from retaining the lawyer in connection with a particular matter. Or a client might anticipate needing legal services in the future and wish to [e]nsure the lawyer's availability at that time, in effect "taking an option" on the lawyer's services. Under those and similar conditions, it is not unreasonable for the lawyer to be compensated for the other business opportunities thus forgone.

> Leaving aside for the moment the size of the fee, this kind of "nonrefundable" fee--often referred to as a fee that is "earned when paid"--should be considered unaffected by *Cooperman*. The client, after all, has received what was paid for, and therefore no refund should ever be due. [19]

The Kansas Supreme Court has acknowledged the continuing ethical viability of the engagement retainer, earned by the lawyer upon receipt and paid to ensure the availability of the attorney. *In re Scimeca* [20] is a well-reasoned case holding that engagement retainers are ethically permissible if properly structured.

In *Scimeca*, the disciplinary administrator alleged that respondent had charged unreasonable fees. The hearing panel found that respondent provided in his retainer agreements, "This attorney fees retainer is a minimum fee and not refundable. In other words, regardless of what happens in the above matter, this Attorney Fees Retainer is owed to Attorney." [21] Respondent stipulated before the Board of Discipline hearing panel "... that nonrefundable unearned retainers are prohibited by the Kansas Comment to Rule 1.5 and by Rule 1.16(d)." [22]

The *Scimeca* Court noted the distinction between advance funds belonging to a client and advance fees:

> An attorney who receives advance funds belonging to a client, either as a fee or expenses, must keep those funds separate and not commingle them with other funds. The key question is whether an advance payment belongs to the client or the attorney. If the funds are paid to the attorney to be used for a specific purpose, they must be used for that purpose. In such a situation, the attorney acts as a fiduciary for his or her client. Where the funds are advanced by the client for costs or expenses, they must be kept in a trust account until used for those purposes ... the status of advance fees can be more complicated. [23]

The Court then set forth the following:

> ***37** The parties stipulated before the panel that a nonrefundable unearned retainer is prohibited by MRPC 1.5. We agree. However, the Deputy Disciplinary Administrator would have this court, as a matter of public policy, require all fees advanced by a client to be refundable, regardless of how designated or agreed to by the parties. We decline to do so. The better view is to resolve the question based upon the agreement between the parties. If the contract or agreement between the attorney and the client clearly states that the fee advanced is paid as a nonrefundable retainer to commit the attorney to represent the client and not as a fee to be earned by future services, then it is earned by the attorney when paid and is the attorney's money. If, on the other hand, the retainer is to be earned by future services performed by the attorney, then it remains the client's money and subject to MRPC 1.15.
>
> Here, the agreement provides that the retainer was not refundable, was a minimum fee, and was owed to the attorney. Designating the advance fee as a minimum fee contemplates that it must be earned by future services to the client. Respondent had done nothing at that point in time for which the client "owed" him a fee. Absent clear language that the retainer is paid solely to commit the attorney to represent the client and not as a fee to be earned by future services, it is refundable. There was no such language in the agreements respondent entered into with his clients. The panel's finding that respondent's "nonrefundable" retainer was a fee advanced for services to be performed, and thus subject to the trust account requirements of MRPC 1.15, is supported by the record. [24]

Both Example III and Example IV, below, qualify under Kansas law as ethically permissible engagement retainers under the rationale of *Scimeca*. Both examples involve a client who wishes to commit the lawyer to be available to represent the client, and neither example suggests that the retainer is an advance payment for future services to be rendered by Able Lawyer.

> **Example III:** Excavating Company inadvertently cuts through a high pressure natural gas pipeline, resulting in the destruction of several neighboring structures, loss of gas service to thousands of customers for two weeks in December, and substantial cleanup and restoration costs. Shirley Wright has litigated numerous pipeline explosion cases for both plaintiffs and defendants. Excavating Company approaches Shirley Wright and offers a $100,000 engagement retainer if Shirley Wright will agree not to represent any other party in the litigation and will agree to represent Excavating Company at the hourly rate of $500 per hour if called upon to do anything further.

> **Example IV:** Farmer Jones has signed a letter of intent to purchase 500 acres of farmland and approaches Able Lawyer to represent him in final negotiations to occur in July. Able Lawyer explains that his 40th wedding anniversary is that week, that his whole family has been planning on vacationing at the beach, and that he declines the offered representation. Farmer Jones is insistent and again requests Able Lawyer to represent him in the negotiations. Able Lawyer again declines the offered representation, points out that he has no special expertise in real estate negotiations, and suggests several other area real estate lawyers whom he knows to be at least as well qualified to represent Farmer Jones. Farmer Jones again approaches. He is more insistent than before and demands that Able Lawyer represent him and tells him to “name your price.” Able Lawyer responds that he will cancel all his plans and represent Farmer Jones for an up-front payment of $10,000 plus payment of his fees for whatever future services he provides at his regular hourly rate of $135 per hour. Farmer Jones agrees.

Although examples III and IV qualify as permissible engagement retainers, they are nevertheless subject to the reasonableness requirement of KRPC 1.5. On the issue of the reasonableness of an engagement retainer, the Restatement provides:

> An engagement-retainer fee satisfies the requirements of this Section if it bears a reasonable relationship to the income the lawyer sacrifices or expense the lawyer incurs by accepting it, including such costs as turning away other clients (for reasons of time or due to conflicts of interest), hiring new associates so as to be able to take the client's matter, keeping up with the relevant field, and the like. When a client experienced in retaining and compensating lawyers agrees to pay an engagement-retainer fee, the fee will almost invariably be found to fall within the range of reasonableness. Engagement-retainer fees agreed to by clients not so experienced should be more closely scrutinized to ensure that they are no greater than is reasonable and that the engagement-retainer fee is not being used to evade the rules requiring a lawyer to return unearned fees. [25]

The eight nonexclusive factors enumerated by KRPC 1.5 are presumably to be applied in determining the reasonableness of an engagement retainer. In the situation posed by Example III, the excavating accident, Shirley Wright is an acknowledged expert, and the matter can reasonably be expected to run into millions of dollars of potential damages. Factor 2 of KRPC 1.5:

> (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

***38** and factor 7:

> (7) the experience, reputation, and ability of the lawyer or lawyers performing the services;

and possibly factor 1:





 

> (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

suggest that an engagement retainer of $100,000, paid by a knowledgeable corporate client to an expert lawyer to commit the attorney to the representation of the excavating company as opposed to any potential plaintiff or other defendant, may very well be proper and reasonable under the facts and circumstances.

Example IV raises greater questions about the reasonableness of the engagement retainer. While Farmer Jones may very well be a sophisticated businessman, he is likely not "experienced in retaining and compensating lawyers,"[26] in the words of the Restatement, and, while 500 acres of farmland may very well be worth many hundreds of thousands of dollars, Able Lawyer has acknowledged that he has no special expertise in real estate negotiations and that other lawyers are equally qualified. Perhaps the only factor arguably applicable to the facts of Example IV is factor 5: "the time limitations imposed by the client or by the circumstances."

Ultimately, one can conclude that if Farmer Jones in Example IV is insistent upon obtaining the services of Able Lawyer, has specifically been made aware that other equally competent lawyers are available, and nevertheless voluntarily decides to pay the engagement retainer to commit Able Lawyer to the representation, then the amount of the engagement retainer must be reasonable at least in the eyes of the client. Certainly all travel deposits forfeited and other out-of-pocket expenses incurred by Able Lawyer in accepting the representation should also be covered.

Both examples III and IV differ significantly from the situation in Example I where a flat fee is paid. Under an "engagement retainer" agreement, the lawyer does not agree to perform any services in exchange for the payment of the engagement retainer. The payment is paid solely to make certain that the lawyer will be available in the event the lawyer's services are required in the future and to commit the lawyer to the representation. Any future services to be performed by the lawyer will be billed as the services are rendered and will still be owed in addition to the engagement retainer. Even if no future services are performed, the full amount of the engagement retainer belongs to the lawyer immediately upon receipt, and no refund is ever due to the client. By contrast, under a "flat fee" agreement, although a lawyer is committed to the representation of the client, the lawyer also agrees to perform designated and agreed upon services in the future. If the services are not performed, the unused portion of the flat fee must be returned to the client.

**2. Minimum Fees and Nonrefundable Retainers.**

Under this type of fee agreement the attorney is paid an advance fee for identified legal services to be performed by the lawyer. The fee agreement provides that the attorney is entitled to retain the total amount of the advance fee upon the termination of the representation, and in the event the representation requires more time than anticipated, the client agrees to pay the additional fees. The so-called "nonrefundable retainer," like the permissible "engagement retainer," commits the lawyer to the representation but, unlike the engagement retainer, it contemplates further services will be performed by the lawyer. Under KRPC[27] and as discussed below, nonrefundable retainer arrangements are prohibited.

> **Example V:** Shirley Right agrees to represent her client in a theft case for the nonrefundable fee of $15,000, to cover the first 100 hours of work. If Shirley works 80 hours, the fee agreement provides she can retain the entire $15,000. If she works more than 100 hours, the excess hours are to be compensated at $150 per hour. This fee arrangement is unethical.

The comment to KRPC 1.5 and KRPC 1.16(d) make it clear that upon termination of representation, a lawyer is required to refund any advance payment of a fee that has not been earned. In addition, KRPC 1.15 requires a lawyer who receives an advance payment for services to be performed in the future to deposit those advance fee payments into a separate trust fund account and not to deposit the fee in the lawyer's general operating account until the services have been performed. [28]

The Kansas Supreme Court has ruled that a nonrefundable unearned retainer is prohibited by KRPC 1.5. [29] If a fee agreement states that a retainer is a nonrefundable retainer, but the retainer is to be earned by future services, then the fee agreement violates KRPC 1.5(a). [30]

Therefore, fee agreements that state they are for a minimum fee or nonrefundable retainers violate the KRPC. If advance fees are paid for future services, any unearned portion of the fees must be refunded to the client upon termination of the representation. Advance fees paid for future services do not belong to the lawyer until earned by the performance of the services.

> ***39 Example VI:** Client approaches Able Lawyer to represent him in a real estate foreclosure action to be brought against the client. Able Lawyer agrees to represent client in the action upon payment to him by the client of a nonrefundable retainer of $10,000, to constitute a minimum fee, to include up to 50 hours of work, plus additional attorneys fees at the rate of $200 per hour if Able Lawyer spends more than 50 hours in defending the action.

Example VI, like Example V involving representation in a criminal proceeding, also is impermissible, since it contemplates futures services by Able Lawyer and in reality is merely an advance payment for future services. If Able Lawyer completes his assignment in 40 hours of work, he is required to refund to the client $2,000 of the “nonrefundable” retainer (40 hours x $200 = $8,000; therefore, $10,000 - $8,000 = $2,000 refund). And, under the rationale of *Scimeca* [31] and *Angst*, [32] by its terms the fee agreement violates the requirements of KRPC 1.5 by attempting to convert a refundable retainer into a nonrefundable retainer in violation of KRPC 1.15(d).

In Example II involving the client accused of criminal embezzlement, the payment of the $10,000 to attorney Shirley Wright, regardless whether labeled as a flat or minimum fee or nonrefundable retainer, is nothing more than the advance payment for future legal services. As such, upon termination of the services, the unused portion of the advance payment is, without exception, always refundable to the client in all circumstances.

When a lawyer enters into a fee agreement with a client and undertakes the representation, then upon the termination of the lawyers' representation by the client prior to the completion of the services to be rendered, the question arises as to what portion of the agreed upon fee should be paid to the lawyer or, in the situation where the lawyer has received an advance payment, what portion must be repaid. The Kansas Supreme Court has most recently addressed the question in *In re Harris*. [33]

In *Harris*, the attorney agreed to represent a client in a personal injury case pursuant to a written contingent fee agreement providing for payment to the attorney of 40 percent of the amount recovered. The attorney was terminated by the client for failing to communicate with the client, followed by the client's successful negotiations with the insurance company, which paid policy limits in settlement. The attorney claimed 40 percent the net recovery, or $4,000. The dispute over fees was submitted to the Johnson County Fee Dispute Committee, which rejected the attorney's claim and instead awarded him a quantum meruit fee based on the number of hours spent by the lawyer at his hourly rate. The Supreme Court approved the quantum meruit award and stated:

> The ABA/BNA Lawyers' Manual on Professional Conduct (1997) provides at p. 41:2012:
>
> “The overarching rule is that when a lawyer is discharged by the client for any reason--or withdraws for good cause-- before the completion of the representation, the lawyer loses the right to recover the compensation set forth in the fee agreement and instead becomes entitled to the reasonable value of his services to the time of discharge or withdrawal. This quantum meruit rule has gained increasing support among the courts as being consistent with the rule that a client has an absolute right to discharge his lawyer, with or without good cause, at any point in the

representation. The client would be deterred from exercising this right if he were required to pay the full amount of the contractual fee despite having discharged his attorney."

The ABA/BNA Lawyer's Manual further provides at p. 41:922: "Moreover, something less than a quantum meruit fee is appropriate for a lawyer who is discharged by the client for good cause, although total forfeiture is not necessarily called for." [34]

Therefore, based upon the rationale of *Harris*, (1) a lawyer discharged by the client, without cause, prior to the conclusion of the representation is entitled to quantum meruit fees, calculated ***40** at his customary hourly rate; and (2) a lawyer discharged by the client, with cause, prior to the conclusion of the representation is not entitled to a quantum meruit fee but may be entitled to something less.

The foregoing support the following general conclusions about nonrefund able retainers, minimum fee agreements, and engagement retainers in Kansas:

**1.** An "engagement retainer" paid to commit the lawyer to take a case is earned by the lawyer at the instant of payment and belongs to the lawyer even if the lawyer renders no future services whatever other than remaining available to assume the representation, as long as the retainer agreement makes it clear that (a) it is paid to commit the attorney to represent the client, and (b) is not a fee to be earned by future services. If the fee agreement meets the requirements of an engagement retainer and is clear that it is paid to commit the lawyer to the case and is not to be earned by future service, the fee is in fact nonrefundable and upon receipt by the attorney belongs to the attorney and should not be placed in the attorney's trust account.

**2.** A "nonrefundable retainer," or minimum fee agreement, even if it states that it is a minimum fee and nonrefundable and is owed to the attorney upon payment, is in fact refundable if it is to be earned by future services to be performed by the attorney for the client. Upon receipt, the minimum fee or "nonrefundable retainer," which contemplates future services will be rendered, must be placed in the attorney's trust account, to be earned as future services are provided to the client. The presumption is that a retainer is refundable and must be deposited to the attorney's trust account, absent clear language in the retainer agreement that the payment is paid solely to commit the attorney to represent the client and not for future services to be rendered.

**Conclusion**

**Flat Fees:** Flat fees are permissible in Kansas. If paid in advance of the services, the fee must be placed in the lawyer's trust account to be paid out to the lawyer upon completion of the services. If paid following the completion of the services, the flat fee belongs to the lawyer upon receipt.

**Engagement Retainers:** Engagement retainers, if properly drafted, are permissible under Kansas law. The engagement retainer is earned upon receipt by the lawyer, should not be placed in the lawyer's trust account, and, because earned upon payment, is not subject to refund.

**Nonrefundable Retainers and Minimum Fees:** A fee agreement whereby the client agrees to pay an advance fee that is a minimum fee or a nonrefundable retainer to cover legal services to be rendered in the future is a violation of KRPC 1.5 and 1.15(d). All advance fee payments to secure future legal services to be performed are always refundable if not fully earned upon the termination of the representation.

**Discharge of Attorney Without Cause:** An attorney discharged by the client without cause prior to the completion of the representation is entitled to a quantum meruit fee based on hourly rate and must refund any advance fee in excess of that amount.

**Discharge of Attorney With Cause:** An attorney discharged by the client with cause prior to the completion of the representation may be entitled to something less than a quantum meruit fee, but computation of the property amount of the reduced fee is uncertain, and, in the absence of any agreement with the client, cautious attorneys may wish to forego all fees and refund all advance fee payments.

**Reasonableness of Fees:** All attorney fees must be reasonable, raising issues about the reasonableness of engagement retainers that have not been addressed by the Kansas Supreme Court.

## Footnotes

a1 ***Philip Ridenour*** *is a partner in Ridenour and Ridenour, Cimarron. He has been a member of the Kansas Board for Discipline of Attorneys since 1992. His practice consists primarily of estate planning, wills, trusts, estates, and related litigation. Ridenour's undergraduate degree (B.A. English, 1965) and law degree (J.D. 1970) are from the University of Kansas. The author wishes to thank Disciplinary Administrator Stan Hazlett, his staff, and the members of the Kansas Board for Discipline of Attorneys for the insights gained from numerous thoughtful and sometimes animated discussions, debates, and arguments on the subject of the article.*

1 *See* generally Hazard and Hodes, THE LAW OF LAWYERING § 8.15 (3rd Ed. 2004).

2 KRPC 1.5.

3 ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1389; (1977).

4 The Kansas Comment mirrors the official ABA Comment at the time the KRPC were adopted. However, as the result of the "Ethics 2000 Task Force," the ABA official comment was revised and no longer contains language referring to flat or fixed fees. *See* Annotated Model Rules of Professional Conduct Rule 1.5, cmt. [1] and [2] (5th Ed. 2003).

5 *In re Rathbun*, 275 Kan. 920, 69 P.3rd 537 (2003).

6 See *In re Wagle*, 275 Kan. 543, 66 P.3rd 884 (2003); *In re Kellogg*, 274 Kan. 281, 50 P.3rd 57 (2002); *In re Shelton*, 274 Kan. 374, 49 P.3rd 10 (2002); *In re Johnson*, 272 Kan. 284, 32 P.3rd 1132 (2001); and *In re Trickey*, 268 Kan 835, 999 P.2d 964 (2000).

7 *In re Carson*, 268 Kan 134, 991 P.2nd 896 (1999).

8 *Id*. at 141.

9 *Infra* at notes 27 through 31, on the issue of "nonrefundable" retainers.

10 *See* The Restatement of the Law Governing Lawyers: §38 cmt. g (1998) (hereinafter "Restatement"), "A client and lawyer might also agree that an advance payment is neither a deposit nor an engagement retainer, but a lump-sum fee constituting complete payment for the lawyer's services." *See* Opinion 97-7, Board of Commissioners on Grievances

and Discipline, the Supreme Court of Ohio, December 5, 1997, discussing opinions from other jurisdictions on the propriety of flat and fixed fees.

11 Restatement § 34, cmt. e.

12 *In re Scimeca*, 265 Kan 742, 962 P.2d 1080 (1998).

13 I%in re Jackson*, 254 Kan 406, 867 P.2d 278 (1994)*.

14 For a good annotation discussing the rationale of various cases from around the country, *see* Model Rules of Professional Conduct Rule 1.5, Annot. (5th Ed. 2003).

15 *Id*.

16 *In re Cooperman*, 83 NY 2d 465, 633 N.E. 2d 1069, 611 N.Y.S. 2d 465 (1964).

17 *Id.*, 83 N.Y. 2d at 470.

18 Hazard and Hodes, THE LAW OF LAWYERING §8.5 (3rd Ed. 2004).

19 *Id*.

20 *In re Scimeca*, 265 Kan. 742, 962 P.2d 1080 (1998).

21 *Id.*, 265 Kan. at 743.

22 *Id.*, 265 Kan. at 752.

23 *Id.*, 265 Kan. at 758-759 (citations omitted).

24 *Id.*, 265 Kan. at 759-760.

25 Restatement § 34, cmt. e.

26 *Id.*, second paragraph.

27 KRPC 1.5, official comment (“A lawyer may require advance payment of a fee but is obligated to return any unearned portion”) and KRPC 1.16(d) (“Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interest, such as ... refunding any advance payment of fee that has not been earned.”).

28 KRPC 1.15(a) (“A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property”) and KRPC 1.15(d)(1) (“All funds of clients paid to a lawyer or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable accounts ...”).

29 *In re Scimeca*, 265 Kan. at 759.

30 *In re Angst*, 275 Kan 388, 389, 64 P.3d 350 (2003).

31 *In re Scimeca*, 265 Kan. at 759-760.

32 *In re Angst*, 275 Kan. at 389.

33 *In re Harris*, 261 Kan. 1063, 934 P.2d 965 (1997).

34 *Id.*, 231 Kan. at 1073.

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# AMERICAN BAR ASSOCIATION

STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

**Formal Opinion 505** **May 3, 2023**

**Fees Paid in Advance for Contemplated Services**

*Under the Model Rules of Professional Conduct, a fee paid to a lawyer in advance for services to be rendered in the future must be placed in a client trust account and may be withdrawn only as earned by the performance of the contemplated services. This protects client funds and promotes client access to legal services in the event the representation terminates before all contemplated services have been rendered. All fees must be reasonable, and unearned fees must be returned to the client. Therefore, it is not accurate to label a fee "nonrefundable" before it actually has been earned, and labels do not dictate whether a fee has been earned.*

This opinion examines a lawyer's obligations under the ABA Model Rules of Professional Conduct with respect to fees paid in advance for legal work to be performed by the lawyer in the future.[1] In particular, this opinion seeks to clarify the proper handling and disposition of fees paid in advance for legal work to be performed in the future, including where the lawyer must deposit and maintain the funds and when the lawyer may treat them as earned. The opinion also explains when a lawyer must refund all or a portion of fees paid in advance and discusses whether such a payment may be, or can even be labeled, "nonrefundable." The answers are derived from the application of several Model Rules, including: 1.5(a), 1.5(b), 1.15(a), 1.15(c), 1.15(d), and 1.16(d).

Fees for services may be paid after completion of the services, of course. However, for certain matters, many lawyers request or require that funds in a certain amount be paid to the lawyer at the outset of the representation to secure payment for the lawyer's later work. Under the Model Rules such fees must be placed in a Rule 1.15-compliant trust account, to be disbursed to the lawyer only after the fee has been earned. This is to protect the client from the risk that the lawyer may not be able to refund the prepaid fee in the event the representation terminates before the contemplated work is completed. The Model Rules protect the lawyer from the risk of nonpayment by allowing advance fees to be received and protect the client by requiring that the funds are kept safe and separate from the funds of the lawyer or firm.

## I. Terminology

As a preliminary matter, it is useful to define terms commonly used to label certain client-lawyer fee arrangements: advances, retainers, flat or fixed fees, and "nonrefundable" or "earned-on-receipt" fees.

[1] This opinion is based on the American Bar Association Model Rules of Professional Conduct as amended by the ABA House of Delegates through August 2022. The laws, court rules, regulations, rules of professional conduct, and opinions promulgated in individual jurisdictions are controlling. This is especially noteworthy for this opinion as jurisdictions have adopted substantially different rules relating to the management of client property including fees paid in advance for legal work to be performed in the future.

### A. Advances v. Retainers

Fees paid by a client to a lawyer in advance for legal work to be performed by the lawyer in the future are sometimes referred to as an "advance fee," an "advanced fee," an "advance fee payment," an "advance fee deposit," a "fee advance," or simply an "advance." Advances are also sometimes called "special retainers," "security retainers," or simply "prepaid fees." To be consistent and clear, this opinion will use the term "advance" when discussing fees paid to the lawyer for legal work to be performed in the future.

When a client pays an advance to a lawyer, the lawyer takes possession – but not ownership – of the funds to secure payment for the services the lawyer will render to the client in the future.

This opinion will also refer to the term "retainer" fee. Neither the term "retainer" nor "retainer fee" is found in the Model Rules of Professional Conduct. Regrettably, many lawyers use the term loosely to mean any sum of money paid to the lawyer at or near the commencement of representation.[2] Whereas an advance is a deposit of money with the lawyer to pay for services to be rendered in the future, there is another type of payment that is not for services. Rather, "[t]he purpose of [a retainer] is to assure the client that the lawyer will be contractually on call to handle the client's legal matters."[3] This type of agreement and payment is variously referred to as a "general retainer," "classic retainer," "true retainer," "availability retainer," or an "engagement retainer."[4] Because all of these terms mean the same thing, this opinion will use the term "general retainer" to refer to this arrangement.[5] A general retainer is paid – and deemed earned – upon the promise of availability to represent a client, whether or not services are actually needed or requested by the client.[6] Thus, a general retainer has been conceptualized as a form of an option

[2] There is widespread agreement that the word "retainer" has been used so inconsistently that is has practically lost all definable meaning. BLACK'S LAW DICTIONARY (11th ed. 2019) ("Over the years, lawyers have used the term 'retainer' in so many conflicting senses that it should be banished from the legal vocabulary.") (quoting Mortimer D. Schwartz & Richard C. Wydick, PROBLEMS IN LEGAL ETHICS 100, 101 (2d ed. 1988)).
[3] CHARLES W. WOLFRAM, MODERN LEGAL ETHICS 506 (West 1986).
[4] Some jurisdictions have commendably sought to define terms and draw distinctions in their court rules. *See* Ariz. Rules of Prof'l Conduct R. 1.5 cmt. [7] ("The 'true' or 'classic' retainer is a fee paid . . . merely to insure the lawyer's availability to represent the client and to preclude the lawyer from taking adverse representation. What is often called a retainer but is in fact merely an advance fee deposit involves a security deposit to insure the payment of fees when they are subsequently earned, either on a flat fee or hourly fee basis. A flat fee is a fee of a set amount for performance of agreed work, which may or may not be paid in advance but is not deemed earned until the work is performed. . . ."). *See also* Fla. State Bar R. 4-1.5(e)(2) (defining "retainer," "flat fee," and "advance fee") and Iowa R. Civ. P. 45.8-10 (defining "general retainer," "special retainer, and "flat fee").
[5] It is sometimes said that retainers come in two varieties: "general retainers" and "special retainers." A special retainer is simply an advance going by another, unfortunately misleading, name. *See* Lester Brickman & Lawrence A. Cunningham, *Nonrefundable Retainers Revisited*, 72 N.C. L. REV. 1, 5-6 (1993) ("A special retainer is an agreement between lawyer and client in which the client agrees to pay the lawyer a specified fee in exchange for specified services to be rendered. The fee may be calculated on an hourly, percentage or other basis and may be payable either in advance or as billed.") (footnotes omitted). The Committee is of the opinion that a special retainer is the same thing as an "advance." To be consistent and clear, this opinion will use the term "advance" when referring to such arrangements, although some of the cited sources and authorities may use the term "special retainer."
[6] "Because the general retainer is not a payment for the performance of services, but rather is compensation for the lawyer's promise of availability, the fee is earned by the lawyer at the time the retainer is paid and thus should not be deposited into a client trust account. The general retainer is not an advance deposit against future legal services, which instead would be separately calculated and charged should the lawyer actually be called upon by the client to

contract.[7] In other words, hourly time is not billed against a general retainer and a general retainer is not a flat fee for a specific amount of the lawyer's time – it is solely to reserve the lawyer's availability. An important result of these related features is that the money paid by the client in connection with a general retainer should not be placed in a trust account since it is considered earned upon the commencement of the contract.[8]

Some authorities treat the term "general retainer" or "true retainer," etc., as synonymous with "nonrefundable." This is not correct. A general retainer may, by custom, be considered earned when paid, but this does not mean that it is forever exempt from scrutiny under the Rules. It may be determined to be an unreasonable fee, or even unearned if the lawyer does not make himself or herself available. For example, if a company retains a lawyer to handle a hostile takeover bid should one arise and the lawyer does not, in fact, accept the engagement, then the fee, which may have been paid many months earlier and treated as the lawyer's own property, may be determined to be unreasonable and/or unearned and therefore the subject of an order requiring it to be returned, refunded, or repaid to the client. Other circumstances requiring refund might include the death, disability, suspension, or disbarment of the lawyer. Like all fees, a general retainer must be reasonable under the circumstances.[9]

General retainers "are quite rare,"[10] and have "largely disappeared from the modern practice of law."[11] However, attempts to cast what is actually an advance payment of fees for services to be performed later as a general retainer are very much present today. Given the rarity and unusual nature of a general retainer, and the fact that very few clients would actually need or benefit from one, the nature of the fee and lawyer's obligations and client's benefits under such an agreement must be explained clearly and in detail, including the fact that fees for legal services performed will be charged in addition to the general retainer,[12] and use of the term should be restricted to its traditional definition.

perform the legal services in the future." Gregory C. Sisk, *Duties to Effectively Represent the Client*, § 4-4.4(b) (A Retainer for Lawyer Availability), *in* LEGAL ETHICS, PROFESSIONAL RESPONSIBILITY, AND THE LEGAL PROFESSION (West 2016).

[7] Lester Brickman, *The Advance Payment Dilemma: Should Payments be Deposited to the Client Trust Account or to the General Office Account*, 10 CARDOZO L REV. 647, 649 n.13 (1989). *See also In re* O'Farrell, 942 N.E.2d 799, 803 (Ind. 2011).

[8] This opinion does not attempt to exhaustively discuss general retainers. Though they can and do have legitimate uses, for years they have been criticized, disfavored, and narrowly construed based on contract law, public policy, and contemporary ethics principles. *See, e.g.*, Charles J. McClain, Jr., *The Strange Concept of the Legal Retaining Fee*, 8 J. LEGAL PROF. 123 (1983) (common law of retainers "rests on rather shaky conceptual foundations" full of "inconsistencies and contradictions" and "contributing yet another irritant to the already strained relations between the legal profession and the public at large"); Pamela S. Kunen, *No Leg to Stand on: The General Retainer Exception to the Ban on Nonrefundable Retainers Must Fall*, 17 CARDOZO L. REV. 719 (1996) (discussing "historical and descriptive misconceptions" and arguing that, in many instances, such retainers generate the fiduciary obligations attending other lawyer-client fee agreements); and Joseph M. Perillo, *The Law of Lawyers' Contracts Is Different*, 67 FORDHAM L. REV. 443, 449-453 (1998).

[9] MODEL RULES OF PROF'L CONDUCT R. 1.5(a); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 34 (2001) [hereinafter RESTATEMENT].

[10] Douglas R. Richmond, *Understanding Retainers and Flat Fees*, 34 J. LEGAL PROF. 113, 116 (2009). *See also In re* O'Farrell, 942 N.E.2d at 804 n.5.

[11] Provanzano v. Nat'l Auto Credit, Inc., 10 F. Supp. 2d 44, 51 (D. Mass. 1998).

[12] MODEL RULES OF PROF'L CONDUCT R. 1.5(b); RESTATEMENT, *supra* note 9, § 38.

This opinion focuses on advance fees paid by individual clients, usually for a single legal matter (or related matters) that will not recur on a regular basis. Examples include a divorce, defense of criminal charges, and discharge from employment or other civil matters not handled on a contingent fee basis. However, some clients may need legal services of a certain type on a repeat basis and may contract for such services. For example, the client and lawyer may enter into a renewable one-year agreement providing for a monthly payment to handle any or all collections arising out of one or more of the client's businesses. Some lawyers and clients may use the term "retainer" or "general retainer" to refer to such an arrangement. Such arrangements may be perfectly appropriate although they may not meet the definition of a general retainer even if "availability" is said to be a part of the arrangement. Perhaps the arrangement may best be understood as a fixed fee agreement, except that instead of handling one matter for a set fee no matter what services end up being required, the lawyer is handling several matters (subject to whatever limitations the parties place on the number, type, geography, etc., of the matters).[13]

**B. Flat or Fixed Fees**

Some lawyers prefer to charge their clients a flat or fixed fee for discrete legal services they provide. Examples include closing the purchase of a single-family home, incorporating a small business, drafting a will, or providing a defined, limited-scope service, such as drafting a motion. A flat fee is one that "embraces all work to be done, whether it be relatively simple and of short duration, or complex and protracted."[14]

If a flat or fixed fee is paid by the client in advance of the lawyer performing the legal work, the fees are an advance. Use of the term "flat fee" or "fixed fee" does not transform the arrangement into a fee that is "earned when paid." "Flat" or "fixed" does not even mean that the fee must be paid at the commencement of the representation, although most lawyers who do not have an existing relationship with a client may want to ensure payment and may, therefore, ask for the fee to be paid in advance before committing to the representation. If they do, as will be emphasized below, then that fee must be placed in a Rule 1.15-compliant trust account, to be disbursed to the lawyer only after the fee has been earned.

Several courts and ethics opinions endorse the option of dividing the representation into segments such that certain portions of a flat fee advance are considered earned before completion

[13] As we have noted, courts scrutinize purported general retainers to ensure that the lawyer is not attempting to circumvent the ethics rules requiring refund of unearned fees upon termination of the representation. The same is true with what are sometimes called "hybrid" fees or retainers. Such a fee is "a putative general retainer that is denominated as both for availability and for services," and it is likely to be considered by courts to be "fully refundable to the extent not earned by services rendered." Lester Brickman & Lawrence A. Cunningham, *Nonrefundable Retainers: A Response to Critics of the Absolute Ban*, 64 U. CIN. L. REV. 11, 22 (1995). *See also* N.Y. City Bar Formal Op. 2015-2 (Nonrefundable Monthly Fee in a Retainer Agreement) (2015), *citing* Agusta & Ross v. Trancamp Contracting Corp., 193 Misc.2d 781, 785-86 (N.Y. Civ. Ct. 2002) for the proposition that "enforcement of a hybrid retainer 'should be subject to close scrutiny, governed by a rebuttable presumption that any moneys retained by counsel are for services, rather than availability.'"
[14] ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1389 (1977).

of all the contemplated work.[15] Some jurisdictions have codified this approach in their rules.[16] Thus, if agreed to, the lawyer may remove such earned portions of a flat fee advance from trust prior to the completion of the full scope of the legal services to be performed as certain "milestones" or stages of the representation are reached or completed. This approach allows the lawyer to be paid in part before the end of the representation and provides some assistance in determining the refund amount in case of early termination. Of course, "extreme 'front-loading' of payment milestones in the context of the anticipated length and complexity of the representation" may not be reasonable.[17]

### C. So Called "Nonrefundable" and "Earned Upon Receipt" Fees

Some lawyers use labels like "nonrefundable retainer," "nonrefundable fee," or "earned on receipt" in the body or title of a fee agreement. These are not actual types of fees. And use of these descriptors does not, in and of itself, make a fee arrangement a general retainer. In fact, these terms are most often used in an attempt to make an advance fee nonrefundable.

The Model Rules of Professional Conduct do not allow a lawyer to sidestep the ethical obligation to safeguard client funds with an act of legerdemain: characterizing an advance as "nonrefundable" and/or "earned upon receipt." This approach does not withstand even superficial scrutiny. A lawyer may not charge an unreasonable fee. See Model Rule 1.5(a) ("A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses."). Comment [4] to Rule 1.5 provides this additional guidance: "A lawyer may require advance payment of a fee, but is obliged to return any unearned portion. See Rule 1.16(d)." See also, Model Rule 1.15(c) and others discussed in connection with Hypothetical 1 below. Therefore, under the Model Rules, an advance fee paid by a client to a lawyer for legal services to be provided in the future cannot be nonrefundable. Any unearned portion must be returned to the client. Labeling a fee paid in advance for work to be done in the future as "earned upon receipt" or "nonrefundable" does not make it so.[18]

Hypothetical scenarios illustrating these concepts and applying the Model Rules are discussed in Section IV below.

[15] *See, e.g.*, New Hampshire Bar Assoc. Ethics Committee Practical Ethics Article, *Practical Suggestions for Flat Fees or Minimum Fees in Criminal Cases* (Jan. 17, 2008). *See also In re* Mance, 980 A.2d 1196, 1202, 1204-1205 (D.C. 2009), *citing* Alec Rothrock, *The Forgotten Flat Fee; Whose Money is it and Where Should it be Deposited?*, 1 FLA. COSTAL L.J. 293, 323 (1999) for the proposition that some opinions "allow the lawyer to withdraw fees according to milestones 'based upon passage of time, the completion of certain tasks, or any other basis mutually agreed upon between the lawyer and client.'"

[16] *See, e.g.*, Colo. Rules of Prof'l Conduct R. 1.5(h) (defining a flat fee, explaining proper handling, setting forth required contents of the agreement, and appending an authorized form agreement).

[17] *In re* Mance, *supra* note 15.

[18] *See, e.g.*, *In re* O'Farrell, 942 N.E.2d 799, 803 (Ind. 2011) ("Regardless of the term used to describe a client's initial payment, its type is determined by its purpose, i.e., what it is intended to purchase."); Mo. Sup. Ct. Advisory Comm. Formal Op. 128 (Amended 2018) (labels not conclusive); *In re* Wintroub, 277 Neb. 787, 801; 765 N.W.2d 482 (2009) (citing cases from several jurisdictions for the proposition that "a lawyer may not retain an unearned fee, even if the fee agreement clearly provides that the fee is nonrefundable"); Iowa Sup. Ct. Att'y Disciplinary Bd. v. Turner, 918 N.W.2d 130, 147 (Iowa 2018) (simply labeling payment of advance fees as "nonrefundable" does not relieve attorney from obligation to deposit them into trust accounts).

## II. Model Rule of Professional Conduct 1.15: The Anti-commingling Rule and the Need to Protect Client Funds, Including Advances

Rules of professional conduct exist for the protection of the public. That purpose is well served when the rules are designed and enforced to prevent concrete financial harm to clients. The anti-commingling principle, embodied in Rule 1.15, is a longstanding and effective component in the client protection arsenal. This is why, since their inception in 1908, the American Bar Association's model codes and rules of ethics have prohibited lawyers from commingling their property (including funds) with the property of clients and third parties.[19]

Under the general anti-commingling rule, Model Rule 1.15(a), client property, which includes unearned fees paid in advance, must be held in an account separate from the lawyer's own property.[20] In 2002, Model Rule 1.15 was amended to address specifically the issue of advance fees in a new paragraph (c): "A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred." Therefore, advances must be placed into a lawyer's trust account until those fees are earned.

The Commission on Evaluation of the Rules of Professional Conduct ("Ethics 2000 Commission"), which recommended the addition of this paragraph, did so in response to reports "that the single largest class of claims made to client protection funds is for the taking of unearned fees."[21] Accordingly, paragraph (c) "provides needed practical guidance to lawyers on how to handle advance deposits of fees and expenses."[22] Stated simply, under the Model Rules advance fees must be placed in a Rule 1.15-compliant trust account, to be disbursed to the lawyer only after the fee has been earned.

Some jurisdictions have authorized lawyers to treat advances as the lawyer's property upon payment, so long as the client signs a fee agreement designating the sum as "nonrefundable" or

[19] *See* ABA CANONS OF PROFESSIONAL ETHICS, Canon 11 (1908); ABA MODEL CODE OF PROF'L RESPONSIBILITY, DR 9-102 (1969); ABA MODEL RULES OF PROF'L CONDUCT R. 1.15 (1983, revised 2002). One treatise explains the nature and breadth of this key obligation:

> One of the core fiduciary duties of a lawyer is to safeguard the property that the lawyer receives from the client or from other sources but that belongs to the client or third persons. Property received from a client may include funds to be applied to a transaction, a payment in satisfaction of a judgment or settlement, an advance deposit against lawyer's fees, valuable documents to be analyzed, or property of evidentiary value. Under Rule 1.15(a) of the Model Rules of Professional Conduct, "[a] lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property." The lawyer therefore must keep the property in a secure location and segregate those assets from the lawyer's own property. Gregory C. Sisk, Duties to Effectively Represent the Client, § 4-5.6 (The Duty to Safeguard Client Funds and Property), in Legal Ethics, Professional Responsibility, and the Legal Profession (West Academic Publishing, 2016).

[20] *In re* Kendall, 804 N.E.2d 1152, 1161 (Ind. 2004). Also, Rule 1.15(a)'s predecessor was applied to advance fees. Iowa Sup. Ct. Bd. of Prof'l Ethics & Conduct v. Frerichs, 671 N.W.2d 470, 477 (Iowa 2003) (failure to place advance fee in a trust account violated DR 9-102(A)).

[21] A LEGISLATIVE HISTORY: THE DEVELOPMENT OF THE ABA MODEL RULES OF PROFESSIONAL CONDUCT, 1982–2005 342 (ABA 2006).

[22] *Id.*

"earned on receipt" or some other variation on this theme.[23] This approach departs from the safekeeping policy of the Model Rules described herein and creates unnecessary risks for the client.[24]

## III. Model Rule of Professional Conduct 1.16: Declining or Terminating Representation

Model Rule 1.16(d) requires that, upon termination of representation, a lawyer shall refund "any advance payment of fee or expense that has not been earned or incurred." This Rule, and Rule

[23] *See, e.g.*, Or. Rules of Prof'l Conduct R. 1.5(c)(3). That jurisdiction's version of Rule 1.15(c) contains an exception to the anti-commingling rule for advance fees when "the fee is denominated as 'earned on receipt,' 'nonrefundable' or similar terms and complies with Rule 1.5(c)(3)." Or. Rules of Prof'l Conduct R. 1.15-1(c). A considerable minority of U.S. jurisdictions have authorized this variant approach to advances by rule, ethics opinion, or judicial decree. *See, e.g.*, State Bar of Ariz. Op. 99-02 (1999) (non-refundable, earned-upon-receipt fee is ethical if reasonable under Rule 1.5 and client is fully informed about and expressly agrees to such a fee, preferably in writing; such a fee does not go into a lawyer's trust account); Fla. Rules of Prof'l Conduct R. 4-1.5(e)(2)(B) and Comment (nonrefundable flat fee is the property of the lawyer and should not be held in trust); Wash. State Rules of Prof'l Conduct R. 1.5(f)(2) (if agreed to in advance in a writing signed by the client, a flat fee is the lawyer's property on receipt and shall not be deposited into a trust account); and N.Y. St. Bar. Assn. Comm. Prof'l Ethics Op. 816 (2007) (reaffirming 1985 opinion concluding that "fees paid to a lawyer in advance of services rendered are not necessarily client funds and need not be deposited in client trust account"). Such jurisdictions typically provide, via rule or otherwise, that advance fees must be refunded if unreasonable or work remains to be done even if language to the contrary is used and the funds have been taken by the lawyer pursuant to a rule and/or agreement.

[24] See *In re* Long, 368 Or. 452, 455–56, 474-75, 491 P.3d 783, 788–89, 798-99 (2021), cert. denied 142 S. Ct. 2685 (2022), in which the court candidly discussed the rule and its fallout:

> Respondent's limited financial resources also led to his extensive use of fee agreements that allowed him to access advance fees before completing the promised services. . . . The [Oregon] Rules of Professional Conduct allow for alternative fee agreements, under which advance fees become the lawyer's property at the time the fees are received—that is, before the lawyer has performed the promised services. RPC 1.5(c)(3). In those instances, the advance fees are not placed in the lawyer's trust account and are sometimes referred to as "earned on receipt." Fees may be "earned on receipt" only pursuant to a written fee agreement disclosing that "the funds will not be deposited into the lawyer trust account" and that "the client may discharge the lawyer at any time and in that event may be entitled to a refund of all or part of the fee if the services for which the fee was paid are not completed." *Id.* [¶] According to respondent, because he frequently had pressing personal and business costs, he would not have been able to operate his legal practice if he could access a client's fees only after he completed the promised services. . . . [¶] Although respondent's handling of those advance fees did not itself violate a Rule of Professional Conduct, it nevertheless left respondent's clients vulnerable. "Earned on receipt" fee agreements shift the risk of loss to the client. If the client relationship ends before the lawyer has performed the services needed to keep the advance fees, then the lawyer is required to return the fees for the uncompleted work. If the lawyer has already spent the advance fees and has no other financial resources upon which to draw, then the lawyer may be unable to provide the client with the required refund. [¶] That is what happened to many of respondent's clients. . . . [¶] Respondent's misconduct caused extensive injuries, which were not merely financial. Many of respondent's clients had limited financial means and needed their advance fees returned before they could afford to hire new lawyers. When respondent failed to return those advance fees, some clients simply went without legal representation.

1.15, work in tandem to achieve the regulatory objective of protection of the public from financial harm caused by inattentive or unscrupulous lawyers.[25]

Advances are unearned because they are payment today for work to be performed in the future. They were unearned upon receipt and remain unearned until the work is performed. The Model Rules mandate that advances belong to the client, must be preserved until they are actually earned, and must be refunded if the representation terminates before the fees are earned.

As a practical matter it may be somewhat more difficult to determine what has been earned and what is unearned when a representation ends before completion of the contemplated services when the client pays a flat or fixed fee instead of an hourly rate. However, courts routinely apportion the services completed and sum earned when a representation terminates before a lawyer has completed all of the contemplated work.[26]

## IV. Hypothetical Scenarios Involving Client Payments at the Commencement of a Specific Representation.

### Hypothetical 1 ("Nonrefundable Retainer")

A lawyer is consulted by a client seeking to terminate her marriage. The lawyer informs the client that the lawyer requires a $6,000 "retainer" to cover the filing of a divorce complaint, preparing a motion to enjoin the transfer of assets and a possible motion for a protective order, attending hearings relative to those motions, and any negotiations or related work until the lawyer expends 20 hours. The client was also informed that additional "retainers" may be required to complete the matter, and that the retainers will be credited toward payment for the lawyer's services at the reasonable rate of $300 per hour. The lawyer's fee agreement states, in pertinent part:

> Client agrees to pay Lawyer a nonrefundable retainer fee of $6,000. Client understands that no portion of this fee shall be refunded or returned to Client for any reason.
>
> Client further agrees that should Lawyer expend more than 20 hours on Client's matter, Client shall pay additional retainers as requested by Lawyer which shall be

[25] Nothing tarnishes the profession's reputation like a lawyer who takes an advance fee for legal services to be performed in the future, does not complete the work contemplated by the fee arrangement, and does not refund the money, perhaps because he or she cannot. Once the money has been spent by the lawyer, it may never be recovered by the client (or by the client protection fund which may have reimbursed the client). Even if a civil judgment or disciplinary order of restitution is entered it may do little good if the lawyer is impecunious, judgment-proof, or bankrupt. Discipline in that case may offer a measure of public protection through deterrence, but it does not recompense the client. That client's access to justice may also be impeded. The client may be unable to pay another advance fee and may, therefore, be unrepresented if legal aid or pro bono assistance is unavailable. Model Rules 1.15 and 1.16 exist to protect a client from these consequences.

[26] *See, e.g., In re* O'Farrell, 942 N.E.2d 799, 808 (Ind. 2011) (quantum meruit available upon client termination of flat fee agreement). *Cf.* Plunkett & Cooney, PC v. Capitol Bancorp Ltd, 212 Mich. App. 325, 331; 536 N.W.2d 886 (1995) (discharged lawyer with fixed-fee agreement entitled to compensation for services rendered calculated by percentage of services required under contract, unless lawyer and client have agreed to other terms for valuing work completed).

applied to Lawyer's billing for this matter at a rate of $300 per hour and to any costs or expenses incurred in the representation.

Three weeks after signing the agreement and paying the $6,000, Client notified Lawyer that she wanted to reconcile with her husband and asked for an itemization of Lawyer's time and expenses and a refund of any unearned fees. Lawyer had filed the complaint, but it had not been served. Lawyer had also prepared but had not filed a motion to enjoin the transfer of certain assets. Lawyer had spent 5.5 hours on the file and $150 to file the complaint, but responded to the Client that no refund was due because the $6,000 was a nonrefundable fee.

*Question*: Does Lawyer owe Client a refund for any of the $6,000 paid to Lawyer and are any rule violations established by this scenario?

*Answer*: Yes, Lawyer owes Client a refund. First, the $6,000 paid by Client to the Lawyer are fees paid in advance not a general retainer. Under this agreement, Lawyer is rendering legal services at the rate of $300 per hour. This is true from the outset as is established by simply reading the portion of the agreement quoted above and performing some simple math. The $6,000 entitles Client to 20 hours of Lawyer's work on the matter.

Second, lawyer was required to have placed the $6,000 of advanced fees into the Lawyer's client trust account. Model Rule 1.15(c) provides that: "A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by Lawyer only as fees are earned or expenses incurred." The so-called nonrefundable fee here is an advance payment of fees that may only be withdrawn from the client trust account as earned by Lawyer. The facts of this hypothetical are silent as to whether Lawyer placed the $6,000 in the trust, operating, or personal account and as to whether it was spent in whole or in part. Lawyers may be disciplined for treating advance fees as their own property before the fees are earned, i.e., before the contemplated legal services are rendered.[27] Commingling and perhaps misappropriation may have occurred here if Lawyer deposited the $6,000 into an account other than a client trust account and spent it.

In this scenario, assuming that the legal work performed was appropriate and useful, Lawyer has earned $1,650.00 in legal fees. Lawyer also spent $150 for the expense of filing the complaint. Failure to return the balance of $4,200 is a violation of Model Rule 1.16(d) (upon termination of representation, a lawyer shall refund any advance payment of fee or expense that has not been earned or incurred). Comment [4] to Rule 1.16(d) explains the fundamental legal principle underlying this requirement: "A client has a right to discharge a lawyer at any time, with or without cause, subject to liability for payment for the lawyer's services." Lawyer's failure to provide an accounting for the fees paid in advance also constitutes a violation of Rule 1.15(d).

[27] "A lawyer misappropriates client funds in violation of DR 1–102(A)(3), (4), (5), and (6)DR 1–102(A)(3), (4), (5), and (6) when special retainers and flat fees paid in advance are treated as money belonging to the lawyer and not maintained in a trust account until the fee has been earned." Iowa Sup. Ct. Bd. of Pro. Ethics & Conduct v. Frerichs, 671 N.W.2d 470, 475 (Iowa 2003). *See also In re* Fazande, 290 So. 3d 178, 185 (La. 2020) (lawyer violated Rule 1.15(c) by failing to deposit into his client trust account advance fees and costs).

Model Rule 1.5(a) provides: "A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses." Comment [4] to Rule 1.5 states: "A lawyer may require advance payment of a fee, but is obliged to return any unearned portion. See Rule 1.16(d)." Thus, keeping the balance ($4,200) violates Rule 1.5(a) on these facts. Because Rule 1.5 precludes a lawyer from agreeing to an unreasonable fee, it is also violated by the Lawyer's inclusion of the following provision in the fee agreement: "Client agrees to pay Lawyer a nonrefundable fee of $6,000. Client understands that no portion of this fee shall be refunded or returned to Client for any reason."[28]

Finally, because a lawyer may, in fact, be required to refund an advance payment of fees in various situations, characterizing such an advance as "nonrefundable" may also amount to a violation of Rule 1.4 (communication) and Rule 8.4(c) (misrepresentation) as the mischaracterization of the funds may have a chilling effect on a client seeking a refund of unearned fees upon termination of the representation.[29]

Lawyer and the fee agreement use the words "retainer" and "fee" interchangeably. In this hypothetical it appears that the word "retainer" is used incorrectly to refer to the advance payment of legal fees at the initiation of a matter, or, really, at any time during the representation as is suggested by the agreement's provision that additional "retainers" may be required.

**Hypothetical 2 (Purported General Retainer)**

The facts are the same as in Hypothetical 1, except that the lawyer's standard fee agreement states, in pertinent part:

> Client agrees to pay Lawyer a non-refundable engagement fee of $6,000 which shall be deemed earned upon receipt by Lawyer. This engagement fee is for the purpose of retaining Lawyer and assuring the availability of Lawyer in this matter. Client understands that no portion of the engagement fee shall be refunded or returned to Client for any reason.
>
> Client further agrees that should Lawyer expend more than 20 hours, Client shall pay upon request an additional retainer in an amount determined by Lawyer which shall be applied to Lawyer's billing for this matter at a rate of $300 per hour and to any costs or expenses incurred in the representation.

[28] *In re* Kendall, 804 N.E.2d 1152, 1160 (Ind. 2004) ("We hold that the assertion in a lawyer fee agreement that such advance payment is nonrefundable violates the requirement of Prof. Cond. R. 1.5(a) that a lawyer's fee 'shall be reasonable.'"). *See also* N.Y. City Bar Ass'n Formal Opinion 1991-3 (in light of reasonableness requirement, duty to refund unearned fees, and client's "essentially absolute" right to discharge counsel, "a lawyer may not properly denominate or characterize a fee as 'nonrefundable' or otherwise use words that could reasonably be expected to convey to the client the understanding that a fee paid before the services are performed will not be subject to refund or adjustment under any possible circumstance").

[29] *See, e.g., In re* Sather, 3 P.3d 403, 415 (Colo. 2000) (knowing use of misleading language, i.e., describing flat advance fee as "nonrefundable," violated Colo. RPC 8.4(c)) and Ala. State Bar Op. RO-93-21 (1993) ("Any indication by the lawyer that the fee is non-refundable is inaccurate and inherently misleading and would violate Rule 1.4(b) Communication; Rule 1.5(b) Fees; and Rule 8.4(c) Misrepresentation."). *See also* Mo. Sup. Ct. Advisory Comm. Formal Op. 128 (Amended 2018) (in various situations "the description of the fee as 'nonrefundable' is misleading").

Again, the facts are the same: Lawyer spent 5.5 hours and a filing fee for the complaint, and Client reconciles and seeks a refund. Lawyer declines to refund any portion of the fee, claiming it is nonrefundable.

*Question*: Does Lawyer owe Client a refund for any of the $6,000 paid to Lawyer and are any rule violations established by this scenario?

*Answer*: Yes. The answer and analysis for Hypothetical 1 apply here as well. The only difference ("retainer" and "engagement fee" language) makes no difference at all. The fee arrangement still has the same basic structure and, for the reasons discussed above, the $6,000 is clearly an advance payment for the future performance of legal services, not an actual "retainer" because the lawyer contemplates billing time against the advance.[30] Accordingly, the $6,000 must be held in trust until earned and any unearned portion properly refunded to the client.

Under the Model Rules, there are no magic words that a lawyer can use to change what is actually an advance payment for fees into a general retainer: "an attorney cannot treat a fee as 'earned' simply by labeling the fee 'earned on receipt' or referring to the fee as an 'engagement retainer.'"[31] Notwithstanding the use of the terms "engagement fee," "retainer," and "availability," the fee in Hypothetical 2 is still not a general retainer fee and is, therefore, not deemed earned on receipt. The purpose of the fee dictates its character and treatment irrespective of labels or terminology used.

Courts examine the transaction and agreement very carefully to ensure that the purported general retainer is not an attempt to charge and retain unearned advance fees.[32] Accordingly, a lawyer claiming to have a general retainer must be prepared to demonstrate a valuable benefit to the client and/or an actual detriment to the lawyer.[33] It is easy to recite that the lawyer is prioritizing the client's work, turning away other work, keeping up on the relevant law, etc. However, it must be shown that such things were not only actually done, but that they were necessary for the representation and not part of the lawyer's basic responsibilities.[34]

[30] *Cf. In re* Lais, No. 91-O-08572, 1998 WL 391171, at *14-15 (Cal. Bar Ct. July 10, 1998) (characterization as "'fixed, non-refundable retaining fee' paid 'for the purpose of assuring the availability of [respondent] in this matter'" was "not determinative" and the fee was not a "true" (general) retainer, but actually payment for the first 10 hours of lawyer's services).
[31] *In re* Sather, 3 P.3d 403, 412 (Colo. 2000). *See also* note 18, *supra*.
[32] Richmond, *supra* note 10, at 116: "As a practical matter, general retainers are rare. . .. The types of representations that justify or require general retainers are also scarce. Courts hearing fee related controversies are therefore properly skeptical of general retainer claims." *See also* RESTATEMENT, *supra* note 9, § 34 ("Engagement-retainer fees agreed to by clients not so experienced should be more closely scrutinized to ensure that they are no greater than is reasonable and that the engagement-retainer fee is not being used to evade the rules requiring a lawyer to return unearned fees.")
[33] Att'y Grievance Comm'n of Maryland v. Stinson, 428 Md. 147, 183-185, 50 A.3d 1222, 1244-1245 (2012) (purported engagement fee for "willingness and availability" to represent client not a true general retainer where no benefit to client or detriment to lawyer established and lawyer "produced no useable work").
[34] *See Stinson*, 50 A.3d at 1243 (benefits offered to the client in exchange for the nonrefundable fee were "nothing more than the ethical obligation imposed on all lawyers when they agree to provide legal services to a client. . . . A lawyer who agrees to perform legal services also necessarily agrees to be available to perform those services."), *citing* Lester Brickman & Lawrence A. Cunningham, *Nonrefundable Retainers Revisited,* 72 N.C. L. REV. 1, 24 (1993), and Iowa Sup. Ct. Bd. of Pro. Ethics & Conduct v. Frerichs, 671 N.W.2d 470, 477 (Iowa 2003).

**Hypothetical 3 (Flat Fee)**

A client seeks to hire a lawyer for representation in a criminal matter. The fee agreement provides: "Client shall pay Lawyer the sum of $15,000 for representation in the matter of State v Client, and that no part of the flat fee shall be refunded for any reason. Client understands that the flat fee is the agreed upon amount due Lawyer regardless of the time expended on the matter or how it is resolved." Client signed the agreement and paid the full $15,000. Lawyer deposited the $15,000 into his firm's operating account. Lawyer reviewed the police report, left a message for the prosecutor and law enforcement officer, appeared on behalf of the defendant at the arraignment, and filed an appearance with the court. A few weeks after the arraignment, Client discharged Lawyer and requested an accounting and partial refund. Lawyer refused, stating that the flat fee was earned when it was paid.

As we noted above, flat fees paid in advance of performing the work are subject to Rule 1.15(c) and the other rules set forth in the analyses in Hypotheticals 1 and 2. In other words, the foregoing rules regarding safekeeping, refundability, and reasonableness apply.

Flat fees are not general retainers and must not be treated as such. That the price set for the representation is not based on hours worked but is instead based on the completion of certain described services does not mean that the fee must be considered earned on receipt or nonrefundable when there is work yet to be done. Of course, if the flat fee is paid *after* the work is completed, the funds are earned and are not deposited into the trust account.

## V. Conclusion

The Model Rules protect a client's right to terminate the fiduciary relationship with a lawyer and have the money to which the client is entitled available to obtain successor counsel if desired. Rule 1.15 requires that fees paid in advance must be held in a trust account until the services for which the fees will be paid are actually rendered, thereby allocating various risks to lawyer and client. The lawyer does not have to bear the risk of nonpayment after the work is completed; Rule 1.15 provides a process for withdrawal of earned fees and even for disputes, should they arise. And the client does not have to bear the risk that the funds will be spent, attached by the lawyer's creditors, or otherwise dissipated before the legal work is performed due to a lawyer's unwillingness or inability to do so.

Other ethics opinions and resources discuss good billing practices and fee agreement drafting tips. However, we offer the following suggestions in relation to the matters addressed in this opinion. Use plain language. Thus, instead of "retainer" say "advance" and explain that it is a "deposit for fees."[35] Explain that the sum deposited will be applied to the balance owed for work on the matter, and how and when this will happen. For example, the fee agreement could provide

[35] GEOFFREY C. HAZARD, JR., PETER R. JARVIS, TRISHA THOMPSON & W. WILLIAM HODES, THE LAW OF LAWYERING §9.07 (4th ed. 2022-2 Supp. 2014). Of course, the applicable Rules of Professional Conduct must be consulted, and it may be prudent or required to use certain terms. However, accurately translating legal terms of art is not only helpful to the client but also assists with interpretation and enforcement. So, if the term "advance" or "special retainer" is used in the applicable rules, the lawyer will want to use it in the fee agreement. However, consider also adding an explanation that it is functionally a deposit to cover fees for work in the future.

that on a monthly basis the client will be invoiced for the time expended by the lawyer and state when the sum reflected in the invoice will be withdrawn from the trust account. When the arrangement is for hourly billing, explain that if the deposit exceeds the final billing any balance will be remitted to the client. If the advance fee is fixed and the representation may continue for some time or involve several stages, consider dividing the representation into reasonable segments and providing for withdrawal of a reasonable portion of the deposited fee as the representation progresses and the fee becomes partially earned.[36] Finally, it may be wise to recognize the reality that many relationships do not last and include a provision explaining what will happen if the representation is terminated before the matter is completed.[37]

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[36] *See supra* notes 15 & 16.
[37] Again, see Colo. R. Prof'l Conduct R. 1.5(h) and accompanying flat fee form providing helpful language for dividing a representation into increments and explaining a method of calculating the fees the lawyer has earned should the representation terminate prior to completion of the tasks or events specified in the agreement.

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# Frauds Targeting Attorney Trust Accounts

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The Practice Resource Center continues to receive reports of frauds targeting attorney trust accounts. The three most prevalent types of frauds are 1) Counterfeit bank checks 2) Compromised wire instructions, and 3) Forged trust account checks. The following is a summary of each fraud.

**Counterfeit Bank Check**

In this scenario, criminals use email to act like potential clients requesting representation (typically commercial debt collection or divorce settlement collection). Once the lawyer responds with a request for more information, the "client" provides the lawyer with documentation of the "debt," often including warehouse receipts, contracts, bills of lading, etc. Shortly after agreeing to pursue the claim and often before a demand letter is even drafted, the lawyer receives a letter and certified bank check from the supposed debtor who is paying because they "don't want to deal with the law." The lawyer then deposits the certified bank check into the trust account. Almost immediately, the client begins demanding their payment via wire. Since the funds are available via provisional credit, the lawyer wires out the money to the client minus the lawyer's share. The client is never heard from again. A few days later, the bank tells the lawyer that the check was counterfeit and removes the already wired amount from the trust account. Since the lawyer disbursed on provisional credit, the lawyer is responsible for replenishing any trust account deficit.

### Compromised Wire Instructions

In this scenario, a criminal gains access to the email account of a party to a real estate, or other, transaction and initiates a fraudulent wire transfer. Once an email account has been hacked, the criminal can learn the details of the real estate transaction and, acting like the seller, emails the lawyer with wiring instructions for the seller's funds. Even law firms with two-level confirmation procedures for wire instructions have been defrauded because the criminal calls the firm as the seller and confirms the wiring instructions. The firm wires the money to the criminal's account and it is never seen again. Further, the bank denies any liability because it merely followed the lawyer's instructions. To prevent this type of theft, law firms should initiate the phone call to confirm the emailed wire instructions, calling only the number listed in the client file regardless of whether a different number is provided in the email.

### Forged Trust Account Checks

In this scenario, a criminal obtains the lawyer's account information (account number/routing number) and creates a fake check payable to cash. The criminal then negotiates that check at a check cashing company with a forged signature. While the lawyer may have recourse to recover the stolen funds from the bank if it honored the checks, in the interim the lawyer must deal with a shortage in the trust account and outstanding checks that may bounce. The lawyer may also need to open a new trust account since the old account was compromised. One way to prevent this potential scenario is to enroll in a bank's positive pay program so only law firm approved checks are honored. Lawyers should review their trust accounts regularly to look for unapproved or unidentified transactions.

# PROCEED WITH CAUTION: PERSON TO PERSON PAYMENT APPLICATIONS

By Suzanne Lever

*(This article appeared in Journal 24,4, December 2019)*

My family has a dog named Zellie. She is a mixed breed rescue from Saving Grace, a wonderful dog rescue in Wake Forest, North Carolina. (Unabashed plug for Saving Grace—it is fantastic; let me know if you are looking for a new family member!

Recently my daughter said she was going to send me some money through Zellie. I thought that was weird. She lives in Atlanta and Zellie lives with me in North Carolina. Plus, Zellie is a dog. I couldn't quite figure out the logistics. Turns out, she was going to send the money through Zelle, NOT Zellie. Honestly, I still didn't understand the logistics. My suggestion that she simply send me a check was met with an audible eyeroll. Potential clients, particularly younger ones, may have a similar reaction to a law firm policy of accepting only cash, check, or chickens for the payment of legal fees. But what is a lawyer's professional responsibility when considering or using money transfer services such as Zelle?

According to its website, "Zelle is an easy way to send money directly between almost any US bank accounts typically within minutes. With just an email address or mobile phone number, you can quickly, safely, and easily send and receive money with more people, regardless of where they bank." This type of application is known as a peer-to-peer or person-to-person (P2P) money transfer service.

There are numerous other P2P services including Venmo, Cash App, PayPal, Google Pay, and Apple Pay. For your sake and mine, I am not going to try to explain precisely how each of these payment services operate. (For more details on these services, go ask a millennial.) Broadly speaking, some of these applications move money directly from one bank account to another bank account, while other applications move the money through an intermediary "digital wallet."

Until recently, lawyers were prohibited from using intermediary payment services for entrusted funds. RPC 247 states that advance fees, mixed funds, and money advanced for costs must be deposited "directly" into a trust account. RPC 247 relied on Rule 1.15-2, which states that "[a]ll trust funds received by or placed under the control of a lawyer shall be promptly deposited in either a general trust account or a dedicated trust account of the lawyer." On March 27, 2019, however, the North Carolina Supreme Court approved the following new comment to Rule 1.15:

> [13] Client or third-party funds on occasion pass through, or are originated by, intermediaries before deposit to a trust or fiduciary account. Such intermediaries include banks, credit card processors, litigation funding entities, and online marketing platforms. A lawyer may use an intermediary to collect a fee. However, the lawyer may not participate in or facilitate the collection of a fee by an intermediary that is unreliable or untrustworthy. Therefore, the lawyer has an obligation to make a reasonable investigation into the reliability, stability, and viability of an intermediary to determine whether reasonable measures are being taken to segregate and safeguard client funds against loss or theft and, should such funds be lost, that the intermediary has the resources to compensate the client. Absent other indicia of fraud (such as the use of non-industry standard methods for collection of credit card information), a lawyer's diligence obligation is satisfied if the intermediary collects client funds using a credit or debit card. Unearned fees, if collected by an intermediary, must be transferred to the lawyer's designated trust or fiduciary account within a reasonable period of time so as to minimize the risk of loss while the funds are in the possession of another, and to enable the collection of interest on the funds for the IOLTA program or the client as appropriate. See 27 N.C.A.C. 1B, Section .1300.

Under the revised comment, lawyers are permitted to use an intermediary payment service if the service is reliable and trustworthy. The lawyer has the personal responsibility to determine whether a particular service meets those standards. Specifically, "the lawyer has an obligation to make a reasonable investigation into the reliability, stability, and viability of an intermediary to determine whether reasonable measures are being taken to segregate and safeguard client funds against loss or theft and, should such funds be lost, that the intermediary has the resources to compensate the client."

The investigatory responsibilities set out in comment [13] are no joke considering the technical intricacies of the operations used by these payment services. The ABA has opined that the risk profile of peer-to-peer transactions will be tied to the risk profile of the underlying payment methodology. According to the ABA, a peer-to-peer transaction will have greater protections if it is based on a payment methodology that affords greater protection. The ABA urges lawyers to choose a service that offers the same kinds of protections provided by other payment options, such as credit and debit cards.

Comment [13] specifically approves of the use of credit or debit cards for collecting client funds. An exception to the prohibition on intermediary payment services has previously been allowed for credit card payments. Interestingly, the Ethics Committee approved of the use of "Master Charge and other credit card services" in 1977. See CPR 129. Because the CPRs are not available in the Handbook or online, CPR 129 is reproduced here in its enlightening entirety:

> CPR 129
> (October 27, 1977)
> Inquiry: Is it ethical for an attorney to offer Master Charge and other credit card services to clients for the payment of fees charged for

services rendered to such clients?

Opinion: Yes.

Further guidelines for the acceptance of credit card payments are set out in RPC 247, Payment of Fees by Electronic Transfer (1997); 97 FEO 9, Credit Card Chargebacks Against a Trust Account (1998); and 2009 FEO 4, Credit Card Account that Avoids Commingling (2009). Pursuant to RPC 247, credit card fees or discount charges assessed against the trust account must be properly accounted for and must not be paid with client funds unless the funds were specifically collected for that purpose. In discussing credit card chargebacks, 97 FEO 9 provides that, "[u]nder all circumstances, a lawyer is ethically compelled to arrange for a payment (from his or her own funds or from some other source) to the trust account sufficient to cover the chargeback in the event that a chargeback jeopardizes the funds of other clients on deposit in the account."

Regardless of whether the application uses an intermediary account, it is the lawyer's responsibility to ensure that the use of the P2P application is compliant with all of the lawyer's professional responsibilities. Rule 1.15 requires a lawyer to manage a trust account according to strict recordkeeping and procedural requirements. The specific recordkeeping requirements set out in Rule 1.15 may prove problematic depending on the operation of the P2P application.

Above all, Rule 1.15 requires lawyers to safekeep entrusted property. Lawyers need to carefully scrutinize the security of the application before linking their trust account to any mobile or online application. 2011 FEO 7 addresses security concerns that arise when a law firm uses online banking to manage a trust account. As noted in 2011 FEO 7, "[f]inancial transactions conducted over the internet are subject to the risk of theft by hackers and other computer criminals." Nevertheless, 2011 FEO 7 provides that law firms may use online banking to manage a client trust account if the recordkeeping and fiduciary obligations in Rule 1.15 can be fulfilled. The opinion states that a lawyer must use reasonable care to "minimize the risk of loss or theft of client property specifically including the regular education of the firm's managing lawyers on the ever-changing security risks of online banking and the active maintenance of end-user security." See also RPC 209 (noting the "general fiduciary duty to safeguard the property of a client") and 98 FEO 15 (requiring a lawyer to exercise "due care" when selecting depository bank for trust account).

Similar security concerns/obligations are emphasized in 2011 FEO 6, Subscribing to Software as a Service while Fulfilling the Duties of Confidentiality and Preservation of Client Property. The opinion provides that:

> the use of the internet to transmit and store client data [or, in this instance, data about client property] presents significant challenges. In this complex and technical environment, a lawyer must be able to fulfill the fiduciary obligations to protect confidential client information and property from risk of disclosure and loss. The lawyer must protect against security weaknesses unique to the internet, particularly "end-user" vulnerabilities found in the lawyer's own law office. The lawyer must also engage in frequent and regular education about the security risks presented by the internet.

(Lawyers also need to consider the duty to protect client information as set out in Rule 1.6. Certain P2P applications incorporate social media features. Lawyers need to be mindful of any social media aspects to a payment service that might disclose confidential client information, including payments made by client to lawyer.)

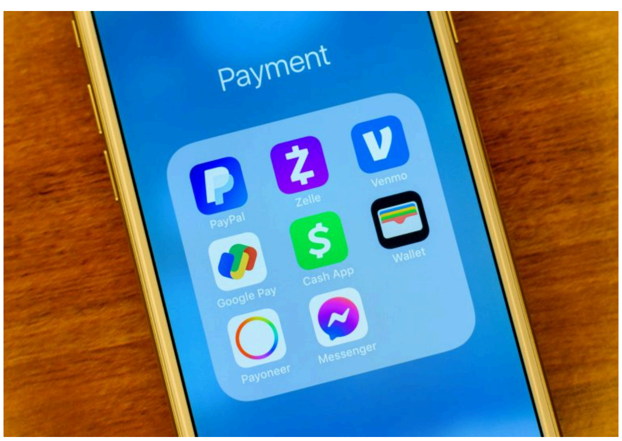
Finally, lawyers need to consider whether the use of the P2P application will result in the comingling of lawyer and client funds. Rule 1.15 prohibits commingling of entrusted property and attorney funds. Some applications only allow a lawyer to choose one account where transferred funds get immediately and directly deposited. Other applications accept payment on behalf of a user and retain the funds in an account within the application; the user must then proactively retrieve the funds from the application's account to complete the transfer of funds into the user's bank account of choice. In the case of entrusted client funds, this type of application essentially places entrusted client funds in a nonattorney trust account until retrieved by the lawyer. Revised comment [13] states that such funds "must be transferred to the lawyer's designated trust or fiduciary account within a reasonable period of time so as to minimize the risk of loss while the funds are in the possession of another, and to enable the collection of interest on the funds for the IOLTA program or the client as appropriate." Considering the purpose and language of Rule 1.15, including the vulnerability of client funds remaining in a nonattorney trust account, the potential harm to be suffered by the client, and the lawyer's requirement to safeguard those client funds, anything less than prompt transfer of those funds to the lawyer's trust account upon becoming available would not be reasonable. Such applications are also ripe for potential commingling of the lawyer's personal funds, earned fees, and client funds. At the very least, a lawyer would be wise to set up a separate account through which any transactions consisting of client funds are directed. Though having multiple accounts may be tedious (and will increase the lawyer's record-keeping and monitoring efforts), the potential for client harm and related misconduct outweigh any concerns of convenience.

It is each lawyer's responsibility to ensure that the transfer method employed by a P2P service complies with the lawyer's professional responsibilities. This will be no easy task given the security concerns that arise with an application that involves the transfer of client funds and links directly to a lawyer's trust account. For a lawyer who performs fixed or flat rate fee services, the risk of using P2P payment services may be minimal. However, with entrusted funds, the ethical issues are more complex and include the strict record keeping requirements and the prohibition against commingling associated with traditional transfers and handling of entrusted funds. For these reasons, a lawyer may want to forego the use of these newfangled P2P payment services when it involves entrusted funds and stick with cash, check, credit card, or chickens instead.

Suzanne Lever is assistant ethics counsel for the North Carolina State Bar.

# Trust, Tech and Traps: Safeguarding Legal Funds in a P2P World

*By Julie Bays*




Safeguarding client funds is one of the most important duties a lawyer has. It's also one of the easiest to get wrong. Trust account management is, on paper, straightforward: Keep client money separate from your own, keep accurate records and reconcile every month. In practice, even honest lawyers sometimes find themselves in disciplinary trouble because they didn't pay enough attention to the details.

And yes, while we like to joke that many lawyers "went to law school because we can't do math," regarding trust accounts, math is no joking matter. Mishandling client funds can put your license at risk.

Now add modern payment apps to the mix. Venmo, PayPal, Zelle, Cash App, Apple Pay and Google Pay are commonly used by clients. They make it easy to pay you from the waiting room, the couch or even while standing in line at the grocery store. For them, it's as natural as ordering coffee on their phone. But what works for buying lunch doesn't always work for holding client funds. These consumer-oriented tools were not built with the strict requirements of the Oklahoma Rules of Professional Conduct (ORPC) in mind.

Accepting retainers or settlement funds through a P2P app without safeguards can undermine client confidentiality, violate trust accounting rules and leave you scrambling if a transaction is reversed. Across the country, bar associations have weighed in. The short version? You can sometimes use them, but only with serious precautions. And if you're handling unearned fees or other trust funds, legal-specific payment processors are almost always the safer route.

**A REVIEW OF THE ORPC IOLTA**

The ORPC require a lawyer to hold property of clients or third persons separate from the lawyer's own property. This means retainers and flat fees, filing fees, deposition and expert witness fees, as well as settlement proceeds, should go into a trust account until distribution.[1] These funds must be deposited in an Interest on Lawyers' Trust Account (IOLTA). The interest earned on IOLTAs is pooled and transferred to the Oklahoma Bar Foundation.

The fiduciary nature of the attorney-client relationship and the need for public confidence in the legal profession require lawyers to maintain trust accounts with the utmost accuracy. Because of this, one requirement under Rule 1.15(k) is that financial institutions must report any overdrafts of IOLTAs to the Oklahoma Bar Association Office of the General Counsel.[2]

Interest earned by pooling these funds in an IOLTA trust account is forwarded to the OBF by the financial institution where the account is held. These funds are used to support civil legal aid services for the poor and elderly, provide greater access to justice, provide public law-related education programs, support high school mock trial programs and support many other vitally needed law-related charitable programs and activities throughout Oklahoma.

ORPC Rule 1.15(h) states:

> A lawyer or law firm that holds funds of clients or third parties in connection with a representation shall create and maintain an interest-bearing demand trust account ("IOLTA Account") and shall deposit therein all such funds to the extent permitted by applicable banking laws, that are nominal in amount or to be held for a short period of time in compliance with the following provisions:
>
> > These funds should be nominal in amount or held for short periods of time. To determine whether the client funds are "nominal in amount" or "to be held for a short period of time," the lawyer should consider whether the funds could be invested to provide a positive net return or benefit to the client considering these factors:
> >
> > 1. the amount of interest the funds would earn during the period the funds are expected to be deposited.
> > 2. the cost of setting up and administering the account, including the cost of lawyer's services, bookkeeping costs, and the cost of preparing any tax reports required for interest accruing to a client's benefit.
> > 3. the capability of the financial institution to calculate and pay interest to individual clients.

Client funds that do not meet the nominal or short-term definitions may be placed in a separate account that may earn interest for the client's benefit. The client's tax ID number should be used on such an account.[3]

**FEES MUST BE EARNED**

Unearned legal fees, expenses that have not yet been incurred and third-party funds related to representation must be placed in an IOLTA account. Retainers, flat fees (until earned), filing fees, deposition and expert witness costs and settlement proceeds must also be held in trust for distribution. Settlement funds are not to be disbursed until all allocation disputes have been resolved.

In *State ex rel. Oklahoma Bar Association v. Weigel*, the Oklahoma Supreme Court found that an attorney violated Rule 1.15(a) by taking client fees without completing the agreed work and by failing to keep client funds separate from personal funds. The court emphasized that advance fee retainers must remain segregated until earned. It also clarified that attorneys may not label advance payments as “nonrefundable retainers.” While fixed fees are permissible, lawyers must refund any unearned portion if representation ends before the work is completed, as required under Rule 1.16(d).[4]

**TECHNOLOGICAL COMPETENCE**

There is an ethical obligation for lawyers to keep abreast of changes in the law and its practice, which includes understanding the benefits and risks associated with relevant technology. This implies a proactive duty to research and comprehend the security features, terms of service and potential vulnerabilities of any payment platform used in their practice.[5]

**PEER-TO-PEER PAYMENT APPLICATIONS**

Using peer-to-peer payment applications introduces many risks that extend well beyond basic trust accounting rules. While these tools may be convenient for clients, they were not designed with lawyers’ fiduciary duties in mind. Issues such as data security, privacy, transaction fees and even the possibility of chargebacks can create ethical and financial complications if not fully understood. Lawyers must also know the regulatory limits of these services, including the lack of federal insurance protection and the potential for technical glitches or outages.

**SECURITY AND PRIVACY CONCERNS**

Lawyers must take reasonable steps to prevent the inadvertent or unwanted disclosure of information regarding transactions with parties other than the lawyer, the client or a third person paying. Several privacy concerns arise when using payment applications. Payment apps often have access to large amounts of personal data, including names, contact information and financial details. If these apps lack strong security measures, that data may be at risk of exposure or theft. Some providers even store data in jurisdictions with weaker protection laws, further increasing vulnerability.

Another issue is data sharing. Many payment apps share user information with third parties for purposes such as marketing or business analytics, and sometimes, they even sell that data. This practice can expose client information beyond its intended scope and potentially conflict with a lawyer’s duty of confidentiality. Although most apps use encryption to secure transactions, the strength of encryption varies. Inadequate protection could leave sensitive data open to threats. Anonymity is not always possible with payment apps.

In situations where a lawyer or client may need anonymity, such as in certain trust or escrow matters, this limitation can be problematic. Finally, data retention is also a concern. Even after a user deletes an account, some apps keep data for extended periods, creating lingering risks that cybercriminals could exploit.

**TRANSACTION FEES**

Payment apps charge transaction fees for receiving payments, and these fees should be a significant consideration when collecting retainers. Lawyers may need to factor in these fees when determining their retainer amounts to ensure they receive the appropriate funds for their services. Furthermore, payment apps withdraw these fees directly from the payment the client makes.

The ORPC requires lawyers to keep client funds separate from their own, maintain accurate records and avoid commingling their personal funds with client funds. Regarding the use of payment apps for handling client funds, the transaction fees charged by these apps can create ethical issues. Lawyers are encouraged to carefully review the user agreements or terms of service before they begin accepting payments, particularly retainers for legal services through their existing trust, operational or personal accounts.

Unless there is a different agreement between the attorney and the client, it is the lawyer's responsibility to pay any transaction fees charged to the account, and such costs should not be deducted from the client's trust funds.

**CHARGEBACKS**

Payment apps also present challenges with chargebacks. A chargeback occurs when a credit card payment is reversed at the request of the bank or cardholder. For lawyers, this can be particularly difficult because legal services are not tangible goods that can be easily evaluated. Clients may dispute the value of services provided and request a chargeback, leaving the lawyer with the burden of proving that services were delivered.

Unlike regulated credit card systems, many payment applications will freeze the entire account rather than isolating the disputed transaction. This means that funds from other clients may be temporarily inaccessible, creating serious risks for lawyers who are holding other clients' money in the same account. Because of these complications, attorneys should be cautious about using platforms such as Venmo, PayPal or Cash App for retainers and should be familiar with the chargeback processes of these providers.

**BANK REGULATIONS VERSUS USER AGREEMENTS**

Another critical distinction lies between traditional bank regulations and the user agreements of payment apps. The Consumer Financial Protection Bureau (CFPB) has warned consumers not to store funds with payment apps, noting that these services are not federally insured. This creates risks if the app faces financial troubles or bankruptcy. Unlike deposits held in Federal Deposit Insurance Corp.-insured banks, funds stored in payment apps do not carry the $250,000 per client protection guarantee.[6]

The collapse of platforms such as FTX highlights the danger when customers cannot access funds because protective measures are absent. In addition, payment apps may face liquidity crises if too many users attempt to withdraw funds at once – a scenario that would rarely occur under traditional banking safeguards.

**OTHER PROBLEMS WITH PAYMENT APPLICATIONS**

Technical glitches and service outages further illustrate the risks of payment apps. Cash App recently suffered a software error that caused duplicate transactions and left many users with negative balances. Although refunds were issued, the disruption created significant problems for affected customers. Similarly, Cash App and Square both reported major outages in September 2023, which delayed transfers and disrupted transactions.

Zelle has also experienced repeated issues. A disruption at JPMorgan Chase in July 2023 lasted over a week, and a separate failure occurred at Bank of America earlier that year. More recently, in May 2025, Zelle experienced a widespread outage affecting several large banks, including Truist, Navy Federal Credit Union and Bank of America. The problem was traced to a third-party processor, Fiserv. During the outage, users could not complete payments, highlighting the fragility of the digital payment infrastructure and the cascading effects of third-party disruptions.

**CFPB OVERSIGHT EFFORTS AND LEGISLATIVE REPEAL**

In late 2024, the CFPB finalized a rule to bring large nonbank digital payment platforms – such as Venmo, PayPal, Cash App, Apple Pay and Google Pay – under federal supervision. The rule would have applied to companies processing over 50 million transactions annually, requiring them to comply with regulations similar to those imposed on banks and credit card providers. These included provisions from the Gramm-Leach-Bliley Act (Regulation P), the Electronic Fund Transfer Act (Regulation E) and prohibitions against unfair, deceptive or abusive acts and practices.

However, in early 2025, Congress overturned the rule using the Congressional Review Act. Despite limited bipartisan support, the resolution was passed and signed into law. This repeal not only nullifies the CFPB's effort to supervise these platforms but also prevents the bureau from issuing a substantially similar rule without explicit new legislative authority.

This rollback results in P2P payment platforms being largely unregulated at the federal level, despite their increasing use for both personal and commercial transactions, including professional services like legal payments. Lawyers using these services should know the potential risks related to data privacy, fraud and fund security due to the lack of federal oversight.

**ANALYSIS OF BAR ASSOCIATION ETHICS OPINIONS ON P2P PAYMENTS**

*South Carolina Bar Ethics Advisory Opinion 18-05 (2018)*

This opinion specifically addressed whether a lawyer may accept an earnest money deposit through PayPal. It concluded that such use is permissible if the PayPal account does not contain the lawyer's own property, thereby preventing commingling. The opinion mandates that appropriate records must be maintained, and if the funds are nominal or short-term, they must be promptly transferred to an IOLTA account for safekeeping. Lawyers are explicitly warned to be aware of the risks of noncollection or reversal of payments, as online payment services have unique terms of service that may allow for reversals on extended timelines compared to traditional checks or wire transfers. It reiterates the requirement for extensive documentation to be kept current and preserved for a period of six years after the termination of representation.[7]

*Florida Bar Professional Ethics Committee Formal Advisory Opinion 21-2 (2021)*

This opinion directly addressed whether lawyers may accept payments from clients via web-based payment processing services, including Venmo and PayPal. It concluded that there is no ethical prohibition to using such services, provided the lawyer fulfills certain stringent requirements.[8]

Lawyers must take reasonable steps to prevent the disclosure of confidential information. This includes using the most restrictive privacy settings available on platforms (*e.g.*, Venmo's "Private" setting) and researching the service to ensure customary security features are in place. While not ethically required, lawyers may consider advising clients about the risks.

Payments must be directed to an account with the service used only to receive client and third-party funds to strictly prevent commingling. These funds must then be promptly placed in the lawyer's qualifying IOLTA account. The opinion also notes that a payee does not immediately acquire possession of funds transmitted by a payment processing service. A "suspense account" may be necessary if direct transfer to IOLTA is impossible due to banking limitations.

Unless there is an agreement to the contrary, the lawyer must ensure that all transaction fees charged by the payment application are paid by the lawyer and are not deducted from client trust funds.

*North Carolina State Bar Guidance*

Guidance from the North Carolina State Bar indicates a significant evolution in its stance. Previously, regulations required lawyers to deposit advance fees and other mixed funds directly into a trust account, prohibiting the use of intermediary payment services for entrusted funds.[9]

However, a revised comment now permits the use of an intermediary payment service if it is determined to be "reliable and trustworthy." The lawyer bears the personal responsibility to make a "reasonable investigation into the reliability, stability and viability of an intermediary" to ensure client funds are segregated and safeguarded against loss or theft. The guidance acknowledges that Rule 1.15's strict recordkeeping requirements may prove problematic depending on the specific operation of the P2P application.

Lawyers are explicitly reminded to be mindful of any social media aspects of a payment service that might disclose confidential client information, including payment details. It warns that some applications only allow a lawyer to choose one account for direct deposit, creating a high risk of commingling the lawyer's personal funds, earned fees and client funds, strongly advising setting up a separate account for client funds.

*Maine Ethics Opinion 226 (2024)*

Issued by the Professional Ethics Commission on Feb. 1, 2024, Maine Ethics Opinion 226 addresses whether Maine attorneys can accept payments through online payment apps – such as Venmo, PayPal, Zelle or Headnote – and the ethical issues surrounding their use.[10]

The opinion concludes that Maine lawyers may accept payments (typically for legal fees, retainers or expenses) through these third-party payment apps, provided that the app and the lawyer's processes prevent the commingling of client funds with their own, and unearned fees are placed exclusively into client trust accounts. It strongly encourages lawyers to select only apps specifically designed for the legal industry and for ethical rules compliance, noting that some apps have built-in safeguards while others do not.

Lawyers cannot delegate their responsibility for compliance with the Rules of Professional Conduct. Apps should be secure and updated, and lawyers should stay informed about how the apps function.

**CONCLUSION**

Bar associations have consistently emphasized the same core requirements: Client funds must remain separate, records must be meticulously maintained, and lawyers bear the ultimate responsibility for safeguarding money held in trust. These principles align with the Oklahoma Rules of Professional Conduct, which focus on preventing commingling, ensuring accuracy and protecting fiduciary relationships with clients.

Peer-to-peer payment apps, while convenient, introduce risks that traditional banking systems and lawyer trust accounts were specifically designed to avoid. Security concerns, transaction fees, chargebacks, account freezes and the lack of federal oversight all stand in stark contrast to the protections built into regulated financial institutions. The lessons from bar association ethics opinions are clear: Lawyers may use these tools in limited circumstances, but only with careful attention to safeguards, client communication and prompt transfer of funds into appropriate accounts.

Ultimately, convenience cannot outweigh compliance. Lawyers who accept payments through consumer-oriented platforms must treat every transaction as if the license to practice law depends on it, because in the end, it just might.

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**ABOUT THE AUTHOR**

Julie Bays is the OBA Management Assistance Program director, providing assistance to attorneys using technology and other tools to efficiently manage their offices. She joined the OBA as practice management advisor in 2018. She is also involved with the OBA Access to Justice Committee and actively contributes to the ABA Law Practice Division. She writes for *Law Practice* magazine and has served on the board of ABA TECHSHOW, including as co-chair in 2025.

**ENDNOTES**

[1] ORPC 1.15(a)(c)(d).

[2] ORPC 1.15(k).

[3] “Money and Ethics: Trust Accounts, Expenses, Loans, Gifts, Fee Divisions and Liens,” *OBJ*, Vol. 76, Issue 34 (Dec. 10, 2005), pp. 2835-2844.

[4] *State ex rel. Oklahoma Bar Ass’n v. Weigel*, 2014 OK 4.

[5] ORPC 1.1 Comment [6].

[6] https://bit.ly/49hgb6m.

[7] https://bit.ly/4qWUgaU.

[8] https://bit.ly/47A7V04.

[9] https://bit.ly/43o6i3c.

[10] https://bit.ly/4nUxNZv.

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## Contact Us

405-416-7000
800-522-8065 (toll free)

P.O. Box 53036
Oklahoma City, OK 73152

1901 N. Lincoln Blvd.
Oklahoma City, OK 73105

LEGAL ETHICS OPINION 1835

TRUST ACCOUNT – CAN A LAWYER REMIT IRREVOCABLY CREDITED FUNDS WHEN ACCOUNT HOLDS FUNDS FOR ONLY ONE CLIENT?

You have presented a hypothetical situation in which a law firm represents a number of creditors in the collection of delinquent consumer/retail accounts. The firm maintains a separate trust account for each major client, into which they deposit only those funds collected on behalf of that client from account debtors. All of these funds held in each individual account belong only to one client, but are collected from a multitude of different debtors.

Under the facts you have presented you have asked the following questions:

1. When an attorney trust account holds funds for only <u>one</u> client, is it necessary to remit <u>only</u> on irrevocably credited funds in a trust account, or may remittances be made on a more prompt basis without violating the Rules of Professional Conduct?

2. If the answer to the first question is that disbursements on uncollected funds are permissible under those circumstances, is the same conclusion reached if the retail accounts that are being collected by the client have been "securitized", leaving the client with only servicing and perhaps some residual rights under the securitization process?

Rule 1.15 governs the lawyer's duty to safeguard other's property and 1.15 (c) states that " [A] lawyer shall: … (4) promptly pay or deliver to the client ….the funds, securities, or other properties in the possession of the lawyer which such person is entitled to receive."

This committee has previously made reference in various LEOs to the term "irrevocably credited" when referring to the appropriate designation of funds available to be ethically disbursed to clients.[1] LEO 1255 clearly states this committee's continuing opinion on the correct timing of disbursement of funds.[2] As the requester correctly states, the term "irrevocably credited" has no legal definition, however, the committee continues to opine that, in spite of past terminology, the funds must be deposited into the lawyer's trust account, credited to the account, and be "cleared" funds that are available for withdrawal and disbursement with no chance of revocation or recall by the financial institution. As the requester has advised, the determination of when funds actually meet

[1] LEOs 183, 1021, 1255, 1256, 1797.

[2] While the disciplinary rule establishes an affirmative duty to pass funds to a party or the parties entitled to the funds, it implicitly prohibits payment of funds from an escrow account to the party who is *not or not yet* entitled to the funds. (emphasis added) Thus, a strict interpretation would require an attorney not to disburse upon items deposited in his trust account until the depository bank had irrevocably credited them to that account. (See LE Op. 183, LE Op. 753 and LE Op. 813) It is well established that an attorney assumes a strict fiduciary responsibility when he holds money belonging to the client. (See *Pickus v. Virginia State Bar*, 232 Va. 5 (1986)). LEO 1255

that standard is determined by federal banking regulations and is a legal issue outside the purview of this committee.[3]

Additionally, the question distinguishes those funds held in a commingled trust account from those funds held in a trust account exclusively for one client. The answer remains the same.

The answer to the second question is not required since the answer to the first question deemed such disbursements to be improper and the second question seems to involve legal concepts outside the purview of this committee.

This opinion is advisory only, based on the facts presented and not binding on any court or tribunal.

[3] The requester accurately states that the amount of time a bank is permitted to hold funds before making the funds available for withdrawal is governed by a federal statute called the Expedited Funds Availability Act, 12 U.S.C. § 4001, *et seq.* (the “EFA”). The EFA places “upper limits” on the amount of time banks are permitted to hold different categories of payment instruments before making the funds available for withdrawal.

# 2026 Kansas Legislative Update

# About Joe

Joseph began serving as Director of Legislative and Access to Justice platforms. Prior to joining the KBA, he was Chief Legal Counsel for the Topeka Metropolitan Transit Authority, where his practice involved insurance subrogation, labor law, and employment law. He also previously served as an Assistant Attorney General, acting as the Director of the Kansas No-Call Act. Molina holds a Bachelor of Arts in Political Science, Philosophy, and Economics from Eastern Oregon University, along with a juris doctorate from the Washburn University School of Law. His primary responsibility is statewide advocacy for KBA issues.

Molina is married to his wife of 20 years, Malessa. He has two sons, Jonah (17) and Isaiah (14). He also has a hanai daughter, Vanessa, who has a young daughter named Alice. Molina is on the Board for Kansas Red Cross and a member of Topeka Sertoma. Molina is originally from Maui, Hawaii, having moved to the mainland for college in 1999.

# 2026 Legislative Highlights

Kansas Legislative Research Department May 18, 2026 klrd.gov

## ABORTION

### Pregnancy Center Autonomy and Rights of Expression Act

**HB 2635** enacts the Pregnancy Center Autonomy and Rights of Expression Act, prohibiting regulations, policies, procedures, and other measures that would require pregnancy centers to offer, perform, or provide referrals for abortions or abortion-inducing drugs or would interfere with a pregnancy center's ability to provide pregnancy, childbirth, or parenting services. Pregnancy centers aggrieved by a violation of the Act could bring a civil action for damages or appropriate relief.

## AGRICULTURE & NATURAL RESOURCES

### Hunting and Fishing Licenses

**SB 364** creates and amends law concerning the resident senior combination hunting and fishing license and the Kansas kids lifetime combination hunting and fishing license.

The bill requires the Kansas Department of Wildlife and Parks to offer residents age 65 years or older a combination hunting and fishing license at a discounted rate not to exceed one-eighth of the fee for a general combination lifetime license.

The bill extends the maximum age range for children to receive a license from 6 or 7 years of age to 6 through 15 years of age. The bill also reduces the maximum fee charged for the license from $500 to $400 for children 6 through 15 years of age. The bill does not change age specifications or fees charged for the license to children 5 years or younger. The bill removes the sunset for license provisions set to expire on July 1, 2032.

### Potable Water and Water Grant Funding

**HB 2462** requires rules and regulations for potable reusable water to be adopted and extends the sunset on transfers from the State General Fund (SGF) to the State Water Plan Fund (SWPF) and transfers from the SWPF to the Water Technical Assistance Fund and Water Projects Grant Fund on a yearly basis until July 1, 2027. The Legislature's intent is to provide for the transfer of $35.0 million from the SGF to the SWPF on July 1, 2028. The bill also makes changes to the grant application and selection criteria and gives priority to municipalities with a population of less than 3,000.

## CHILDREN & YOUTH

### Juvenile Code Revisions and Juvenile Crisis Stabilization Centers

**HB 2329**, among other things, amends provisions in the Revised Kansas Juvenile Justice Code (Juvenile Code) relating to pre-adjudication placement and sentencing. The bill also changes the name of juvenile crisis intervention centers to juvenile stabilization centers throughout the Revised Kansas Code for the Care of Children (CINC Code) and the Juvenile Code and modifies the intake criteria for and the treatment and services provided by such centers.

**Pre-adjudication Placement.** The bill directs the court to approve an override placing a juvenile in a juvenile detention facility when such juvenile is alleged to have possessed or used a firearm during the commission of an offense or has been presented to a juvenile intake and assessment center for the second time in three months for an offense that, if committed by an adult, would constitute a misdemeanor or felony charge. The bill also extends the maximum detention limit for a juvenile to 90 days from 45 days.

## CONTENTS

**Sentencing.** The bill authorizes the court to commit a juvenile directly to a juvenile correctional complex if the juvenile was adjudicated for an offense that would constitute a felony for an adult and a firearm was possessed or used during the commission of the offense or the juvenile is a chronic offender and is assessed as moderate-risk.

The bill directs the Secretary of Corrections to contract with therapeutic foster homes and emergency shelters and to establish Youth Residential Centers (YRCs). The bill further authorizes the court to sentence adjudicated juveniles directly to YRCs.

**Juvenile Stabilization Centers.** The bill requires both family skill building and individual communication services to be provided to individuals admitted to juvenile stabilization centers. Priority for admission to such centers would be given to young people who are 10 years of age or older, are at risk of being adjudicated, or are already adjudicated as a child in need of care.

### Child Placement Agencies and Kansas Tort Claims Act

**HB 2521** modifies the definition of "governmental entity" in the Kansas Tort Claims Act to add a child placement agency, if the child placement agency had an active contract with the Secretary for Children and Families when the act or omission giving rise to the claim occurred. The bill limits application of the revised definition to a cause of action accruing on or after July 1, 2026, and the provision will sunset on July 1, 2029.

### Child Abuse and Neglect Registry; Abuse and Neglect Reporting

**HB 2601** establishes a Child Abuse and Neglect Registry (Registry) in statute, to be maintained by the Secretary for Children and Families. The bill requires an administrative hearing and an opportunity for appeal before placing an individual on the Registry, and provides a process for expunging the name of an individual ordered to be placed on the Registry. The bill also requires child abuse and neglect reports to include information about any known custody dispute involving the child subject to the report.

## COMMERCE & LABOR

### Digital Right-to-repair Act

**HB 2700** creates the Kansas Digital Right-to-repair Act, which establishes requirements for original equipment manufacturers (OEMs) and legal authorization for consumers related to the maintenance and repair of certain digital electronic equipment.

Within one year of the first sale of a product in Kansas, the bill generally requires an OEM to make replacement parts or tools available to any independent repair provider or owner of the equipment manufactured, sold, or supplied by the OEM. Such parts or tools must be the same products that the OEM makes available to authorized repair providers.

The bill applies to any product with a wholesale price of at least $50 sold or leased to a Kansas consumer that depends on digital electronics embedded in or attached to the product for its intended functionality. The bill exempts certain types of products, including farming equipment, motor vehicles, and toys from provisions of the Act. The Act only applies to digital equipment made for sale in Kansas by an OEM on or after July 1, 2027.

## CONCEALED CARRY & FIREARMS

### Firearms Hold Agreements; Firearm Suppressors and Short-barrel Shotguns

**Senate Sub. for HB 2501**, among other things, creates law concerning firearms hold agreements and amends criminal and sentencing laws related to firearm suppressors and short-barrel shotguns.

The bill creates laws that allow a federal firearms licensee (FFL) to enter into an agreement to hold firearms for a firearm owner. Under such agreements, the FFL is immune from civil liability for storage or for returning the firearm to the owner per the agreement. Once the agreement is terminated, the FFL must return the firearm to the owner, so long as the owner is able to legally possess a firearm.

The bill also amends criminal law to allow for possession of firearm suppressors and short-barrel shotguns, while enhancing sentencing laws for certain felony offenses committed while using a suppressor or short-barrel shotgun.

## CORRECTIONS

### Prisoner Review Board

**SB 459** establishes the Prisoner Review Board (Board) as an entity independent of the Kansas Department of Corrections. The bill increases Board membership from three members to five members, authorizes the Governor and Attorney General to appoint Board members, and modifies the requirements for parole hearings and the granting of parole.

### Prison-made Goods Act—Hutchinson Pilot Program

**HB 2596** creates a limited exception to the Prison-made Goods Act of Kansas authorizing the Secretary of Corrections (Secretary) to establish a pilot program at the Hutchinson Correctional Facility to enter into contracts for production of manufactured or modular homes.

The bill requires any private individual, corporation, partnership, or association contracting with the Secretary as a part of the pilot program to provide a nationally recognized construction education certification program for participants; evaluate the success of such program after participation and release; and pay all costs related to the project.

Any nonprofit organization contracting with the Secretary is required to agree not to request a property tax exemption for such housing units and to pay property or ad valorem taxes on units it retains and owns.

## ECONOMIC DEVELOPMENT

### Extraordinary Event Proclamations

**Senate Sub. for HB 2212** authorizes the Governor to issue a proclamation declaring the need for enhanced public safety and security for an extraordinary event.

An "extraordinary event" includes events hosted in Kansas, or in any county bordering Kansas, that would cause a significant impact in the state, including the World Cup, the Super Bowl, a national political convention, or other events similar in scope and size with respect to expected attendance and security requirements.

Any such proclamation would activate the disaster response and recovery aspects of the State Disaster Emergency Plan and any applicable local and interjurisdictional disaster plans and would be valid for a maximum of 15 days but could be extended by the Legislative Coordinating Council for up to 90 days.

### Kansas Sports Facilities Authority; STAR Bonds

**HB 2466** enacts the Kansas Sports Facilities Authority Act (Act) and makes various changes to the STAR Bonds Financing Act (STAR Bonds).

*Sports Facilities Authority*

The Act establishes the Kansas Sports Facilities Authority (Authority) as a political subdivision of the state to provide for the development, management, and long-term use of a sports facility and related infrastructure (Facilities) for the Kansas City Chiefs (Team) to play home games and host other events and entertainment.

The Authority will consist of 11 members, to be appointed by August 31, 2026, to include the Secretary of Commerce (Secretary) and members appointed by the Governor, certain members of the Legislature, the Kansas City Chiefs (Team), and the mayors of the two cities in which the Facilities are to be located.

Authority property used for public purposes is exempt from all property taxes and purchases for constructing, equipping, or furnishing the Facilities are exempt from sales and use taxes until the bonds used to fund such development are repaid.

*STAR Bonds Changes*

**Visitation Goals.** The bill requires the Secretary to establish project-specific visitation goals for visitors from at least 100 miles away and from out-of-state and creates a process for monitoring and encouraging satisfactory developer compliance with such goals.

**Amusement Park Rides.** The bill authorizes the use of STAR Bonds to finance amusement park rides and certain related buildings, including interactive visitor experiences with the capacity to attract over 100,000 people per year.

**District Boundaries.** The bill allows more than one STAR Bonds project within a project area and authorizes the Secretary to modify project boundaries after initial approval, provided it does not affect city or county participation or pledged revenues without local approval.

**Pledged Revenues.** The bill prohibits State General Fund revenues from being used to repay STAR Bonds and also prohibits tax increment revenue of a STAR Bond district from being pledged toward subsequent STAR Bond projects. The bill allows incremental revenue from Community Improvement Districts and Transportation Development Districts to be used to repay STAR Bonds.

**Eminent Domain Authority.** The bill eliminates the authority of local governments to exercise eminent domain to acquire property for a STAR Bond project.

### World Cup Alcohol Sales; Short-term Rentals

**HB 2481** authorizes counties and cities to allow, through ordinance or resolution, the sale of alcoholic beverages 23 hours a day, 7 days a week, for the duration of the FIFA 2026 World Cup, and between May 15, 2026, and July 25, 2026, requires the collection of transient guest taxes for any short-term rental or vacation unit and prohibits cities and counties from limiting the number of permits or other authorizations required for the operation of such units.

## EDUCATION

### Federal Tax Credit Participation

**SB 361** authorizes Kansas to participate in the federal tax credit program for contributions of individuals to scholarship granting organizations (SGOs) pursuant to Section 25F of the federal Internal Revenue Code for all taxable years beginning after December 31, 2026.

The bill directs the State Treasurer to annually provide to the U.S. Secretary of the Treasury, or the Secretary's delegate, any required information, including, but not limited to, a list of the SGOs located in Kansas that meet the requirements described in Section 25F of the Internal Revenue Code.

The bill also prohibits any state department, division, or other agency from promulgating any rules and regulations that are more stringent than the applicable federal law or rules and regulations.

### Personal Communication Device and Social Media Policies

**Senate Sub. for HB 2299**, among other things, requires each school district and accredited nonpublic school (private school) to adopt policies and procedures regarding the use of personal electronic communication devices (devices) and social media platforms.

**Personal Communication Device Policies.** Each school district and private school is required to adopt policies and procedures to prohibit student use of devices during the school day. Such policies must require, among other things, that all devices be turned off and securely stored away from the student's person in an inaccessible location.

Districts and private schools may optionally adopt similar policies and procedures that prohibit the use of devices during school-sponsored events or events occurring outside of the school day.

**Social Media Policies.** The bill requires all school districts and private schools to adopt policies and procedures to prohibit school employees from privately or directly communicating with any student via social media platforms and from requiring the use of social media for any assignment or extracurricular activity. Districts are allowed to approve a social media platform to be used for official school purposes.

### Establishment of the KIRK Act Governing Campus Expressive Activity

**HB 2333** establishes the Kansas Intellectual Rights and Knowledge (KIRK) Act (Act) and makes changes to the Kansas Preservation of Religious Freedom Act.

**KIRK Act.** The Act prohibits institutions from creating free speech zones and limits them to enforcing only reasonable time, place, and manner restrictions on free speech activities. Institutions are allowed to charge permit-related security fees based on neutral criteria such as location, anticipated audience size, and whether alcohol will be served.

The Act requires institutions to publish free expression policies, train relevant personnel, and submit annual reports to the Governor and Legislature. The bill also creates a cause of action against institutions and officials who are not immune from suit or liability under the Act.

**Kansas Preservation of Religious Freedom Act.** The bill also adds political and ideological student associations to groups protected under the Kansas Preservation of Religious Freedom Act.

### Students Safe at School Act, Fentanyl Abuse Education, Naloxone in Schools

**HB 2534**, among other things, requires school districts to develop fentanyl abuse education programs and maintain stock supplies of naloxone, creates the Students Safe at School Act, and amends the definition of "crisis drill" for purposes of rules and regulations promulgated by the State Fire Marshal.

**Fentanyl Abuse Education Programs.** The bill requires the State Board of Education (State Board) to develop guidance for age-appropriate instruction on the prevention of the abuse of and addiction to fentanyl and other opioids and requires each school district's board of education to develop fentanyl abuse education programs.

**Naloxone.** The bill requires school districts to maintain a stock supply of naloxone, as recommended by a school nurse, at each school operated by the district. The bill also authorizes a school nurse or designated school personnel to administer naloxone in an emergency situation to any individual who displays the signs and symptoms of opioid overdose.

**Students Safe at School Act.** The bill establishes the Students Safe at School Act related to active shooter drills and simulations. Among other things, the bill requires school districts and accredited nonpublic schools to adopt policies for the conduct of active shooter drills; prohibits schools from conducting, sponsoring, or permitting any active shooter simulation on school property where students in grades kindergarten through 8 regularly attend; allows specified persons to conduct and participate in certain tactical training exercises; and requires a 24-hour notice and opt-out policy.

*State Fire Marshal Rules and Regulations.* The bill defines the term "crisis drills" used in continuing law to include intruder response drills, lockdown drills, and active shooter drills. The bill prohibits crisis drills from including an active shooter simulation or any element of an active shooter simulation as defined within the bill.

### Higher Education Policy Promulgation Authority

**HB 2560**, among other things, exempts state educational institutions from certain requirements upon promulgation of policy by the state educational institution and the subsequent approval by the State Board of Regents. These requirements include statutes concerning the execution of contracts, procurement of goods and services, transactions involving easements, disposition of surplus property, establishment of hospitality limitations, and participation in the Kansas Quality Program.

### Attorney Training Program for Rural Kansas Act

**Sub. for HB 2595** establishes the Attorney Training Program for Rural Kansas Act (Act), administered by the Department of Commerce (Department) in coordination with the Office of Judicial Administration. The Act contains a stipend program administered by the Department in coordination with Washburn Law School and the University of Kansas School of Law, which provides a stipend of no more than $3,000 per school year for up to 3 years to qualifying students. The Act also contains an attorney training and loan repayment program in which the State pays all or part of the principal, interest, and related expenses of educational loans for eligible rural attorneys selected to participate. The amount provided to each eligible attorney, determined by the Department, cannot exceed $20,000 for each year the attorney establishes eligibility. The total amount of repayment for any eligible attorney cannot exceed $100,000, and participation in the program is limited to 5 years.

## ELECTIONS & ETHICS

### Amendments to Election Law, the Campaign Finance Act, and the Mail Ballot Election Act

**House Sub. for SB 260** makes various amendments to election law, the Campaign Finance Act, and the Mail Ballot Election Act concerning the withdrawal of candidates from certain elections, a vacancy in the joint candidacy of the Governor and Lieutenant Governor, and "paid for" or "sponsored by" attributions, among other provisions.

**Withdrawal from Certain Elections.** The bill permits a candidate for school board, city official, or community college trustee to withdraw their candidacy if certain criteria are met, including severe medical hardship on the candidate or the candidate's immediate family or the candidate no longer resides in the district for which the candidate filed for office.

The bill also authorizes withdrawal of a candidate for any national, state, county, or township office if the nominee does not reside in Kansas or in the county or district in which the candidate was nominated.

If the county election officer receives a certification or a candidate dies on or before September 1 of the year of the election, the candidate's name will be withdrawn.

**Vacancy in the Joint Candidacy of Governor and Lieutenant Governor.** The bill states that no vacancy in the candidacy of Governor or Lieutenant Governor shall be filled after a joint candidacy has been filed with the Secretary, and such vacancy would cause the candidacy to be terminated. The bill allows the remaining candidate to file a new joint candidacy with another individual in accordance with all statutory requirements for filing.

**"Paid For" or "Sponsored By" Attributions.** The bill amends the definition of "corrupt political advertising" within the Campaign Finance Act and election crimes law to remove the requirement to list the treasurer in "paid for" or "sponsored by" attributions in political advertisements.

### SAVE Kansas Act, Voter Registration List Maintenance, and Voter Registration Application Websites

**HB 2437** enacts the SAVE Kansas Act, concerning voter registration record maintenance, and creates restrictions for voter registration websites.

**SAVE Kansas Act.** The bill directs the Secretary of State (Secretary) to use the Systematic Alien Verification for Entitlements (SAVE) database to check against the voter registration list for potential noncitizens registered to vote, and provides for administrative procedures when a suspected match is found.

*Voter Registration List Maintenance.* The bill expands the sources the Secretary and county election officers are authorized and directed to utilize when maintaining the registration list and the centralized electronic voter registration database maintained by the Secretary, in accordance with the National Voter Registration Act.

The bill directs confirmation notices be sent to registered voters within 45 days of certain events indicating a change of address. The bill gives the voter 45 days to respond to the confirmation notice, and if no confirmation is received or the voter confirms they have moved to a new residence, the county election officer is directed to remove the voter from the registration list.

The bill directs county election officers to remove a voter from the registration list and party affiliation lists when such voter is declared deceased on a notarized form executed by a family member. The bill further directs county election officers to remove a voter from the registration list when an obituary notice is published online by a funeral home.

**Electronic Voter Registration Applications.** The bill restricts a person registering to vote through a website to using only a website with a .gov domain or a website that has been approved to accept and transmit electronic voter registration applications by the Secretary. The bill provides criteria a website must meet in order to be approved by the Secretary for such purposes and creates a crime for persons or groups running such websites without approval.

### Residency Requirements for State and Certain Local Elected Officials

**HB 2733** requires certain elected officials to be, and remain, qualified electors and residents of Kansas and of such official's respective district. A failure to remain a qualified elector residing in the appropriate district constitutes an immediate vacancy in the candidacy or office.

## FEDERAL & STATE AFFAIRS

### Data Sharing Requirements for Federal Benefit Programs

**Senate Sub. for HB 2004** establishes and amends law regarding the sharing of information related to federal assistance programs with the Office of the Inspector

General (OIG), U.S. Department of Agriculture, and U.S. Department of Health and Human Services.

The bill requires the Department for Children and Families and the OIG to cooperate in the exchange of information related to cash assistance, child care assistance, and food assistance applicants and eligibility determinations, among other data. The bill also requires the Secretary for Children and Families and the Secretary of Health and Environment, upon a written request of a federal agency, to provide the data contained in state records related to such federal partner, and fully respond in a timely manner.

### Unlawful Approach and Interference with Law Enforcement; Immigration Enforcement

HB 2372, among other things, creates the crime of unlawful approach of a first responder, and creates and amends law related to immigration enforcement.

**Unlawful Approach of a First Responder.** The bill creates a new class B misdemeanor crime of unlawful approach of a first responder. Elements of the crime include being within 25 feet of a first responder and causing the first responder to be distracted from their duties or to have an increased level of concern of physical harm or property damage, among other elements.

**287(g) Agreements.** The bill provides for certain legal representation, immunity, and payment of judgment costs for state and local law enforcement agencies or officers acting in good faith under a 287(g) agreement with U.S. Immigration and Customs Enforcement (ICE). A 287(g) agreement allows such agencies to carry out certain federal immigration enforcement actions.

*Sheriff Authority.* The bill provides that a sheriff seeking to enter into a 287(g) agreement is exempt from certain statutory requirements and is allowed to sign such agreement without authorization of the county's board of county commissioners.

**Federal Detainer Detention.** The bill authorizes a sheriff or keeper of a county jail to detain a person with a facially sufficient immigration detainer request issued by ICE or a U.S. Department of Homeland Security or ICE warrant. The bill specifies conditions for release, including the person proving their lawful presence.

**Kansas Tort Claims Act.** The bill amends the Kansas Tort Claims Act to add that a governmental entity or an employee acting within the scope of employment is not liable for damages resulting from enforcement of or failure to enforce any federal law or executive order, whether valid or invalid.

### Article V Convention

HCR 5022 and SCR 1604 serve as Kansas' application for the purpose of calling a convention of states under Article V of the *U.S. Constitution* to consider constitutional amendments on term limits and federal government restraints.

## FINANCIAL INSTITUTIONS & INSURANCE

### Fraud Prevention and TEFFI Receivership

HB 2591 amends and creates law regarding financial exploitation reporting, cryptocurrency ATMs, and receivership of technology-enabled fiduciary financial institutions (TEFFI).

**Financial Exploitation Reporting and Trusted Contact.** The bill allows a financial institution to, in good faith and with reasonable cause, report any suspected financial exploitation of an adult account holder to a law enforcement agency with jurisdiction or to the Kansas Department for Children and Families. If such report is made, the bill permits the institution to place a temporary hold on the reported transaction or disbursement from the adult's account for up to 10 business days. The financial institution is permitted to extend such hold under certain circumstances.

The bill also allows a financial institution to, in good faith, notify a trusted contact of an adult account holder of suspected financial exploitation, unless the institution reasonably believes that the trusted contact has committed or attempted financial exploitation of the account holder.

**Virtual Currency Kiosk Consumer Protection Act.** The bill establishes the Virtual Currency Kiosk Consumer Protection Act as part of the Kansas Money Transmission Act. The bill outlines disclosure requirements for cryptocurrency ATMs and their operators, requires several fraud-prevention measures, and establishes a cap on certain fees.

**TEFFI Receivership.** The bill prohibits the Office of the State Bank Commissioner or any other state agency from becoming a receiver for a TEFFI that becomes insolvent or declares bankruptcy.

## HEALTH

### Pharmacy Act and Pharmacy Practice Act Updates

HB 2068 amends various provisions in the Pharmacy Act of the State of Kansas and the Pharmacy Practice Act regarding pharmacist scope of practice, pharmaceutical compounding, authority to delegate access to the state's prescription monitoring program database, and the remote practice of pharmacy.

The bill allows for a pharmacist to prescribe medication, excluding most controlled substances, or durable medical equipment under certain conditions and to provide a one-time emergency refill of a non-controlled prescription drug when no refills remain and continuation of therapy is necessary to prevent interruption of care. Pharmacists choosing to independently initiate therapy under the bill are required to maintain professional liability insurance.

### Optometry Scope of Practice

**HB 2223** amends law regarding optometry scope of practice to provide clarification, specification, and exclusions regarding procedures an optometrist is allowed to perform subject to education, training, and credentialing criteria.

The bill also requires an optometrist who is credentialed to perform certain procedures to carry a minimum amount of professional liability insurance and to participate in the Health Care Stabilization Fund beginning January 1, 2028.

### Emergency Medications and Expedited Partner Therapy

**HB 2250** adds administering an emergency opioid antagonist as a protected act immune from criminal prosecution if the person to whom aid was rendered reasonably appeared to need medical assistance or requested medical assistance from law enforcement or emergency medical services as a result of the use of a controlled substance and adds civil liability protection for first responders. The bill permits the administration of an emergency opioid antagonist up to 10 years past the product's expiration date but prohibits pharmacists, health care providers, and school nurses from prescribing, dispensing, distributing, or furnishing expired emergency opioid antagonists.

The bill permits pharmacists to distribute epinephrine delivery systems to schools for emergency medication kits, allowing delivery systems beyond auto-injectors to be available for individuals experiencing an allergic reaction.

The bill also authorizes the use of expedited partner therapy (EPT) to treat sexually transmitted diseases (STDs), allowing a health care provider who clinically diagnoses a patient with an STD to provide EPT if the health care provider determines the patient's sexual partner is unlikely or unable to present for examination, testing, and treatment.

### Controlled Substances

**HB 2365** amends the Uniform Controlled Substances Act (CSA) by adding and removing certain substances in Schedules I, III, and IV, including adding 7-hydroxymitragynine (7-OH), a derivative of kratom, and mitragynine, the primary psychoactive component of kratom, to Schedule I of the CSA. The bill also modifies language related to fentanyl and cannabis to conform state statute with federal law and makes conforming amendments to the definition of "fentanyl-related controlled substance" in the Kansas Criminal Code.

### Changes to State Board of Nursing

**HB 2528** amends statutes regarding the Board of Nursing (Board), including voiding certain non-practice disciplinary actions based upon a violation of certain statutes, providing a 30-day grace period for nursing license renewal and a process for late renewal, and amending the definition of "unprofessional conduct" under the Kansas Nurse Practice Act to exclude behaviors unrelated to the practice of nursing, such as failure to timely renew a license. Among its provisions, the bill provides immunity from liability to individuals reporting malpractice in good faith to the Board and prohibits the Board from taking any retaliatory action against reporting individuals. The bill creates a private cause of action for individuals aggrieved by a violation of the bill if not addressed by the Board by September 1, 2026.

## HOUSING

### State Preemption of Local Rental Housing Ordinances and Resolutions

**SB 391** prohibits any city or county from adopting or enforcing any ordinance or resolution that: prohibits landlords from refusing to lease privately owned property to a person because their source of income to pay rent consists, in whole or in part, of a financial payment or consideration from or through the federal Housing Choice Voucher Program or any other voluntary housing assistance program; restricts a landlord's ability to use or consider income-qualifying methods, credit scores, credit reports, eviction history, property damage history, or criminal history or to request such information when determining whether to lease a property to a prospective tenant according to the landlord's customarily applied criteria; limits the amount of a security deposit a landlord may require to lease a property to a prospective tenant; or requires landlords to grant an automatic right of first refusal to tenants.

### Expungement and Mediation in Eviction Proceedings

**Sub. for HB 2357** creates and amends law related to eviction proceedings for rental agreements subject to the Residential Landlord and Tenant Act.

Among other things, the bill requires expungement of certain court records if any related judgments are satisfied. A landlord may object to an expungement request, which will be considered by the court in determining whether to grant an expungement.

## JUDICIARY

### Interference with a Religious Assembly

**Senate Sub. for HB 2018** creates the crimes of "interference with the conduct of a religious assembly" and "aggravated interference with the conduct of a religious assembly," and provides for the severity levels and penalties associated with such crimes. In certain circumstances the bill provides the Attorney General with the authority to prosecute such crimes or to pursue damages for victims. The bill also creates a civil cause of action for victims, allowing recovery of damages, fees, and injunctive relief, and sets a five-year limitation for filing claims.

### Removal of Squatters Act

**HB 2378** enacts the Removal of Squatters Act that, among other things, creates a procedure for property owners to request law enforcement remove unauthorized persons from a dwelling unit through submission of an affidavit. The bill also allows a person to bring a legal action for wrongful removal from a dwelling unit.

**Unauthorized Occupant Affidavit.** The bill authorizes the owner of a dwelling unit or their agent to request the removal of a squatter by submitting a notarized affidavit to a law enforcement agency in the county where the unit is located. The bill requires the affidavit to contain certain statements stating why the squatter is not authorized to occupy the unit.

**Property Owner Notice to Vacate.** In addition to completing the affidavit, the bill requires the affiant to provide notice at the dwelling unit to the unauthorized person that such person has no right to occupancy and must vacate the unit immediately.

### Theft of an Implement of Husbandry, Livestock, Grain, and Hay

**HB 2413**, among other provisions, amends the crime of theft to include theft of an implement of husbandry, livestock, grain, and hay. Theft of livestock or an implement of husbandry is classified as a severity level 5 nonperson felony, and theft of grain is classified as a severity level 6 nonperson felony.

### Electronic Monitoring of Persons Charged with Domestic Violence Offenses; Increased Penalties for Endangering a Child

**HB 2479**, among other provisions, requires a court to consider ordering electronic monitoring with victim notification as a condition of release for persons charged with certain domestic violence-related offenses and establishes parameters for the use of such monitoring. The bill also increases the penalties for the crimes of endangering a child and aggravated endangering a child when such child is less than 6 years of age.

### Caleb's Law – Sexual Extortion

**HB 2537**, among other provisions, amends the definition of the crime of sexual extortion to include additional conduct and creates two new crimes of aggravated sexual extortion.

**Sexual Extortion.** Among other changes, the bill amends the definition of sexual extortion by adding provisions that include threatening to disseminate sexual pictures or videos of a person with the intent to extort, and it raises the criminal penalty for related crimes involving minors and dependent adult victims.

**Aggravated Sexual Extortion Crimes.** The bill creates new offenses of aggravated sexual extortion causing great bodily harm (severity level 3 person felony), and aggravated sexual extortion causing death (severity level 1 person felony).

**Attorney General Educational Materials.** Among other things, the bill requires the Attorney General to prepare and provide educational materials concerning sexual extortion and, in collaboration with the State Board of Education and law enforcement agencies, notify and educate the public about the amendments made by the bill.

## LOCAL GOVERNMENT

### Public Nuisance and Negligent Actions

**SB 462** prohibits certain public nuisance claims, limits when a political subdivision can bring a public nuisance claim, and requires special injury for certain public nuisance actions. The bill also prohibits persons who engaged in, participated in, or attempted to engage or participate in wrongful conduct from bringing an action or collecting damages for negligence related to such wrongful conduct.

### Water Transfer or Appropriation

**HB 2433** adds an exception to county home rule regarding the transfer or appropriation of water, to prohibit a county from enacting or enforcing any resolution or other action regulating the transfer or appropriation of water that conflicts with, interferes with, is more stringent than, or duplicates the control, regulation, enforcement, or oversight of the Chief Engineer or the Water Transfer Hearing Panel.

### Municipal Contingency Fee Contract Requirements

**HB 2593** requires any political subdivision, as defined in continuing law, to hold an open meeting before approving a contingent fee contract for legal services and requires such contract to be approved by the Attorney General before becoming effective. The provisions of the bill expire on July 1, 2031.

## SOCIAL SERVICES

### Public Assistance Program Updates

**HB 2731** establishes data-matching and eligibility-verification requirements for the Secretary for Children and Families and the Secretary of Health and Environment for certain public assistance programs; permits continuous eligibility provisions for select individuals; prohibits certain exemptions, waivers, and self-attestation; and changes eligibility requirements for certain public assistance programs.

The bill requires the Department for Children and Families and the Department of Health and Environment to verify participants' eligibility on one or more of the following parameters: income, residency, age, household composition, caretaker relative status, or receipt of other coverage. The bill also increases the age of able-bodied adults from 49 to 64 years of age and lowers the age of dependents of able-bodied adults to be under 14 years of age.

## STATE FINANCES

### Included in the FY 2026 Budget

**HB 2513** adjusts total state expenditures to $27.8 billion, including $10.9 billion SGF, in FY 2026. This is an all funds increase of $1.7 billion, or 6.4 percent, and an SGF decrease of $209.5 million, or 1.9 percent, from the FY 2026 approved budget. Further, this is an all funds increase of $354.8 million, or 1.3 percent, and an SGF increase of $331.1 million, or 3.1 percent, above HB 2434 and SB 315 as introduced. This leaves a remaining balance in the SGF of $2.2 billion in FY 2026.

*Significant Adjustments—FY 2026*

**Reappropriations**. *SGF*. Adds $285.6 million SGF to restore select reappropriations that were lapsed by the Special Committee on the State Budget.

*SWPF*. Adds $16.6 million to the State Water Plan Fund to restore select reappropriations.

**Human Services**. *Contract Staffing*. Adds $39.2 million SGF for contract staffing for nursing and other services at State Hospitals.

**Public Safety**. *EMPG Grant*. Adds $4.0 million SGF to cover reimbursements lost in federal adjustments to Emergency Management Performance Grant funds.

### Included in the FY 2027 Budget

HB 2513 adjusts total state expenditures to $26.8 billion, including $10.7 billion SGF, for FY 2027. This is an all funds decrease of $1.1 billion, or 3.8 percent, and an SGF decrease of $189.4 million, or 1.7 percent, from the FY 2026 approved budget. Further, this is an all funds increase of $474.7 million, or 1.8 percent, and an SGF increase of $239.4 million, or 2.3 percent, above HB 2434 and SB 315 as introduced. This would leave a remaining balance in the SGF of $1.8 billion for FY 2027.

*Human Services Caseloads*. Adds $431.0 million, including deleting $68.9 million SGF, to adopt the Fall 2025 Consensus human services caseloads estimates. The SGF decrease is primarily attributable to lower-than-anticipated KanCare costs statewide; however, these savings are offset by increases in foster care costs in the Sedgwick County region.

*Significant Adjustments—FY 2027*

**Human Services**. *Medicaid Capacity*. Adds $49.8 million, including $18.9 million SGF, for a Medicaid capacity payment for nursing facilities of $15 per resident per day.

*CHIP*. Adds $56.5 million, including $15.0 million SGF, for the Children's Health Insurance Program.

*I/DD Waiver*. Adds $41.7 million, including $16.0 million SGF, to provide a 6.0 percent reimbursement rate increase for providers of HCBS Intellectual/ Developmental Disability (I/DD) waiver services.

*FE Waitlist*. Adds $40.0 million, including $15.0 million SGF, to cover the current HCBS Frail Elderly (FE) waiver services overages and to formally establish a waitlist for such waiver services.

*SC MH Hospital*. Adds $22.0 million, including $20.0 million SGF, and 336.0 FTE positions, to fund the first year of operations at the South Central Regional Mental Health Hospital.

*PD Waiver*. Adds $13.3 million, including $5.3 million SGF, to increase the Physical Disability Agency-Directed Personal Care Services rate from $19.52 to $29.00 per hour and reduces the FE Level 3 Personal Care Services rate from $33.24 to $30.00 per hour.

*Contract Staffing*. Adds $12.0 million SGF to increase expenditures for contract staffing at Larned State Hospital and Osawatomie State Hospital.

*Behavioral Health*. Adds $10.0 million SGF for hospitals providing inpatient behavioral health services for adults.

**Education.** *Tech and Community Aid*. Adds $20.7 million SGF for technical and community colleges.

*Veterinary Lab*. Adds $11.0 million SGF for debt service payments for the Veterinary Diagnostic Lab at the Kansas State University Veterinary Medical Center.

*Special Education*. Adds $6.0 million SGF for Special Education State Aid.

**General Government**. *Business Development*. Adds $10.0 million American Rescue Plan Act (ARPA) funds to attract and develop new businesses in Kansas.

**Public Safety**. *Health Care Contract*. Adds $5.4 million SGF for the health care contract for correctional facilities.

*KHP Modernization*. Adds $3.2 million, including $2.4 million from the Kansas Highway Patrol Operations Fund, for modernization of agency equipment and technology.

*Food Contract*. Adds $2.2 million SGF to fully fund the food service contract for correctional facilities.

*Mapping Grants*. Adds $2.0 million, all from the 911 Operating Fund, for critical facility mapping grants.

**Statewide Adjustments**. *Executive Branch Pay*. Adds $35.3 million, including $13.2 million SGF, for a 1.0 percent salary adjustment for Executive Branch employees.

*Operations Lapse*. Deletes $9.3 million SGF to lapse 1.5 percent of state operations funded from the SGF. This lapse would not apply to SGF-financed operating expenditures for authorized contractual services, specific projects, or an identified program or entity. Additionally, the following entities are exempt from this provision: judicial and legislative agencies, correctional facilities, the Kansas Bureau of Investigation, Kansas Sentencing Commission, veterans homes, the Office of the Attorney General, state hospitals, the Kansas Highway Patrol, the State Board of Regents, and State Board of Regents institutions.

*Policy Changes—FY 2027*

**Education**. *School Walkouts*. Adds language requiring Kansas State Department of Education use existing funds to establish a complaint process and penalties for school districts regarding student walkouts under certain circumstances; requiring that penalties assessed from such walkouts be remitted to the SGF; and specifying that any school day in which a walkout occurs will not count as an instructional school day.

**General Government**. *Performance Metrics*. Adds language requiring all applicants requesting state-appropriated funds provide the following information before funds are distributed: a statement of purpose, measurable outcome metrics, and a description of how progress will be measured. Applicants would receive 50.0 percent of the funds awarded upfront and 50.0 percent upon demonstration of measurable progress toward the declared outcome metrics.

**Human Services**. *Abortion Funding*. Adds language prohibiting the Kansas Department of Health and Environment from expending any funds to enter into a contract with, or make a grant to entities that assist, provide, perform, promote, counsel toward, refer for, or provide facilities for abortions. Additionally, this language excludes entities prohibited from performing abortions under chapter 76 of the *Kansas Statutes Annotated*—except in the event of a medical emergency.

**Statewide Adjustments**. *Vacant Positions*. Adds language to lapse SGF moneys associated with the salaries and wages of positions that have been vacant for 60 calendar days or the entire fiscal year.

*Budget Stabilization Fund*. Adds language to credit earned Budget Stabilization Fund (BSF) interest to the SGF for FY 2027 through FY 2030. This provision would take effect only when the BSF balance reaches 20.0 percent of actual tax receipt revenues in the previous fiscal year, and this transfer would be limited to 50.0 percent of the amount of tax-only receipts that exceed Consensus Revenue Estimates.

## STATE GOVERNMENT

### Limiting Use of Multiple-occupancy Private Spaces in Public Buildings to One Sex; Invalidation and Correction of Certain Driver's Licenses and Birth Certificates

**House Sub. for SB 244** requires the governing body or chief administrative officer of each public building in the state to designate each multiple-occupancy restroom, locker room, changing room, shower room, or other multiple-occupancy private space in such building for use only by individuals of one sex, and reasonable steps must be taken to enforce the law. The bill authorizes a person to file a complaint with the Attorney General against a governmental entity for violations of the law.

The bill also invalidates any birth certificate or driver's license issued before July 1, 2026, that lists a gender contrary to an individual's biological sex at birth and requires correction of such certificate or driver's license.

## TAXATION

### Tax Credits

**SB 82 and HB 2464** concern tax credits. SB 82 creates new tax credits for purchases of lockable gun and ammunition storage and certain ethanol blends of motor fuels. The bill also expands a tax credit for employer expenditures for child care up to 75 percent of expenditures and creates a new credit for employer contributions to expand the availability of child care in their communities. The bill also repeals certain expired and unused tax credits.

HB 2464 extends the sunsets for tax credits for angel investors, the aviation and aerospace industry, and contributions to the Eisenhower Foundation and Friends of Cedar Crest.

### Property Valuation Adjustment or Appraisal Requirement

**HB 2644** requires county appraisers to either adjust property values downwards or provide a fee simple appraisal if the value of residential property increases by more than 5 percent above the prior-year valuation if the value of the property has been reduced on appeal in the past five years.

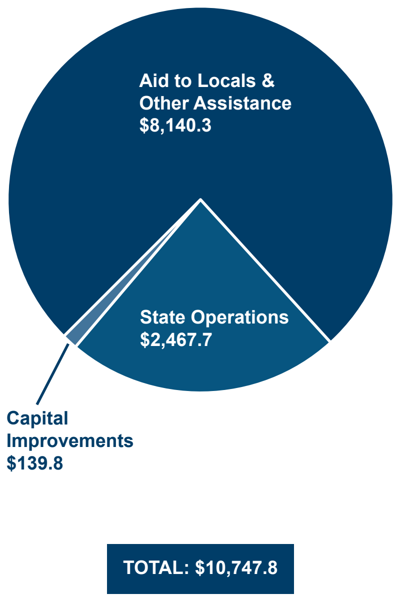
## TRANSPORTATION

### Motor Vehicle Registration

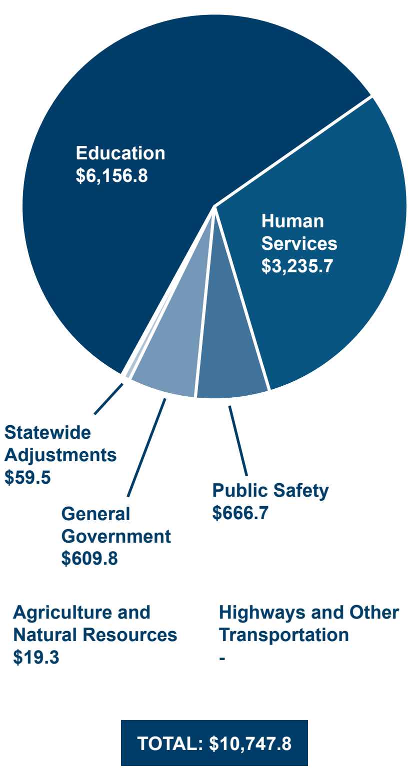
**SB 325**, among other things, modifies the fees charged at vehicle registration.

**Changes to Vehicle Registration Fees.** The bill renames the facility fee to a transaction fee and limits it to $5. The county treasurer is authorized to recommend an increase of the fee up to $10, subject to approval or modification by the board of county commissioners, until January 1, 2030, when the fee will return to $5. The bill requires the Kansas County Treasurers Association to submit a report to the House and Senate Committees on Transportation

**FY 2027 Approved State General Fund Budget by Major Purpose (Dollars in Millions)**




**FY 2027 Approved State General Fund Budget by Function of Government (Dollars in Millions)**




on or before January 10, 2028, detailing the implementation of any fee increases, impact on county budgets, and usage of increased fee revenue.

### Prohibiting Handheld Phone Use in Work and School Zones

House Sub. for SB 366, among other things, prohibits use of a mobile telephone in a school zone when a reduced speed limit is enforced or in a road construction zone while workers are present and signs are posted at the beginning of the road construction zone. Holding a mobile telephone constitutes a rebuttable presumption of a violation of this prohibition. Exceptions to the prohibition include use by law enforcement officers, in safely and lawfully halted vehicles, while using hands-free devices, and in certain emergency situations. The bill also establishes a violation as a traffic infraction and authorizes a fine of $60. However, law enforcement officers are required to issue a warning citation for such violations until July 1, 2027.

### Restoring Driving Privileges

HB 2467 prohibits the Division of Vehicles, Department of Revenue, from considering a driver's license "sanction"—suspension or restricted driving privileges—for failure to fully comply with a traffic citation if that sanction is more than five years old, allowing driver's license reinstatement for those with no additional sanctions.

## UTILITIES & TELECOMMUNICATIONS

### Electric Vehicle Charging Station Rates

SB 380 requires retail electric suppliers to offer fair, reasonable, and non-discriminatory rates and prohibits the supplier's rate base from including services to all charging stations and certain costs, with some exclusions.

**Rates and Services.** The bill requires a retail electric supplier that provides, owns, operates, or maintains a fast charging station for direct public use to offer fair, reasonable, and non-discriminatory rates and services to all entities providing similar services and prohibits the supplier from acting in a manner that provides an unreasonable competitive advantage for the retail electric supplier's fast charging station.

**Exclusions.** The bill does not apply to any fast charging stations already in place before July 1, 2026; stations used exclusively by a retail electric supplier for internal purposes; and stations required to be owned or operated by a retail electric supplier under federal or state law or by an order of the Kansas Corporation Commission.

### Statewide Conduit System

HB 2647 establishes the Statewide Conduit System (System) for fiber optic transmissions of broadband connections and the Kansas Broadband Revolving Fund to create and maintain the System. The bill requires the Secretary of Transportation to establish a schedule of fees to be charged to entities installing or using the System. Any entity that installs equipment in or uses the System must obtain a highway right-of-way use permit.

## VETERANS & MILITARY

### Homeless Veteran IDs; Purple Heart Designation

HB 2274 authorizes the issuance of non-driver identification cards to homeless veterans who provide certain documentation to the State, and designates Kansas as a Purple Heart State and August 7 of each year as Purple Heart Day in recognition of Kansans who have earned the Purple Heart as a result of being wounded while engaged in combat with an enemy force.

## 2026 Legislative Session At-A-Glance

### Bill Information

| | |
|---|---|
| Senate bills carried over from 2025 Session | 239 |
| Senate bills introduced in 2026 session | 237 |
| Total Senate Bills | 476 |
| House bills carried over from 2025 session | 318 |
| House bills introduced in 2026 session | 392 |
| Total House bills | 710 |

### Bills Considered in 2026 Session That Became Law:

| | |
|---|---|
| House Bills | 109 |
| Senate Bills | 48 |
| Percentage of Bills that became law | 13.24% |

2026 Days in Session: 73

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### Fiscal Information for FY 2026
### (Dollars in Millions)

| | |
|---|---|
| **Estimated State General Fund Revenue** | |
| Income Taxes | $ 5,995.00 |
| Excise Taxes | 3,713.80 |
| All Other | 390.6 |
| Total | $ 10,099.40 |
| **Estimated State Budget** | |
| State General Fund | $ 10,748.10 |
| All Other | 16,020.60 |
| Total | $ 26,768.70 |

2025 Population Estimate: 2,977,220

### What's inside this edition of *Legislative Highlights*:

2026 KANSAS LEGISLATIVE REVIEW

- Presented by:
- Joseph N. Molina III
- June 26, 2026

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KANSAS BAR ASSOCIATION

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Judicial Branch
Public Defenders
Legislation
Elections

2026 LEGISLATIVE REVIEW


2

# Judicial Branch

3

## Judicial Branch Budget

- Specialty Courts Funding - $1,045,000
- Specialty Court Coordinator – 2 – FTE's
- Court Services Coordinator - $103,296/1 FTE
- Rural Justice Initiative - $586,795

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## KS Rural Attorney Program

**SB 214 - Introduced**
- Student Loan Plan
- Student Scholarship Plan

**HB 2595 - Passed**
- Student Loan Repayment
- $3000 Stipend
- 5-year sunset

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## Court Bills

- SB 299 – SCNC OPEN RECORDS
- HB 2652 – CLERK TO PUBLISH MONTHLY CASE REPORTS
- HB 2545 - INCREASE MUNICIPAL COURT FEE BY $5.50 (FAILED)
- HB 2569 – ELECTION LAWSUITS FILED IN SHAWNEE COUNTY (VETO SUSTAINED)
- HB 2723 – COURT TO CREATE COURT DATE REMINDER SYSTEM (FAILED)

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KS BIDS

- Assigned Counsel Caseloads - $1,204,205 FY26
- Expert Witness Caseload - $1,000,000 FY26
- IT Upgrades - $15,000 (Cellphones)
- * Asked for $2,997,700 for Expert Fees

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# 2026 Legislation

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## Vetoes Overridden

- HB 2333 – Kirk Act
- HB 2603 – Electric Fences
- SB 244 – Protect Women's Spaces
- HB 2531 – Legislative Budget

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## Vetoes Sustained

- HB 2468 - $5 million private school tax credit
- HB 2587 – Citizen Status on Drivers License
- SB 254 – In State Tuition for noncitizens

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## KBA Priorities

- HB 2351 - Insurance Arbitration (Supported)
- HB 2696 – Modernization of Notarial Act (Opposed)
- HB 2609 – Supported Decision-Making Act (Neutral)
- SB 480 – Absentee Estates (Supported)
- HB 2480 – Social Worker Exception (Supported)

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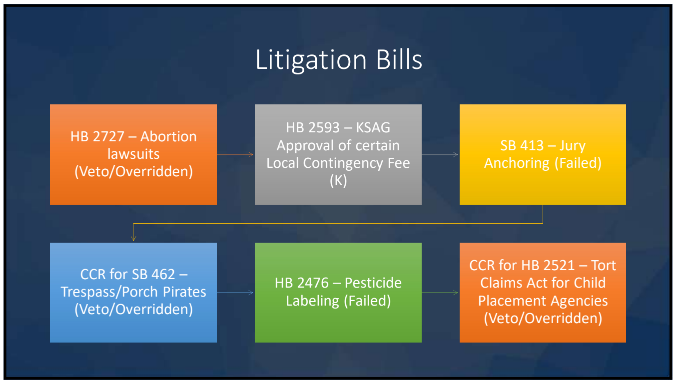
## Access to Justice Bills

- HB 2467 – Prohibit Sanctions for failure to comply if more that 5 yrs old.
- HB 2655 – Municipal Court expungement of Conviction/Poverty Affidavit.
- HB 2724 – Consider Poverty Affidavits in Expungement Cases
- HB 2699 – Legal Notices on County Website

12


Litigation Bills
HB 2727 – Abortion lawsuits (Veto/Overridden)
HB 2593 – KSAG Approval of certain Local Contingency Fee (K)
SB 413 – Jury Anchoring (Failed)
CCR for SB 462 – Trespass/Porch Pirates (Veto/Overridden)
HB 2476 – Pesticide Labeling (Failed)
CCR for HB 2521 – Tort Claims Act for Child Placement Agencies (Veto/Overridden)

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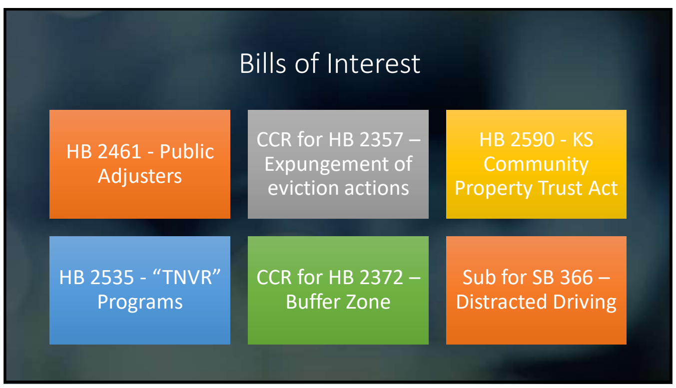
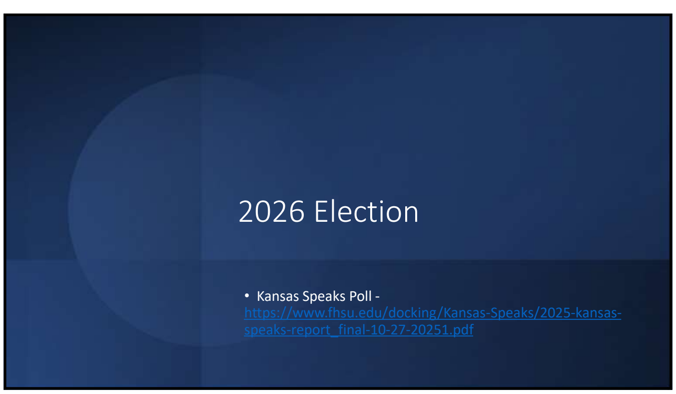

Bills of Interest
HB 2461 - Public Adjusters
CCR for HB 2357 – Expungement of eviction actions
HB 2590 - KS Community Property Trust Act
HB 2535 - "TNVR" Programs
CCR for HB 2372 – Buffer Zone
Sub for SB 366 – Distracted Driving

14


2026 Election
• Kansas Speaks Poll - https://www.fhsu.edu/docking/Kansas-Speaks/2025-kansas-speaks-report_final-10-27-20251.pdf

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## 2026 Elections

- Governor
- Attorney General
- State Treasurer
- Secretary of State
- 125 House Members
- 4 Congressional Seats
- 1 US Senator

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## History of Midterm Election

**2006**
George W Bush - Loss of 30 Seats
Democrats Take Control

**2010**
Barack H. Obama - Loss of 63 Seats
Republicans Take Control

**2014**
Barack H. Obama - Loss of 13 Seats
Republicans Retain Control

**2018**
Donald J. Trump Loss of - 40 Seats
Democrats Take Control

**2022**
Joseph R. Biden - Loss of 9 Seats
Republicans Take Control

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## SCR 1611 – Direct Election of Justices

- Abolish Merit Selection Commission
- Public vote on August 4, 2026
- KSLEG to set rules for these elections
- Polling Data
- Elect Justices to 6-year terms
  - 2028 Hon. Standridge, Hon. Biles & Hon. Wall
  - 2030 Hon Rosen & Hon. Luckert
  - 2032 Hon. Walsh & Hon. Stegall


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Your Kansas Judges
[https://ksbar.org/?pg=Your-kansas-judges](https://ksbar.org/?pg=Your-kansas-judges)

- Survey to All Kansas Lawyers
- Information on all Appellate judges up for retention
- Educational information on Merit Selection


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Governor

- Republicans
  - Doug Billings, Conservative Podcaster, Olathe
  - Jeff Colyer, former Lt. Governor & Governor
  - Joy Eakins, Wichita Business Owner
  - Ty Masterson, Senate President, R-Andover
  - Charlotte Ohara, former Johnson County Commissioner
  - Stacy Rogers, Wichita Business Owner
  - Philip Sarneki, Johnson County Businessman
  - Vicki Schmidt, Insurance Commissioner, Topeka
  - Scott Schwab, Secretary of State, Olathe
- Democrats
  - Ethan Corson, State Senator, D-Fairway
  - Cindy Holscher, State Senator, D-Overland Park
  - Marty Tuley, Educator from Lawrence

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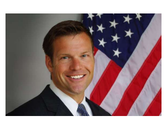
Attorney General

- Kris Kobach, R (Incumbent)
- Chris Mann, D-Lawrence

*Kansas Attorney General Kris Kobach narrowly defeated Chris Mann in 2022 for Kansas Attorney General by a margin of 50.8 to 49.2%.



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## Secretary of State

- Pat Proctor, State Representative, R-Ft. Leavenworth
- Ken Rahjes, State Representative, R-Agra
- Jennifer Day, D-Overland Park
- Samuel Lane, D-Shawnee

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## Legislative Resources

Kansas Legislature
www.kslegislature.org/li

Kansas Leg. Research
http://www.kslegresearch.org/KLRD-web/Policy.html

State of Kansas:
www.kansas.gov

Office of the Governor:
www.ksgovernor.org

Judicial Branch:
www.kscourts.org

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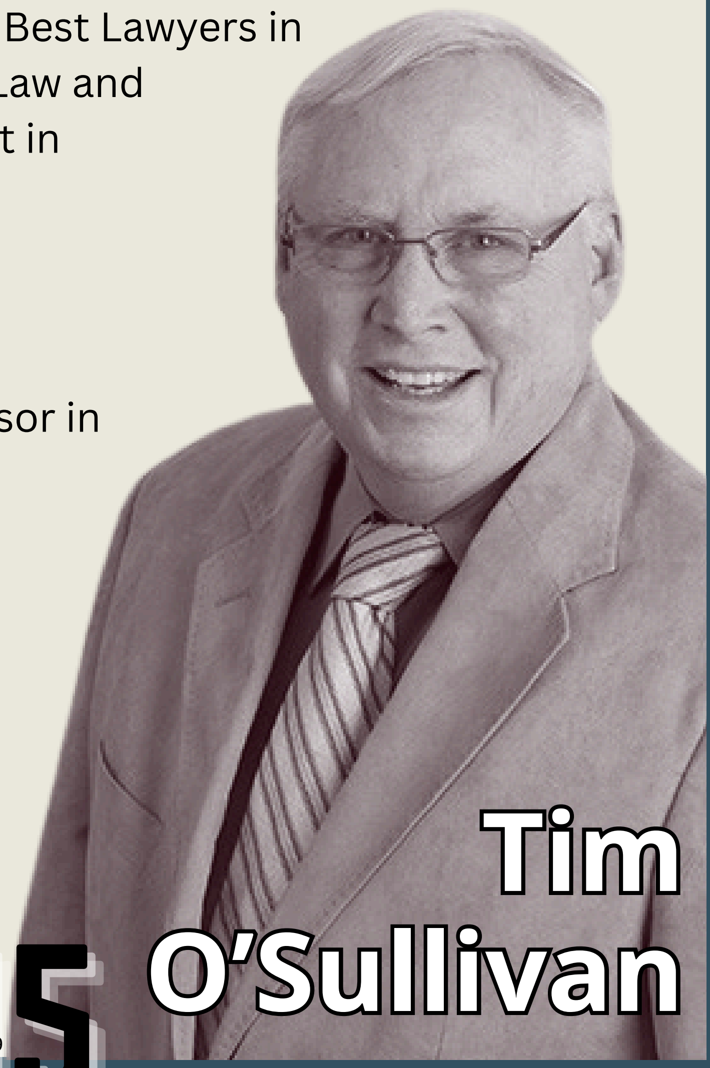
# Estate Planning Forum Scenarios

# About Tim

Timothy P. O'Sullivan is Senior Counsel with the Wheeler & Mitchelson, Chartered in Pittsburg, Kansas, concentrating his practice in the areas of estate planning, elder law, probate, and trust law, and taxation. Tim holds a Bachelor of Science Degree from St. Louis University, a Juris Doctorate from Washburn University (with honors), and an L.L.M. in Taxation from the University of Missouri-Kansas City School of Law. He was admitted to the Kansas Bar in 1975 and admitted to practice before the U.S. Tax Court in 1982.

Tim has served as President of the Executive Committee of the Real Estate, Probate & Trust and Tax Sections of the Kansas Bar Association, as well as the Kansas Chapter of the National Academy of Elder Law Attorneys (NAELA). He was listed in The Best Lawyers in America© in Estate Planning and Elder Law and in Missouri & Kansas Super Lawyers® List in Estate Planning. Tim is a fellow of the American College of Trust and Estate Counsel (ACTEC).

He has also served as an adjunct professor in Estate Planning at Washburn University School of Law (1992-present), the University of Missouri-Kansas City School of Law (1996-2000), and in the L.L.M. in Estate Planning program at the University of Miami (Florida) School of Law (1996-2000). Tim is one of the most frequent speakers on estate planning topics for the Kansas Bar Association.



## Four Estate Planning Situations

### Situation 1

A couple, Brent and Amy Wilson, are both in their mid-30's; Brent is a pediatrician; Amy is a counselor. The total value of their estate is $7.0 million, mostly held in joint tenancy, including their personal residence, stock funds, plus a $3.0 million life insurance policy on Brent of which Brent is the owner and Amy is the beneficiary. They have three children, a son and two daughters, ages 10, 12 and 16, respectively. Their son, the oldest child, is autistic and not likely to ever be fully functional. They have some concern that the survivor will remarry, their estate plan become subsequently distorted, and they do not want a subsequent spouse of the survivor to benefit from the assets they have accumulated. Given their own levels of personal ambition, they also want to ensure their children don't get too much, too soon and do not want their "inheritance" from them to detract from their personal self-motivation. Given his profession, Brent is particularly concerned about malpractice claims. They are considering naming their siblings as their "executors" after each other, as well as guardians for their autistic or minor child.

Amy has one living parent, her father. She is his only child. He has a relatively modest estate of $900,000, is in his 60's and frail. His estate consists mostly of depreciated rental property, his residence of 40 years, modest savings and a brokerage account in an index fund. Brent's parents, in their mid-70's, have considerable estates, mostly in low-basis farmland. Their parents on both sides are amenable to coordinating the assets they leave Brent and Amy consistent with their children's wishes, but they do not want their property passing subsequently to an in-law and not to their descendants. Their parents are not your clients.

Their current estate plan only consists of simple wills.

### Situation 2

Jim and Diane Barton are in their 50's; they have two adult children, who are both married and in their mid-30's. They have five minor grandchildren. They are concerned about the looming social security, Medicare and Medicaid crises, along with the massive federal debt and what that might portend from a federal tax policy perspective. Jim is an engineer and Diane is an architect. Both of their children have modest jobs and estates, but they doubt they have significant savings. They inform you that their children get along well together but have concerns as to the level of their individual financial acumen and the spending habits of their spouses.

Jim and Diane are both highly financially successful, prudent investors, charitably inclined and have a current total estate of $12 million. There is some natural concern that the survivor may remarry, and their joint estate plan become distorted. They are predisposed to naming both of their children as fiduciaries of their estates upon the death of the survivor, for they "know the family" and view the devolution of their estates as a "family matter."

## Situation Three

Brian and Bonnie McFarland are married, in their seventies and are a long-standing farm family. They have three children, a son and two daughters, who are all married and range in age from 40 to 52. Their son, age 40, quit his job as a financial advisor to assist his father in managing the farm following his father's heart problems commencing 15 years ago that are likely to continue to persist. His wages from the farm have been significantly less than in his prior employment. Bonnie is currently fine mentally but has some history of dementia in her family. Their residence is on their farm in central Kansas, where they own 3,500 acres of productive farmland Brian farms with a panoply of personally owned farm machinery. They value their total estate at a net value of $18 million dollars with only a modest amount of debt but typically have only a small amount of cash. All of their titled assets are currently held in joint tenancy.

Their children are all very mature and get along well together from their parents' perspective. The McFarland's wish to keep the farmland, which is highly appreciated and them, has been in the family for 80 years, intact in the long-term following their passing with their son managing it for him, their children and their descendants. They also may wish to consider giving him a somewhat greater share of their estate in appreciation of his past devotion to the farm, them and sacrifice in giving up his prior profession. Like most farm families, they highly value family harmony.

They have simple wills from three decades ago that have not been updated and have no long-term care insurance.

## Situation Four

John and Marie Bontrager, in their mid-60's, are on their second marriage. They have a typical "waiver of all marital rights" second marriage premarital agreement. He has three children from his prior marriage; she has two. They have been married ten years and have not updated their simple wills from their prior marriages, which due to their prior divorces Kansas law and premarital agreement, would currently thus pass the probate estate of each upon their deaths to their respective children.

Their cumulative assets are almost equal parts farmland Brian farms and intangible personal property investment assets, for a total cumulative net value of $16 million, plus a personal residence valued at $300,000 which is debt free. Their farm debt is modest and manageable. Brian currently owns the farmland in his name, and the rest of their titled assets are held in joint tenancy. As one might expect, they have varying levels of concern with their children's marriages, maturity levels and spending habits. Both sides of the family only irregularly get together.

They have informed you they have discussed their estate planning wishes and would like to first benefit the surviving spouse with his or her HEMS needs from their total estate for their lifetimes and upon the death of the survivor, have the entire remaining assets pass three-fifths to John's descendants and two-fifths to her descendants, which on looking back they determined was the approximate ratio of assets each brought into the marriage.

Having each been through a prior divorce, they are patently aware of the possibility the survivor could remarry and worry about the effect on their estate plan.

# Married Asset Imventory

# PERSONAL INFORMATION & ASSET INVENTORY

(Married Persons)

## Personal Information:

Please provide us with the following information (put N/A when not applicable):

Husband________________________________________________
(First Name) (Middle Name) (Last Name) (Nickname)

Wife________________________________________________
(First Name) (Middle Name) (Last Name) (Nickname)

Home Address______________________________County ____________
(P.O. Box and Street Address)
City_____________State___________Zip ________Home Phone____________
E-mail______________ Fax (if any)__________ Mobile/Cellular Phone__________
Date of Birth: Husband:____________________ Wife:______________
Social Security Numbers: Husband:______________ Wife:______________
U.S. Citizen? Husband:____________________ Wife:______________
How did you learn of us?________________________________________
Husband's Employer:________________________________________
Business Address________________________________________
How long employed?________________Business Phone:______________
Position:____________________
Wife's Employer?________________________________________
Business Address________________________________________
How long employed?________________Business Phone:______________
Position:____________________
Predeceased Spouse of Husband? Name:________________ Date of Death:_______
Predeceased Spouse of Wife? Name:________________ Date of Death:_______
Preferred Mailing Address: Home______ Husband's Employer______ Wife's Employer_____
(check one)

Date of Marriage:________________
Name of Accountant:____________________ Company:______________
Business Address:____________________ Phone:______________

Financial Planner/Investment Advisor______________ Company:______________
Business Address:____________________ Phone:______________

**Children and/or other dependents (identify relationship if not child):**

Name:________________________ DOB:__________ SSN:__________
Name:________________________ DOB:__________ SSN:__________
Name:________________________ DOB:__________ SSN:__________
Name:________________________ DOB:__________ SSN:__________
Name:________________________ DOB:__________ SSN:__________
Name:________________________ DOB:__________ SSN:__________

**Step-Children (under "Parent" list the name of your child who is the step-parent):**

Name:______________________________ DOB:__________ Parent:__________

Name:______________________________ DOB:__________ Parent:__________

Name:______________________________ DOB:__________ Parent:__________

**Assets and Liabilities:**

So that we can understand your financial position and analyze your estate, please estimate your asset values and liabilities. We may ask for precise, detailed information later, so do not be concerned about exact amounts at this time.

| Estimated Assets: | Husband | Wife | Joint |
|---|---|---|---|
| Personal Residence Market Value | $ | $ | $ |
| Investment Real Estate | $ | $ | $ |
| Agricultural Real Estate | $ | $ | $ |
| Farm Personal Property (e.g., livestock, machinery) | $ | $ | $ |
| Checking, Bank, Credit Union Accounts | $ | $ | $ |
| Airplanes | $ | $ | $ |
| Antiques | $ | $ | $ |
| Artwork | $ | $ | $ |
| Boats | $ | $ | $ |
| Collections (e.g., coins, stamps, guns) | $ | $ | $ |
| Personal Property (Cars, Jewelry, Furniture, etc.) | $ | $ | $ |
| Certificates of Deposit | $ | $ | $ |
| Money Market Accounts | $ | $ | $ |
| US Govt. Securities (T-Bills, GNMAs, Etc.) | $ | $ | $ |
| Publicly-Traded Common and Preferred Stocks | $ | $ | $ |
| Closely-Held Stock | $ | $ | $ |
| Bonds | $ | $ | $ |
| Mutual Funds | $ | $ | $ |
| Oil and Gas Interests | $ | $ | $ |
| Patents, Copyrights and Royalties | $ | $ | $ |
| Partnership Interests | $ | $ | $ |
| Limited Liability Company Interests | $ | $ | $ |
| Mortgages and Other Loans Owed You | $ | $ | $ |
| Tax Sheltered Annuities (TSAs) | $ | $ | $ |
| Other Annuities | $ | $ | $ |
| Accidental Death Life Insurance (Death Benefit) | $ | $ | $ |
| Term Life Insurance (Death Benefit) | $ | $ | $ |
| Permanent Life Insurance (Death Benefit) | $ | $ | $ |
| Life Insurance Cash Values | $ | $ | $ |
| Other Investment Assets | $ | $ | $ |
| IRAs | $ | $ | $ |
| Profit Sharing, 401(k), other Retirement Plans | $ | $ | $ |
| Other Assets (Brief Description): | $ | $ | $ |
| ____________________ | $ | $ | $ |
| ____________________ | $ | $ | $ |
| **TOTAL** | $ | $ | $ |

Note: If any assets are held by a trust (either revocable or irrevocable) for your benefit, please provide name of trust(s):_____________________________________________________________________________________.

**Estimated Debt**:

| | |
|---|---|
| Home Mortgage | $____________________ |
| Investment Debts | $____________________ |
| Consumer and Credit Card Loans | $____________________ |
| Life Insurance Loans | $____________________ |
| Other Debts | $____________________ |
| **TOTAL** | **$____________________** |

**Annual Income:**

Please estimate your annual income from the following sources:

| | |
|---|---|
| Husband Earnings | $____________________ |
| Wife Earnings | $____________________ |
| Savings and Investments Earnings | $____________________ |
| Retirement Plan, Pensions, Etc. Distributions | $____________________ |
| Social Security | $____________________ |
| Other Sources | $____________________ |
| **TOTAL** | **$____________________** |

**Miscellaneous Information:**

For any of the following questions answered "yes", please provide the additional information or copies of the document(s) requested.

1. Have you been divorced? If so, please provide a copy of the divorce decree and any property settlement agreement.

2. Are all the children listed on the first page from your present marriage? If not, list name(s) of child(ren) and which of you is the child's parent.

3. Are any of your children adopted? If so, who or whom? At what age were such children adopted?

4. Do you have a premarital or postnuptial agreement? If so, please provide a copy.

5. During your marriage, have you ever lived in a community property state (Texas, New Mexico, Arizona, Nevada, California, Washington, Idaho, Louisiana or Wisconsin)?

6. Do you have existing Wills? If so, please provide a copy.

7. Have you created any Trusts that are in existence? If so, please provide copies.

8. Have you made any gifts under the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA), sometimes referred to as custodial accounts? If so, are you or your spouse the custodian of any such accounts?

9. Do you anticipate receiving a substantial amount of property from an inheritance, a gift, or as beneficiary of a trust? If so, please describe.

10. Are you the beneficiary of any trust, exclusive of a revocable trust created by you? If so, please provide a copy of the trust.

11. Have you made any gifts requiring a gift tax return (more than $19,000 to any one person in any year)? If so, please indicate the value of the gift(s) and provide copies of any gift tax return(s) filed.

12. Do you own property jointly with someone other than your spouse or do you own property which is payable on your death (by beneficiary designation) to someone other than your spouse? If so, please describe.

13. If you have an individual retirement account (IRA), or participate in a 401(k), profit-sharing plan, employee stock ownership or other retirement plan, is someone other than your spouse the primary beneficiary? If so, please describe.

14. Does a third party (individual or corporation) own life insurance on your life? If so, please indicate the name of the owner, the cash value, and the face amount of the policy(ies).

15. Do you own life insurance on the life of someone else? If so, please indicate the name of the owner, the cash value, and the face amount of the policy(ies).

16. Have you entered into any Buy-Sell or Shareholder Agreement? If so, please provide a copy.

17. Have you entered into any Partnership Agreement or Operating Agreement involving a limited liability company? If so, please provide a copy.

18. Do you own stock in an "S" corporation? If so, what is the name of the corporation?

19. Do any family members owe you money? If so, provide details.

20. If you have any adult children, has any adult child been providing care or any service to you? If so, provide details.

21. Do you have a prepaid funeral or burial plan? If yes, with whom?

22. Do you have long-term care insurance?

23. Do you have a safe deposit box? If so, where is it located?

24. Do your personal or religious beliefs preclude you from swearing under oath in executing a will or trust?

25. Do you have pets?

    a. If so, have you made plans for their care after you are deceased and what are your plans?

    b. Do you want to include provisions for the care of your pets in your estate plan?

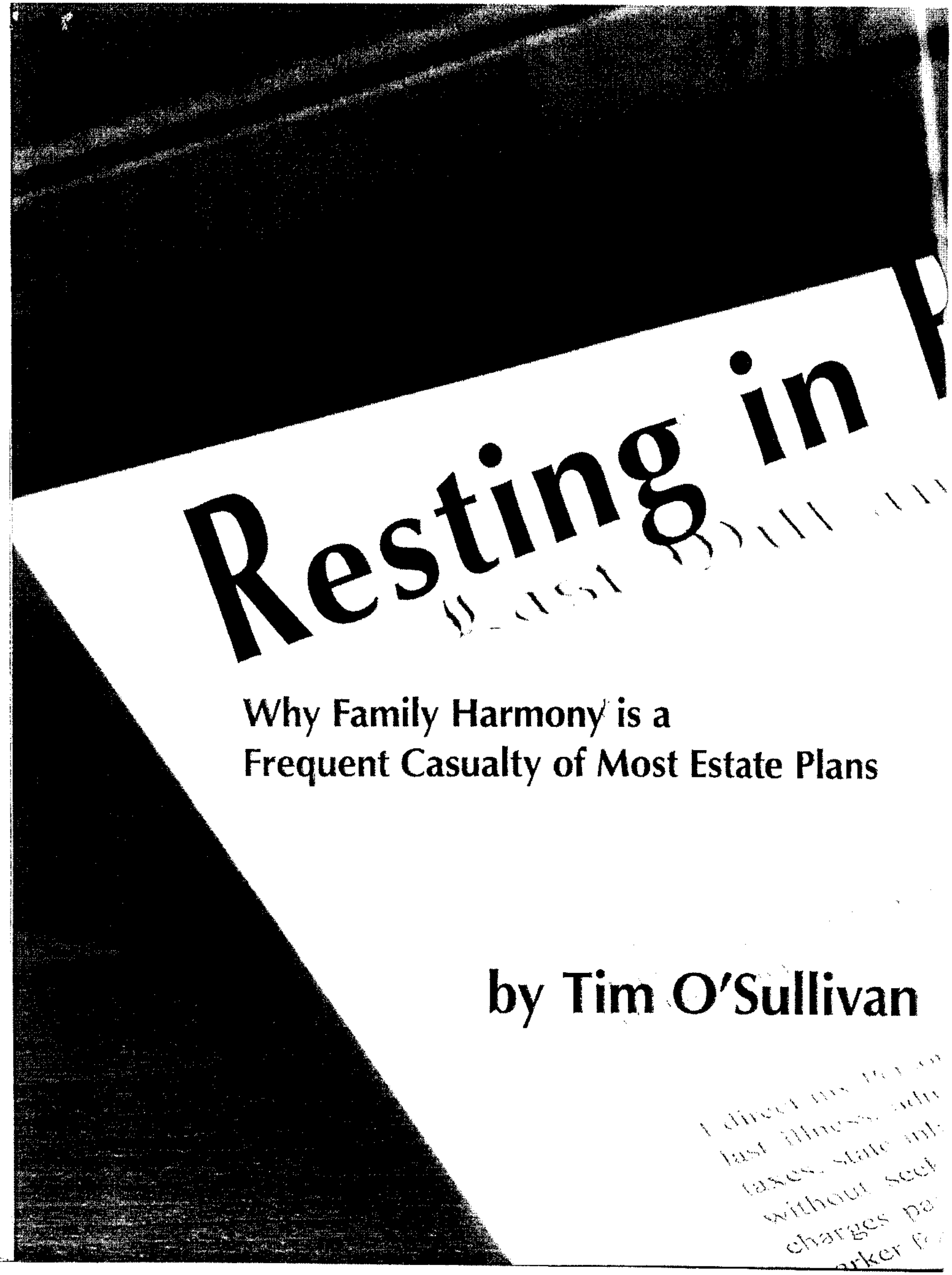
26. Do you own any Class 3 NFA weapons (if you do, you would know it)?

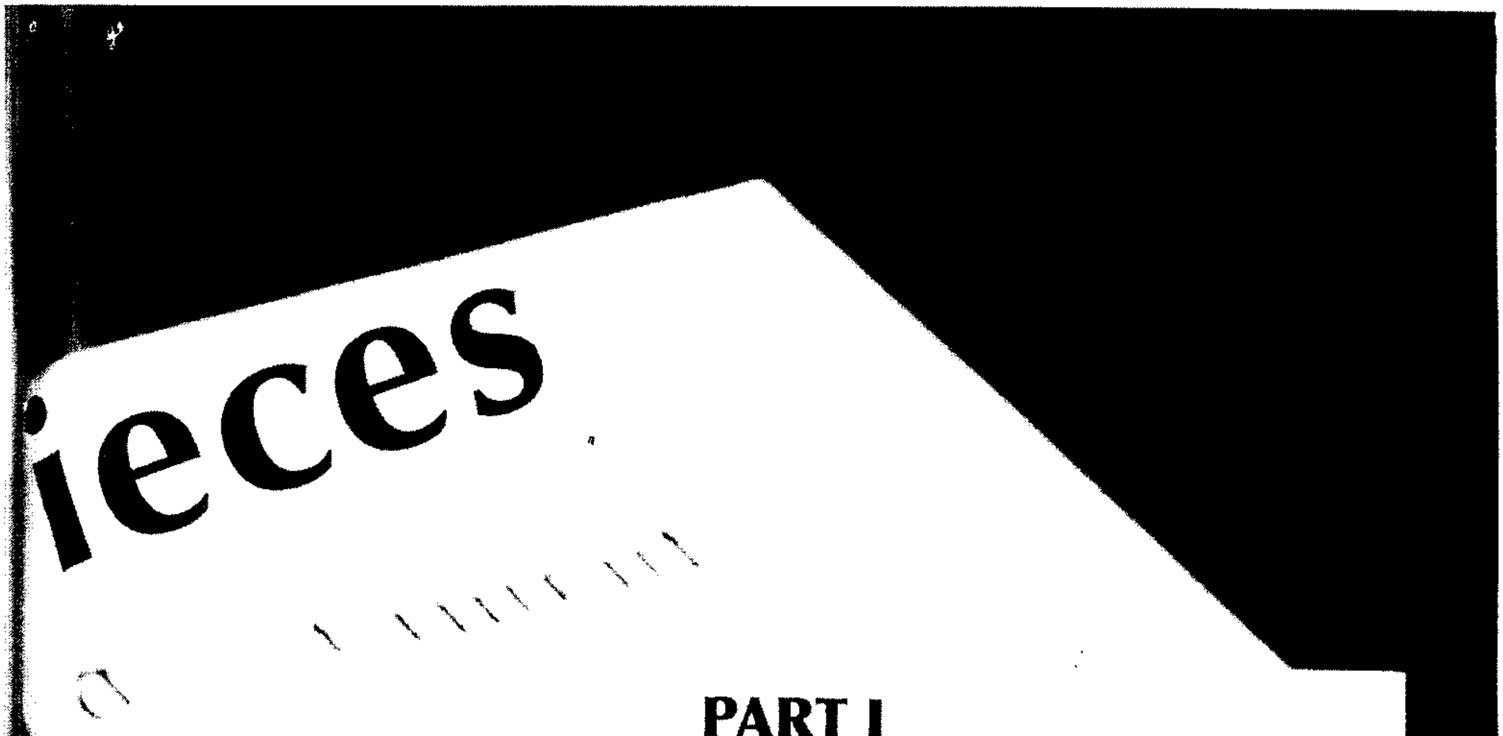
27. Do you use a home computer, and if so, do you prefer to have copies of your signed estate planning documents on a CD or in a notebook, so you can make additional copies as needed?

## WORKSHEET FOR ATTORNEY DISCUSSION AND NOTES
**(Attorney to complete this page)**

| **Estimated** **Assets** | **Husband** | **Wife** | **Joint** | **Exempt** | **Medicaid Non-Exempt** |
|---|---|---|---|---|---|
| | | | | | |
| Personal Residence Market Value | | | | | |
| Investment Real Estate | | | | | |
| Agricultural Real Estate | | | | | |
| Farm Personal Property (e.g., livestock, machinery) | | | | | |
| Checking, Bank, Credit Union Accounts | | | | | |
| Airplanes | | | | | |
| Antiques | | | | | |
| Artwork | | | | | |
| Boats | | | | | |
| Collections (e.g., coins, stamps, guns) | | | | | |
| Personal Property (cars, jewelry, furniture, etc.) | | | | | |
| Certificates of Deposit | | | | | |
| Money Market Accounts | | | | | |
| US Government Securities (T-Bills, GNMA's, etc.) | | | | | |
| Publicly-Traded Common and Preferred Stocks | | | | | |
| Closely-Held Stock | | | | | |
| Bonds | | | | | |
| Mutual Funds | | | | | |
| Oil and Gas Interests | | | | | |
| Patents, Copyrights and Royalties | | | | | |
| Partnership Interests | | | | | |
| Limited Liability Company Interests | | | | | |
| Mortgages and Other Loans Owed You | | | | | |
| Tax Sheltered Annuities (TSA's) | | | | | |
| Other Annuities | | | | | |
| Accidental Death Life Insurance (Death Benefit) | | | | | |
| Term Life Insurance (Death Benefit) | | | | | |
| Permanent Life Insurance (Death Benefit) | | | | | |
| Life Insurance Cash Value | | | | | |
| Other Investment Assets | | | | | |
| IRA's | | | | | |
| Profit Sharing, 401(k),Other Retirement Plans | | | | | |
| Other Assets (brief description) | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| **TOTAL** | | | | | |

# Resting in Pieces - Part I


Resting in P
Why Family Harmony is a
Frequent Casualty of Most Estate Plans
by Tim O'Sullivan




# PART I

Happy families are all alike; every unhappy family is unhappy in its own way.

*Leo Tolstoy*, Anna Karenina
Chapter 1, first line

The post mortem squabblings and contests on mental condition...have made a will the least secure of all human dealings.

*Lloyd v. Wayne Circuit Judge*
23 N.S. 28, 30 (Mich. 1885)

You never know people until you have shared an inheritance with them.

*Tom Campbell*, co-founder,
Family Business Institute

## Introduction

In its broader context, estate planning extends beyond the confines of the investment, management and disposition of an individual's assets during a disability and following death. It also includes ensuring that intangible family values, not the least of which is family harmony, are protected in the estate planning process. The need for clarity, accuracy and comprehensiveness in estate planning documents in addressing the many technical tax, asset protection, governmental resource, and other goals involving the disposition and management of a client's property following a disability or death have been a long-standing cynosure of an estate planning practice. However, their achievement bears only a tangential relationship to the achievement of family harmony goals.

When asked, most clients readily conclude that preserving family harmony in the estate planning and administration process is a very important goal. It is not all that atypical for clients to go as far to say that they would rather give their property to a charity than have their children fight over their estates. Given the prominence that parents normally would place on this estate planning goal, it would seem to ineluctably follow that addressing family harmony issues would be commonplace in the estate planning process. Unfortunately, that has not been the case, underscored—and compounded by—the virtual absence of such discussion in estate planning textbooks, legal seminars and articles. It is further attested to by the relative paucity of provisions in wills and revocable trusts, as well as in counseling rendered by estate planning attorneys, that would serve to undergird its preservation.

However, this goal is not likely to be raised by clients, who, as one might expect, are typically uninformed of the impact estate planning decisions can have on family harmony. Unlike other professional fields such as medicine and financial planning, with respect to which most individuals have become quite aware from their environment, the media and their education of their complexities and the corresponding need for professional advice when making health decisions, clients seeking estate planning advice, unaware of its nuances and complexities, tend to be predisposed to simplistic, often errant, preconceptions. It is thus left to their legal counsel to importune the consideration of this aspect, among other, estate planning considerations.

The author submits that the general failure of estate planning attorneys to appropriately address this issue, including by the author for a substantial portion of his practice, has been a major factor in the very high incidence of family disharmonies during the estate planning process, following a client's disability, and in the post-death administration of a client's estate. For estate planners, such high incidence has rendered the term "nuclear family" a double entendre.

The main factors for such inattention appear to be: an absence of professional sensitivity to the importance of this issue; the mistaken view that this subject matter is more appropriate for family counselors and advisors; an enduring practice inertia centering on the technical aspects of estate planning; and a lack of expertise on strategies, and accompanying form provisions, that have the capability to adroitly address this issue.

Family harmony is not the only resultant casualty. If family harmony is lost following the disability or death of a family member, the goal of reducing costs in the administration of an estate is likewise put at a high risk of failure. Although such failure concomitantly increases the need for attendant legal services, the author in no way believes this is a significant factor in such failure. Without question, estate planning attorneys would be expected to pursue what is in their clients' best interests, devoid of any consideration of their own economic interests.

Although by far the most frequent, family relationships among adult siblings of a parent are not the only relationships vulnerable to family disharmony in the estate planning process. Also vulnerable are relationships between a parent and adult child, a parent and a child's spouse, adult siblings and step-siblings, and between stepchildren and a stepparent. The impact family disharmony has on estate planning and administration issues is quite familiar to most estate planning attorneys, although the impact their estate planning practices have—or fail to have—on such adverse consequences would be expected to have a much lesser familiarity, the only logical reason extant such issue is not already being duly addressed.

The discussion that follows addresses estate planning issues adversely impacting family harmony and presents salutary strategies the author has found efficacious in enhancing its preservation. Such strategies are practical in nature and the legal principles involved for the most part well known to estate planners, for which few cites are needed. It will be assumed in such discussion that parents have more than one adult child, for there obviously would be little to no risk of family disharmony in a multi-child family currently having only minor children or a single-child family relating to a parent's estate plan, save that in such latter circumstance which may result, as discussed *infra*, from a parent's disclosure of the estate plan. For ease of reference, any references herein to a "testamentary instrument" or "instrument" of a parent are intended to include both wills and revocable trusts; to the estate and its administration to both probate estates and revocable trust estates; and to the fiduciary or financial fiduciary of the estate to a trustee of a revocable trust estate or executor or personal representative of a probate estate, unless the context should indicate otherwise.

## Choosing the Appropriate Fiduciary

He who represents himself has a fool for a client.
*Abraham Lincoln*

Death is not the end. There remains the squabbling over the estate.
*Ambrose Bierce*

The estate planning decision likely to have the greatest impact on family harmony is the choice of financial fiduciary to serve during a client's disability (agent under a financial power of attorney and trustee of a revocable trust) and following death (the trustee of a revocable trust and executor or personal representative of a probate estate). Although clients have an understandable propensity to prefer an adult child serving in such capacity (following their death if unmarried or normally after the death of a surviving spouse excepting second marriages), the all too frequent acquiescence of estate planning attorneys in this preference, sans a meaningful discussion with clients such decision's potential adverse impact on family harmony, presents a very high risk of its loss in the plan's implementation.

Estate planning clients are no more prepared to make an informed decision concerning the appropriate fiduciary of their estates in the absence of objective professional advice than are individuals in determining medical choices without the advice of a physician. The same is also generally true regarding individuals lacking knowledge in investment matters making investment decisions bereft of the advice of knowledgeable experienced investment advisors.

Based on practice experience, professional inquiries, and the polling by the author of estate planning attorneys and certified public accountants at professional seminars, the author

has determined that there is an approximate one-third to forty percent risk of significant family discord in the post-death administration of an estate attributable to a child or children serving as a financial fiduciary of a parent's estate when a parent is survived by more than one adult child. Irrespective of the exact percentage, there is little question but that such risk is quite high. As one might expect, there appears to be a direct correlation between the number of children and number of in-laws and the degree of such risk. Interestingly, however, the size of the estate appears to be a lesser factor. As estate planning attorneys well know, a high percentage of such family disharmony extends well beyond the closing of the estate, often for the remainder of affected children's lifetimes.

The risk of family disharmony increases to some extent should a child additionally serve as financial fiduciary for a disabled parent either as agent under a financial power of attorney or as trustee under a revocable trust. It increases to an even greater extent should a child serve as fiduciary not only of a parent's estate, but also of a trust created under the instrument benefitting another child or a stepparent. This latter circumstance creates a very high risk of disharmony extending beyond just the normal conflicts and tensions occurring between the child named as fiduciary and such child's siblings, but also those between such child, the stepparent and stepparent's children, and between such child and siblings with respect to decisions regarding the stepparent's beneficial interest in the trust should such child's siblings have a remainder interest in the trust following the death of the stepparent.

A misconception among children is that serving as a financial fiduciary is some sort of "plum" or parental honor bestowed upon them. It is also often viewed by a child as their final parental "grade card" of filial merit. This perspective is a major cause of disgruntlement among siblings not chosen. However, the appointed child usually comes to a quick realization such appointment presents a significant burden with little offsetting benefit. In addition to incurring any resultant family disharmony, such child typically has to take time away from work and family to undertake a time-consuming task for which the child is normally ill-prepared, inexperienced and for which the child may not be in receipt of even a modicum of sibling appreciation.

The reasons for the high frequency of such adverse family harmony consequences are myriad. First, beyond obvious sibling jealousy, resentment, past conflicts, and avarice, parents are the family's "emotional glue" which becomes abruptly absent following their passing. Upon the death of the surviving parent, grief and "orphan syndrome" often combine to create a highly charged emotional cauldron adversely impacting the harmonious administration and distribution of the parent's estate. It is not all that unusual for the mindset of adult children in this environment to revert to a level rivaling prior prepubescent sibling rivalry. In-law involvement typically only serves to increase family tensions.

If parents believe such tensions can be avoided by appointing more than one child or all children as co-fiduciaries, they are likely to be mistaken. For in addition to posing administrative hurdles depending upon the number of children appointed, this strategy typically serves to create other friction points, as children frequently are not of like mind on the various issues impacting the administration of an estate. In that context, most any issue can become material, including those which in other contexts might be considered quite inconsequential. Further, children serving as co-fiduciaries who ultimately end up having to do a disproportionate amount of the estate administration, without compensation or appreciation from their siblings serving in the same capacity, can become resentful. Should an odd number of children be appointed, children holding a minority position can quickly accrue a high level of resentment. Conversely, having an even number of children as co-fiduciaries may result in a contentious deadlock.

Compounding the problem, a child serving as financial fiduciary not infrequently assumes an arrogant "I'm in charge" posture, thereby disaffecting siblings. The author has learned that a child most desirous of serving as a fiduciary may be the child especially prone to possessing a divisive imperious attitude if named as financial fiduciary of a parent's estate. Frequently, communication problems with siblings, both as to content and frequency, can occur regarding the administration of a parent's assets, be they real or perceived. Other children feeling there is an information vacuum tend to presume the worst, often garnering a suspicious "I wonder what my [brother or sister] is doing" perspective.

Parents should also be made mindful that a child serving as financial fiduciary can have a significant financial conflict of interest. Many decisions a child makes, or has the discretion to make, as financial fiduciary in the administration and distribution of the estate, may be exercised at the edge of such discretion to such child's benefit. Even when such decisions are impartially made, siblings can have a far different subjective perspective.

Compounding family disharmony opportunities is the complexity of a financial fiduciary's tasks. Mistakes can be made in investment, management and tax decisions, especially if family fiduciaries make decisions without benefit of competent professional advice. Even when making sound fiduciary decisions, other family members are often prone to "second guess" their decisions. Compared with experienced third parties, children serving as fiduciaries tend to be much less diligent and compliant with the provisions of the testamentary instrument and statutory requirements governing the management of an estate, beyond simply being a reflection of their lack of knowledge and appreciation of the subject matter.

Rather than viewing their fiduciary role from an objective perspective, children often feel that other family members should simply trust them, even sometimes to the extent of not expecting an inventory or accounting. A request by another family member for an accounting or other information is often viewed by a family fiduciary as questioning their veracity. Administrative mistakes, both real and perceived, can engender ill will and heighten the level of disagreements, all too frequently resulting in substantial family discontent. Other children also commonly disagree on the family fiduciary's management determinations on a plethora of administrative matters for which they are devoid of knowledge as to their legal requirements. Many administrative tasks are rife for disagreement simply because they rest upon the personal judgment of the fiduciary applied to the facts at hand.

As estate planning attorneys well know, such matters include:

(1) the distribution of tangible personal items (jewelry, furniture, pictures, clothing, family heirlooms, etc.) among children for which there was no specific disposition in the testamentary instruments or documents of the decedent;

(2) the distribution of assets in kind in satisfaction of proportionate shares of the estate based on their fair market value;

(3) the timeliness in completing the administration of the estate;

(4) whether to make interim distributions to family members prior to the termination of the estate;

(5) whether a sibling serving as a fiduciary sufficiently consulted with them on administrative matters, even if not legally required to do so;

(6) whether accountings of administration expenses and receipts were timely furnished and accurate, a frequent problem due to children often failing to keep adequate financial records;

(7) decisions regarding whether estate property should be sold, when it is to be sold and at what price during the post-death estate administration process, often with little concern, awareness or appreciation by other children of their sibling's fiduciary responsibilities in that regard;

(8) whether the child fiduciary properly sought or chose appropriate legal and tax counsel for the estate;

(9) whether the assets of the estate were accurately reported by the fiduciary on an inventory;

(10) whether claims against the estate were properly settled;

(11) whether claims on behalf of the decedent were settled properly;

(12) tax elections during the administration of an estate having a disparate impact upon beneficiaries and whether a corresponding equitable adjustment which should be made in favor of adversely affected beneficiaries;

(13) whether a child serving as a fiduciary should take an administrative fee and its reasonableness;

(14) whether any transfers by the decedent to a family member during the parent's lifetime were appropriately considered as loans or gifts in determining the family member's share of the estate;

(15) whether a child who cared for a parent in a non-fiduciary capacity during the parent's lifetime has a legal or equitable basis for seeking compensation for such services from the parent's estate;

(16) whether property passing outside the estate to a child through joint tenancy or a beneficiary designation should be taken into account in determining a child's share of the estate; and

(17) the appropriate time for the closing of the estate. Ameliorative strategies regarding the first and last four above matters are addressed below.

Of particular note, when a child serves as financial fiduciary, siblings are often of the view that their sibling should not be entitled to a fee, notwithstanding being legally entitled thereto in the same manner as a third party, even if the instrument specifically provides for compensation for the family fiduciary. This position often is the result of other family members being of the opinion that the administration of the estate by a sibling is strictly a "family matter." This view typically will be resented by the child serving as financial fiduciary as indicating a lack of appreciation for their efforts and services as fiduciary. Even if family members are accepting of a fiduciary fee being taken by a sibling, they frequently take objection to the amount, particularly if their sibling has not assiduously kept records of time expended and matters addressed as a fiduciary, a quite common situation.

The foregoing problem areas abound even in circumstances where the family fiduciary is diligently trying to exercise fiduciary responsibilities in an objective, even-handed manner. When such is not the case, other serious consequences can ensue. Less than impartial child fiduciaries are tempted to manipulate the decision-making process for their own economic gain. They also may go to the extreme of ignoring the dictates of the testamentary instrument in favor of exercising their own judgment as to what their parent "really intended." Although certainly isolated occurrences, most estate planners having any significant tenure have experienced incidences of the purloining of estate property or embezzlement of estate funds by a child serving as a fiduciary

Such problems are compounded in a "blended family" situation where a parent is leaving property to both children and stepchildren. This is one of the most potentially divisive and contentious of all family estate planning situations. As opposed to naming a child as sole fiduciary, which can be quite incendiary, the all too frequent unwise strategy of balancing competing family interests by naming an equal number of children and stepchildren as co-fiduciaries is even less worthy of consideration. It has the inverse effect of engendering frequent and costly disagreements between family factions on both sides and among family members on each side, all too frequently resulting in a costly stalemate. In discussions with clients, the author has likened this ill-advised strategy to tying the tails of two cats together.

Beyond the negative family disharmony consequence all too frequently occasioned by having a child serve as financial fiduciary, there is also potential personal liability resulting from errors in the management of the parent's estate. This can be both emotionally and financially devastating to a family fiduciary. It often occurs due to a family fiduciary "winging it" regarding the administration of the estate without seeking legal advice, from oversimplifying the process, sheer ignorance, or simply to avoid incurring accounting or legal professional fees. Any resultant emotional damage to family harmony can be exacerbated when the testamentary instrument has waived fiduciary liability for actions by individual fiduciaries which are merely negligent rather than intentionally errant. Although such provisions are designed to not penalize a child for unintentional mistakes, such exoneration does little to assuage, and may even worsen the rancor of other family members, who are thereby left with no means of redress for damages incurred by a sibling's mismanagement of their parent's estate.

Due to the foregoing formidable risks to family harmony posed by a child serving as financial fiduciary of a parent's estate, there is rarely a family situation in which the risk to family harmony in having a child serve as financial fiduciary of a parent's estate is insignificant, no matter how harmonious the family during the parent's lifetime. Because such situation does not present itself during a parent's lifetime and the factors affecting family harmony are both complex and multitudinous, it is simply not feasible for parents to be able to properly evaluate and predict this risk in their own family with any reasonable degree of certitude.

The confluence of the foregoing factors can result in naming a family member as a financial fiduciary being the ultimate "acid test" of family harmony, taxing it to its limit. Any resultant damage will obviously tend to be much greater in more harmonious families, for such families have "more to lose" by such an occurrence. In situations where significant family disharmony is already present, naming a family member as fiduciary carries with it a much higher risk of discontent and attendant administrative costs.

Interjected into such breech is a parental proclivity to name a child as financial fiduciary of their estate. At first blush, parents quite understandably tend to view the administration of an estate, as do their children, as simply a "family matter," thus, unless there is an estranged relationship with their children or they are otherwise held in disfavor, instinctively concluding a child who "knows the family" is best suited to carry out their intent. However, simply put, the administration of a parent's estate is not a "family matter." It is a legal and financial matter which only happens to involve the administration and distribution of parental assets, the objective administration of which is not furthered, but in fact normally impeded, by the impact of family dynamics. Family dynamics should play absolutely no part, legally or otherwise, in the interpretation to be given an estate planning document or the proper administration of an estate. The term family dynamics refers to the way family members interact with each other, with its inherent emotional aspects, and thus its impact is independent of any objective aspects. When family dynamics impact the administration of a parent's estate due to a child serving as financial fiduciary, any semblance of objectivity by family members can quickly become evanescent.

Even if such family harmony risk was objectively deter-

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minable in the abstract, parents would not be expected to be objective in determining this risk in their own family. The understandable natural tendency is for parents to have a rather Panglossian view that their children possess the better elements of human nature, presenting little to no risk of failing irrespective of the circumstances. Consequently, prior to having a full discussion with counsel of this issue, parents are likely to dismissively conclude that family disharmony resulting from the appointment of their child as financial fiduciary simply "won't happen in my family."

Beyond the family disharmony risk, naming a child as financial fiduciary is accompanied by an administrative burden. A child must devote significant attention away from their family and personal or work schedule to attend to estate matters with which the child typically has no prior experience. Such burden is increased if a child is geographically challenged with respect to administrative duties requiring such child's physical presence, such as inventorying and distributing tangible personal property, overseeing estate sales and meetings with other family members and professional advisors.

Naming a child as a financial fiduciary of a deceased parent's estate is analogous to an owner of a highly technical and complex business employing a manager having no prior experience or expertise in the business, potential financial conflicts of interest in such capacity, and who is at high risk of incurring divisive personality conflicts with employees. Obviously, such hiring would normally be ill-advised, posing a significant economic and employee morale risk to the business. A child having inherent financial conflicts of interest who is at high risk of being resented by, and having disagreements with, siblings, and who has no prior experience as financial fiduciary of a parent's estate, similarly puts the estate at a substantial economic and family harmony risk.

Just as parents cannot be truly objective as to the risks in naming a child or children as fiduciary of their estates, a child serving as fiduciary cannot be objective as fiduciary vis-a-vis such child's relationship with siblings in the discharge of such child's fiduciary duties. Siblings in turn similarly cannot be objective about their sibling's exercise of such sibling's fiduciary duties. Even attorneys, notwithstanding their legal training to be objective, as Abraham Lincoln aptly noted, have a "fool for a client" should they choose to represent themselves. Emotions, family dynamics, conflicts of interest and inherent partiality severely impair the objectivity of all siblings involved in such situation to a degree normally far beyond that which would be expected to adversely impact the objectivity of an attorney favoring self-representation.

Unfortunately, the parental propensity to name children as fiduciaries of their estates is at least acquiesced in, if not actually shared by, a high percentage of estate planning practitioners who fail to provide objective fulsome advice to their clients in making this momentous decision. The rationalization that an estate planning attorney is simply following a client's wishes as to a financial fiduciary is unacceptable. Only through a comprehensive and extensive objective discussion with clients, disabusing them of any misconceptions and preconceptions, fully informing them of its inherent significant risks to family harmony, and providing viable alternative strategies, will clients even have the opportunity to make the informed decision on this issue they deserve and which estate planning attorneys are professionally ordained to provide.

Parents who have gained an appreciation of the high risk to family harmony engendered by their appointment of a child as financial fiduciary of their estate have a natural tendency to shift to preferring a more distant relative to serve in such capacity, such as a parent, brother or sister. However, prior to doing so, they should be advised that: (a) normally no estate administrative experience will be gained by such appointment; (b) depending upon the nature and degree of such relationship, such relationship will at least to some degree impair such relative's objectivity in the administration of the estate; (c) they may be placing a burden on a relative at a time in their lives (such as during retirement) which can be quite inconvenient and obtrusive; (d) such appointment and resulting administrative actions with which a beneficiary may disagree, as well as administrative errors, can result in damaging relationships between such relative and the beneficiaries of the estate; and (e) there will be a probable expectancy by estate beneficiaries that such relative will perform fiduciary services for no fee.

## Naming a Child to Serve as Co-Fiduciary with a Third Party

The foregoing family harmony risks when a child serves as fiduciary are only partially assuaged by naming a child and an independent experienced third-party fiduciary, such as a bank or trust company, as co-fiduciaries. Although having such third party as a co-fiduciary should substantially reduce the administrative burden on the child fiduciary, other children may still be resentful in not having been named to serve in such capacity and may nonetheless blame their sibling for administrative decisions with which they disagree. Further, the lack of objectivity of a child may adversely impact the decision-making process. Finally, having a child and third party as co-fiduciaries may increase administrative costs. Consideration thus should be given instead to the alternative strategy discussed below of naming a child or children as "fiduciary discharger(s)" and appointing an independent experienced third-party as sole fiduciary.

Prior to concluding discussion on this option, it should be mentioned that such strategy nonetheless is worthy of consideration under a family business succession plan involving a farm or other closely held business. Parents are understandably quite reticent in reposing the management of their fam-


ily business in a third-party fiduciary during the estate administration period. A family member thus could be named as co-fiduciary with an independent fiduciary for the sole and exclusive purpose of such child managing the family business or voting the interest in the business entity, either solely or as co-fiduciary with an independent third party, during the period of administration of the estate prior to its termination. The independent fiduciary would solely handle all other aspects of the estate administration, thus preserving family harmony in the more volatile aspects of the administration of the trust estate. However, this strategy is probably only viable with revocable trusts, for there is no statutory authority for a bifurcation of fiduciary responsibilities between or among executors.

### Naming an Independent Third-Party Fiduciary

A viable alternative strategy to naming a child or other relative as financial fiduciary is naming a financially astute, experienced and objective third party, such as a certified public accountant (preferably having no relationship, business or otherwise, with a family member) or corporate fiduciary (bank with trust powers or a trust company), to serve in such capacity. Such appointment unquestionably serves to greatly reduce internecine family stress and attendant risks to family disharmony, as well as provide a much greater assurance that the estate will be properly and objectively managed.

This is not to say that estate planning attorneys also are not proper candidates worthy of consideration as third-party financial fiduciaries. However, depending upon the situation and attorney under consideration, and notwithstanding the fact that an attorney would be expected to be quite competent as to all legal matters in the administration of an estate, several factors can militate against an attorney being the appointee. First, a high percentage of estate planning attorneys simply do not enjoy serving as financial fiduciaries of estates, many facets of which involve non-legal matters they tend not to find enjoyable. Estate planning attorneys are by nature estate planners, not administrators. Attorneys less than comfortable or enthusiastic with the administrative aspects of managing an estate would naturally have a lesser predilection to focus on attending to such task at the highest level of their ability. Naming an estate planning attorney as fiduciary would be analogous to asking an architect who designed a building to also supervise its construction, a request with respect to which the architect would likely demur, for similar reasons.

Secondly, an attorney may not have the experience, adequate support staff, or internal controls and procedures necessary to competently and efficiently handle the investment, accounting, and other ancillary administrative aspects unique to estate administration. Having the authority and legal ability under the instrument to delegate such facets to a third-party fiduciary may only serve to increase overall costs. Third, many administrative tasks of a financial fiduciary requiring less expertise can be performed quite satisfactorily at a lesser cost than at average hourly attorney rates or perhaps even at paralegal fee rates (e.g., supervising distribution of tangible personal property items, meetings with family members and other professionals involved in the administration, etc.). Fourth, although there certainly is no ethical conflict in an estate planning attorney serving as a financial fiduciary under the testamentary instrument the attorney drafted, provided the attorney has adequately informed a client of other alternatives and their risks and benefits vis-a-vis appointing the attorney as fiduciary, estate beneficiaries nonetheless may have a negative perception of an attorney who drafted the estate planning documents also serving as fiduciary of the estate. They may view an attorney assuming both roles to be purely self-serving, question whether any exculpatory clauses in the testamentary instrument to protect individual fiduciaries, including the attorney, from simple negligence were proper or fully understood by the decedent, or believe the attorney would not admit to any deficiencies or errors in the testamentary instrument the attorney drafted. Finally, attorneys serving in such capacity would need to confirm that their fiduciary duties are covered by malpractice insurance. The foregoing considerations lead many attorneys to have a standard practice of dissuading clients from naming them as fiduciaries, notwithstanding the remunerative aspect of such an appointment.

Competent third-party fiduciaries, such as certified public accountants having significant experience as financial fiduciaries and corporate fiduciaries, are impartial and can draw upon a wealth of practical and professional experience in managing estates. In addition to their family harmony enhancing benefits, they tend to make far fewer administrative mistakes, achieve on the average a better investment return, keep better records, provide more accurate and informative accountings, and have more knowledge of the complex laws governing the administration of estates (e.g., Kansas probate statutes, the Kansas Uniform Prudent Investor Act, and the Kansas Uniform Trust Code) than would a child serving in such capacity.

For obvious reasons, an estate planning attorney is likely to receive a greater economic benefit if a family member, rather than a third party, is named to serve as financial fiduciary. Family members usually tend to select their parents' estate planning attorney as fiduciary counsel to assist them in administering the documents the attorney drafted. They also typically need far more legal advice, assistance and support than would a third-party fiduciary experienced in handling estate matters. The enhanced risk of significant family disharmony when a family member is serving as a financial fiduciary additionally can significantly foster increased legal costs. Thus, when an estate planning attorney advises clients to consider the family harmony and estate administration benefits in naming an independent financial fiduciary, clients can be assured that their attorney is advising them solely as to what is in their best interest, not that which might benefit their personal financial interest.

## Cost/Risk versus Benefit Analysis in Naming an Independent Trustee

Clients, particularly those with modest estates, have an understandable fear that the costs of an experienced third party serving as financial fiduciary may significantly deplete their estates. Such fear is normally unfounded. Such costs can substantially reduce other administrative costs, for, as noted above, experienced third parties are possessed of the knowledge in the aspects of their administrative duties that family members must, and should, otherwise glean from their engagement of attorneys and accountants or risk economic damage to the estate should they not do so. It can also lessen, if not avoid, potential legal expenses that otherwise might have arisen from family squabbles due to the appointment of a family fiduciary. Finally, such administrative fee is deductible against the income or any estate tax liability of the estate, thereby normally resulting in a reduced "after tax" cost. I.R.C. §§67(e)(1); 2053(a)(2).

Individual professional third-party fiduciaries, such as certified public accountants and attorneys, normally charge their services at hourly rates. Corporate fiduciary fees, depending upon the size and complexity of the estate and the corporate fiduciary named, are typically based on a percentage of the estate ranging from one to three percent of the size of the estate, the larger the estate, the smaller the typical percentage fee. If the property is income producing real property, the fee is typically a percentage of the income, say 10 percent of its annual net income. Such fee will normally be somewhat greater with respect to probate estates. Obviously, such cumulative fee would be greater should the corporate fiduciary also be called upon to serve as a fiduciary during a period of disability.

The fees for individual fiduciaries charging hourly rates are harder to compare, not only with respect to corporate fiduciaries, but also among themselves. Their total fee will be dependent upon their hourly rates, as well as that of their paraprofessionals, and the total time expended. Such total time in turn will vary among such individuals based upon their efficiency, knowledge, experience and sophistication and efficiency of their form systems. Also, as compared to bonded corporate fiduciaries, such services may or may not be covered by malpractice insurance, an important consideration. Nonetheless, such fees, when converted to a percentage fee "after the fact," would likewise only be expected to exact a very small percentage of the estate. By way of comparison, clients often routinely find acceptable a fee of perhaps one percent per year on their investment assets for financial and investment advice, and perhaps a six percent commission on the sale of their personal residence.

Certainly, when factoring in the risk of fractious family disputes resulting from the appointment of a family fiduciary, the net administrative costs in having a competent third-party serve as fiduciary can actually result in a net savings to the estate as opposed to a family member serving as a fiduciary. When the foregoing aspects are fully and objectively explained to clients under a comprehensive risk versus benefit analysis, clients normally will conclude that such fiduciary fees associated with the post-death administration of their estate are acceptable, and may well result in an economic benefit, particularly when the salutary aspects of enhancing family harmony and relieving children from bearing such administrative burden are also factors meriting consideration.

Such decision may be best posited with clients as analogous to that of taking out property insurance. Individuals insure against risks they have determined they can't afford to take based on a risk versus benefit analysis. In the author's city of Wichita, for example, there is an approximate 1 in 400 risk of a tornado or high wind destroying or seriously damaging a personal residence over a 40-year period. Nonetheless, despite such extremely low risk and the highly likely prospect of wasting casualty premium payments over an entire lifetime, most residents choose to insure against such loss. They do so having determined that such possibility, however remote, of such a major economic loss is a risk they simply can't afford to take when balanced with the relative cost of insuring against it. By way of contrast, when individuals name a child as financial fiduciary of their estates, they are incurring an exponentially higher risk of damaging or destroying what they nearly typically view as a much more valuable intangible asset, family harmony, and a possible attendant high economic cost as well. Moreover, in contrast to property insurance, minimizing such risk is simply a matter of comprehensively addressing it in the estate plan, with no subsequent periodic premium payments being required.

Following comprehensive discussions of this issue with clients, the author has found that approximately three-fourths of clients will choose to not name a child in favor of an independent third party as financial fiduciary of their estates.

Prior to engaging in such extended discussions with clients on the issue, the experience ratio approximated the inverse ratio.

### The Role of a Fiduciary Discharger

By naming an independent financial fiduciary, parents need not abjure any input of their children in the estate administration process. The family member who would otherwise have been the client's choice as financial fiduciary may be named as "fiduciary discharger" in the testamentary instrument, possessed of discretionary authority to discharge a non-family party serving as fiduciary and name as successor fiduciary another third party (usually preferably limited to another third party such as a certified public accountant or corporate fiduciary). More than one child also may be named to serve in such capacity, with decision-making by a majority or unanimity of such children.

The author has found it normally preferable, depending upon the number of children and their individual attributes, for both family harmony reasons and to avoid children feeling "left out" of the process, to provide that all children serve as fiduciary discharger. Further, it is also typically advisable to provide that such decision be made by unanimity rather than by majority in recognition of the major import of such decision, to avoid children taking umbrage at being outvoted, as well as not risking the possibility that a majority decision was motivated by only a segment of the children in furtherance of their personal subjective interests. The tenure of a fiduciary discharger would end upon the termination of the estate and not extend to any sub-trusts created under the instrument.

As above discussed, family disharmony is minimized when family members are not directly involved in the estate administration process, whether as a fiduciary or even as a co-fiduciary with a non-family member. The role of fiduciary discharger puts the desired family member(s) in control of the party who or which is to serve as fiduciary without having the burden or any "family baggage" which can accompany a family member being named as sole financial fiduciary or co-fiduciary with an independent fiduciary. The inclusion of such provision normally satisfies the preference clients often express for family input to be involved at least in some respect in the estate administration process. Such authority also may enhance the responsiveness of third-party fiduciaries to the beneficial interests of family members in the estate. Having a family member or members serve as "fiduciary discharger" additionally permits them to negotiate the lowest fiduciary fee possible. Consequentially, a high percentage of clients conclude that this approach achieves the "best of both worlds," and due to its remoteness from actual fiduciary decision-making, carries little risk to family harmony in its operational phases.

Under the provisions of a revocable trust, to the extent not reposed in a fiduciary discharger, authority could also be reposed in a Trust Protector or Special Trustee to discharge any trustee, other than the grantor or grantor's spouse, thus possibly also including a child serving in such capacity, and appoint a corporate fiduciary or a successor corporate fiduciary, as the case may be, in the event such party has determined that same was merited by family disharmony or was otherwise desirable under the circumstances to ensure the proper and efficient cost administration of the trust estate.

However, because the provisions appointing executors are statutory, any change in the executor or personal representative in a probate estate, even that which could possibly be effectuated by a fiduciary discharger, is subject to judicial approval. K.S.A §59-701, *et seq.* Thus, such provisions are of lesser efficacy than if reposed under the provisions of a revocable trust, where such parties possessing such authority would be termed "trustee dischargers."

### Naming a Child to Serve as Financial Fiduciary only during a Period of Disability

Although naming a child to serve as a financial fiduciary during a parent's disability (financial agent or trust of a revocable trust) carries with it some risk of family disharmony, particularly should the child charge a fee for services, the much greater risk is normally during the post-death estate administration period. Thus, many clients may desire naming a child to serve as financial fiduciary in the event of their disability, when the need for professional advice in the administration of their assets is of lesser importance, while appointing an independent fiduciary to serve as fiduciary during the post-death administration of their estate. At that time, such child's role could transition to that of a fiduciary discharger. Clients making such choice, particularly those having modest estates, also may do so out of a concern that substantial third-party administrative costs would be incurred should there be an extended period of disability.

Nonetheless, a parent should be reminded of the burden that such fiduciary responsibility places on a child and be cautioned that there still is some degree of risk that the other children will question such child's management of the parent's assets, be suspicious of their influence on a parent, question any fees they take, and disagree on the child's management of parental assets. Further, a child serving in such capacity may conceivably access the parent's testamentary instrument and attempt to influence a disabled parent to amend the estate plan in the child's favor, which may even occur in circumstances where the disabled parent has questionable legal capacity to execute a testamentary instrument.

### Authorizing Child Financial Fiduciary to Appoint Successor Corporate Fiduciary

Those clients who nonetheless choose to appoint a child or children to serve as a financial fiduciary of their estates typically further name other children as successor fiduciaries, perhaps followed by a corporate fiduciary in the event there is no child willing and able to then serve. In that circumstance, the parent should be counseled that it may be advisable to consider providing in their testamentary instrument for a child serving as fiduciary to resign at any time and appoint a corporate fiduciary to serve in such child's stead, thereby superseding the otherwise applicable fiduciary succession provisions.

Not infrequently, another child named as successor fiduciary, who may resent not having been named by the parent to serve as initial financial fiduciary, will unduly criticize or challenge a sibling's fiduciary decision-making, perhaps in the hope such fiduciary will resign and open the door for the disgruntled child to become the successor fiduciary. Including such provision has the beneficial aspect of mollifying any further damage to family disharmony and avoiding the child financial fiduciary having to make the Hobson's choice of either continuing to serve in a disharmonious family environment or resigning as fiduciary, only to have a disgruntled sibling serve as such child's successor and continue the aggravation of family harmony.

It also allows a child serving as fiduciary to foster family harmony at the outset by informing siblings that such child did not ask for the appointment (assuming that is factually correct), did not consider such position to be other than a strictly financial matter to be handled professionally and objectively according to the provisions of the parent's testamentary instrument, and does not intend to take a fee for serving as a financial fiduciary if the estate administration proceeds smoothly without family rancor. However, should such administration become disharmonious, such child would indicate such child would intend to exercise such option, given by a parent in furtherance of family harmony, to resign and name a corporate fiduciary to serve in such child's stead. In a revocable trust, such provisions could also be made applicable when a parent is under a disability.

This option, in conjunction with the foregoing statement to siblings, should: (a) disabuse siblings of any notion that such child is on a "power trip;" (b) serve to disincentivize all siblings from fomenting family disharmony in view of the additional administrative costs they likely will perceive to be significant should their sibling resign in favor of a corporate fiduciary; and (c) remove the incentive of a successor sibling to unduly criticize the child serving as financial fiduciary or seek such child's discharge in the hope of succeeding as financial fiduciary.

As with the aforementioned inclusion of a fiduciary discharger provision, this option is of lesser efficacy under the provisions of a will than a revocable trust. For unlike wills, such appointment of a successor trustee is not statutorily subject to judicial approval.

## Summary

It's tough to make predictions, especially about the future.
*Yogi Berra*

Clients' decisions in naming a financial fiduciary should only be made after due consideration of all its relevant aspects with their estate planning attorney and what such decision portends for the future of their family and estate plan. Unfortunately, a very high percentage of individuals executing financial powers of attorney and testamentary instruments are unlikely to have been sufficiently apprised of the foregoing factors to be able to make an informed decision. Far too often, there is only a brief superficial discussion of this issue, limited in essence to legal counsel inquiring of the client as to the client's preference, and if the nominee is a child, perhaps follow up inquiries as to whether such child is mature, financially responsible and "gets along" with siblings.

Devoid of a comprehensive understanding of the complex issues involved and viable alternatives, a parent is typically predisposed to select a child as fiduciary of their estate or successor fiduciary following a spouse. Conversely, as noted above, in the author's experience a strong majority of clients who have been comprehensively and objectively informed of the foregoing factors will decide instead to go outside the family in selecting a financial fiduciary. Even more telling, the author has experienced situations in which children who have been similarly informed of the potential risk to family harmony and the burden they will likely bear if named as financial fiduciary have indicated to parents they prefer declining such role in favor of the appointment of an independent third party fiduciary.

Nonetheless, whether resulting from a lack of thoughtful analysis, instinctively concluding that disharmony simply "can't happen in my family," or having decided that the benefits they perceive by naming a child as financial fiduciary outweigh the risks, a minor percentage of well-informed clients nonetheless will choose to name a child as financial fiduciary of their estate. In the end, such decision ultimately must rest with the client. The role of estate planning attorneys is not to proselytize, recommend or otherwise try to persuade clients one way or another in such determination, but simply to objectively inform them of all appropriate considerations, as well as alternative fiduciary strategies. In short, the financial fiduciary "pros and cons balance sheet" should speak for itself. From the perspective of an estate planning attorney, whatever decision duly-advised clients ultimately make in their choice of financial fiduciary should always be considered the appropriate decision for that client.

## Disposition of Tangible Personal Property

Following the selection of the financial fiduciary of the estate, the disposition of tangible personal property among children probably incurs the second greatest risk to family harmony. Such risk is clearly at its zenith if a child is serving as financial fiduciary. Consequently, this aspect of estate administration is worthy of more than a brief discussion. The goal of most parents is to provide for their distribution among children either as equally in value as possible or provide for an equitable method in their distribution, or a balancing thereof. The various methods in doing so have wide variances not only in their ability to accomplish such goals, but also in their impact on family harmony.

At the outset, it should be acknowledged that the import of this risk varies considerably based on the nature, quantity and value of such property in any given estate. Frequently, such facet has little import on family harmony due to most of a decedent parent's property of significance to children having been previously distributed by parents to them prior to their death. In other situations, it may consist of a houseful of such items, many of substantial economic and emotional value. Thus, the important aspects of the distribution methods outlined below should be considered in that vein. That being said, as most estate planning attorneys well know, even items of little economic value often take on great emotional significance in the process of their post-death distribution among children.

The high risk of family disharmony in the disposition of the tangible personal property is primarily due to the emotionally-charged environment in which it takes place, replete with competition among siblings for the possession of personal property items imbued with sentiment, nostalgia and which often serve as an enduring emotional touchstone to parents the children have lost. In such complex environs, the problem areas are legion, including parental approaches in discussions with their children eliciting their preferences in this regard, the failure of parents to specifically delineate their personal items disposition in lists, the selection of the financial fiduciary, the discretion reposed in the financial fiduciary in making such distribution, the provisions in the testamentary instruments governing their definition and distribution, and the prospect of children intentionally violating the applicable distribution process.

The last above problem area is of initial concern in the distribution process. Irrespective of the process, steps should be initially taken by the fiduciary following a parent's death to ensure that the process is not compromised at the outset. A child may "jump the gun" and employ "self-help" by surreptitiously taking items from the parent's residence. This is not that infrequent an occurrence, particularly when a child has a key to the residence and, with respect to larger items, a ready means of transporting its contents, such as a pickup. This possibility has been termed by the author's partner as the "pickup doctrine."

A propitious avoidance strategy is for the financial fiduciary to timely secure the parental residence following the parent's death by changing the locks. This action also protects against the residence being entered by third parties who also may possess a key. Nonetheless, this protective action, if undertaken by a child serving as fiduciary is likely to meet with immediate umbrage by siblings. Other children tend to distrust a sibling's motives, can be in high dudgeon in being "locked out" of their parent's residence by their sibling, and may even have suspicions of their own that such action was taken by the sibling for the purpose of purloining residential items for the sibling's personal benefit.

Another problem area is provisions in the instrument either failing to clearly define tangible personal items to be distributed to family members or which are too inclusive. Overly broad definitions exacerbate family harmony problems by unnecessarily increasing the types of items, particularly those of high value for which children typically have little sentimental attachment. Thus, consideration should be given to limiting the definition to specified categories of sentimental personal property items (e.g., jewelry, scrapbooks, pictures, clothing, heirlooms, etc.) or items of interest for perhaps personal usage (e.g., furniture, recreational and yard equipment). This normally excludes such "big ticket" items as cars, airplanes, and boats, as well as valuable paintings, artworks and collections (such as coins, stamps, and figurines). Such items not only typically have little sentimental value, they are often more in the nature of investment property. When having substantial monetary value, they tend to greatly destabilize family dynamics in their distribution.

A more limited definition also favors estate planning objectives. Tangible personal property items having little sentimental or personal use value to children, particularly when they are of significant monetary value, are usually best distributed under the residuary clause of the testamentary instrument among family members in the same proportions as the parent's other remaining assets.

## Disposition of Tangible Personal Property by List

As estate planning attorneys are well aware, Kansas law assists in the disposition of tangible personal property items by providing, without need of following the formalities of wills, for an individual to dispose of tangible personal property not used in a trade or business by simply leaving a written list (hereinafter referred to as a "Personal Effects List" or simply "List"), provided there is a specific reference in the testamentary instrument to the possibility of leaving such List. K.S.A. §§ 59-623; 58a-418. The law requires that the List either be in the handwriting of-or signed by-the testator. *Id.* Further, the List must describe the items with "reasonable certainty" so that they are identifiable. *Id.* Such disposition would have been able to be effectuated even in the absence of such specific statutory authority in revocable trusts simply by drafting the List in the form of a trust amendment. Quite obvious to estate planning attorneys. identifying the beneficiaries of furniture and household effects items by referencing numbers or names attached to the back of the item, rather than by a description on the List, although a time-worn technique employed by many parents, is inherently flawed due to their "mobile" nature, a facet well appreciated by children disapproving of a specific disposition.

If parents duly provide for the disposition of all significant tangible personal property items of interest to children either in their testamentary instruments, or usually much more efficiently and desirably, under the provisions of a Personal Effects List, the potential resentment by children of parental choices in their disposition aside, family harmony would not be adversely impacted. However, given the normally significant number of such items, their changing makeup, the vicissitudes of parental desires regarding their disposition, procrastination, and simply the reluctance of many parents in undertaking this task, this is understandably far from a normal occurrence.

Nonetheless, rather than leave the post-death disposition of tangible personal property to methods discussed below, none of which are completely without family harmony risks, parents should be strongly encouraged by their estate planning attorneys to prepare the List. The List should, at a minimum, include items the parent perceives to be of the most significant sentimental or personal use value to children. At a minimum, its preparation should also reduce the possibility of contentious, and frequently baseless, assertions by a child that a parent "told me that [a particular item] would be mine." If true, such item obviously likely would have been included in the List. It would also bring into question the location and possession of any item that was on the List but absent from the residence.

The preparation of a Personal Effects List is especially important in second marriages where, unless the personal residence and its furnishings are to pass to the decedent's children, the default provision in the testamentary instrument should normally provide for the disposition of household furniture and furnishings to the surviving spouse, with the remaining items going to children, typically in as equal shares as practically possible. This avoids children and a stepparent engaging in divisive arguments over the ownership of the parent and stepparent as to the typically numerous tangible personal property items in and about the personal residence that are in such categories. In that situation, the parent should ensure the List directs the disposition of any items that the parent desires to pass to a surviving spouse or to their children in the event such items would have passed otherwise under the foregoing provisions of the testamentary instrument if not on the List.

Unfortunately, Personal Effects Lists sometimes have a habit of coincidentally "disappearing" when kept in an insecure place, such as in an unlocked cabinet or drawer in the parent's residence, or even in a secure place, such as the parent's safe deposit box, when a disapproving child is named as successor financial fiduciary or otherwise has access to the box. Thus, to best protect against an unintended disclosure of the List during the parent's lifetime, as well as its protection following the parent's death, the List should be placed with the parent's original documents in a sealed envelope in a safe deposit box. Irrespective of whether a child is a signatory on the box, a copy of the most updated List should be sent to the parent's estate planning attorney and so noted on the List, to protect against its "disappearance."

The List should be revisited periodically, removing any items which may have been lost, sold, or destroyed in the previous year, and adding more recently acquired items which parents believe might be of sentimental or personal use value to their children. The parent also may find it desirable to make a video of such items for identification purposes. It would also be informative to include in the audio component of such video the provenance and relationship of any such items to family heritage.

### Parental Discussions with Children in Preparation of List

Prior to preparing a Personal Effects List, it is advisable for parents to discuss with children their preferences in the devolution of tangible personal property items. Rather than leave clients to their own devices in that respect, it is preferable for estate planning attorneys to outline methods for parents to garner sufficient information for them to make informed and equitable distribution decisions (from the parent's perspective) that are least hazardous to family harmony. The discussion that follows analyzes the effectiveness of various strategies in achieving that objective.

Parents should preface such discussions by advising children that the distribution method chosen following their deaths will be designed to maximize family harmony, the parent's most important estate planning goal, while avoiding any significant monetary disparities among children in their disposition. Children should be advised such method is thus designed to encourage preferences based solely on an item's sentimental or personal use value rather than its actual value. To that end, children would be further advised that any substantial inequality in the value of personal items of significant value they select and which are left to them on the List, or which are otherwise distributed to them following their death, are subject to a possible value adjustment to the extent their value is over a relatively modest amount, affecting their share of the remaining assets in their estate.

Each child would then be instructed to prepare a list of items they would like to receive following the parent's death, listing them in order of their preference. Children would be informed that in preparing the List, the parent would consider both the priority placed on items by mutually interested children and the overall number and priority of requested items of each child. Further, children would be informed that also for family harmony reasons, their submitted preference lists would not be shared by them with their siblings, nor would the List be disclosed to any child prior to their death. This also would avoid any possibility, however perceived to be remote, of any child attempting to persuade them to make changes to the List, seek current distribution of any items, or object to their disposition to a sibling.

The List would then indicate whether any items distributed under the List are, or are not, to be subject to any such value adjustment. In order to preserve confidentiality, the List should not be stored in a place accessible to a child. Rather, as noted above, it should be kept in a secure location.

## Distribution of Remaining Tangible Personal Property not Disposed by List

Unfortunately, as noted above, only a minority of parents even prepare a Personal Effects List disposing of their tangible personal property. Those that do usually leave a List that is far from comprehensive. As such, it is a requisite that the testamentary instrument appropriately address this situation by providing a mechanism for the disposition of remaining items that is facilitative to the maintenance of family harmony. Placing too much discretion in such disposition method in the financial fiduciary incurs the risk of the financial fiduciary choosing a method not conducive to its maintenance, which is particularly hazardous when a child is serving in such capacity. Thus, if not otherwise articulated with some particularity in the testamentary instrument, it would be advisable for parents to leave a precatory document, perhaps as an attachment to the testamentary instrument, suggesting the appropriate method consistent with the nature of their assets, and which are not disposed of by List, with their estate planning documents.

The distribution procedures discussed below applicable to items not on a Personal Effects List are designed in varying degrees to satisfy the predominant family harmony prerequisite, i.e., not providing an incentive for children to choose tangible personal property items based on their economic value as opposed to their sentimental or personal use value. For should a child in such process end up being in receipt of personal property items having a value significantly greater than such child's share, the parent's overall intended proportions of their estate passing to children will be skewed. Even more importantly, it can result in significant family disharmony not only as a result of any significant resultant economic disparity, but by placing children in competition for the more valuable items in the process, thereby fostering resentment when a sibling chooses items perceived by other siblings to be based strictly on their economic value.

In all such processes, it could be provided that a minor child could be represented in such distribution process by the trustee of any sub-trust created under the instrument for such minor child, or if none, the guardian appointed under the instrument for such child, irrespective of whether such appointment had then judicially occurred.

## Initial Procedure Regarding Substantive Items

As an initial procedure, following the death of the parent it would be advisable for the financial fiduciary to seek a list from each child with respect to any remaining property of the parent not on the List that the fiduciary has determined has a potential value in excess of a modest threshold amount (e.g. $200 or more). Such threshold amount avoids the process as to all items being fully tied to economics and allows for some offset should an asset be overvalued. The fiduciary would inform the children preparing the list that such property, if professionally valued for more than such amount, will result in such excess being offset against such child's proportionate share of the parent's residuary estate should such child receive such asset. Consequently, pursuant to the wishes of the parent, they should select such item primarily on its sentimental or personal use value, not its economic value.

The fiduciary would then seek a "walk through appraisal" by an experienced estate salesperson as to the value of all such selected items by children which are over the threshold amount, hereinafter referenced as Substantive Items or Items. A professional appraiser may need to be sought for selected unique category Substantive Items such as jewelry, collections, antiques and heirlooms that were not disposed of by the List. Such valuations would then be made known to all children listing a Substantive Item, with any child who is then informed of an Item's valuation, being able to withdraw any such child's preference as to an Item prior to its actual distribution.

If only one child was desirous of an Item, the fiduciary would distribute the Item to that child. If more than one child desired an Item, the Items in which the children desiring such Items would be chosen by a random sequential lottery method, with the sequence being reversed in each subsequent round having the same participants. Such process would continue until all such Items in which a child had exhibited a preferential interest were distributed.

The overall differential among children in the value of Items each child received in the process over the threshold amount of each such Item would then be an advancement as to each respective child's share of the residuary estate. All remaining personal property items would be distributed between or among children under one of the procedures below without having any advancement aspect, excepting a Substantive Item in which no child received under the foregoing preference procedure.

## Distribution by Agreement of Children

At first blush, it would appear reasonable and consistent with most parental desires for the testamentary instrument to give children a reasonable amount of time, say ninety days following a parent's death, to agree among themselves on the disposition of remaining tangible personal property items for which any child has an interest. Such approach is quite common and the period for its expiration need not extend beyond the expiration of the time period delineated in the testamentary instrument for the List to be located or be of no force or effect, say 90 days. In the event the distribution of items in which children have an interest cannot be agreed upon, such items would then be distributed among children under one of the remaining methods below. However, this procedure normally should not be authorized if there is a minor child not represented by another party as noted above so as to be unable to have sufficient maturity to meaningfully participate in this procedure.

However, clients should be counseled at the outset by the fiduciary that such authorization for agreement by children is fraught with a high risk of contentious arguments in seeking an agreeable resolution, with each child often having a subjective reason for receipt of individual items (e.g., "I gave it to Mom and I should get it back," "Mom promised it to me," or "Mom already gave it to me"). Moreover, a family harmony enhancing request which normally should be made by the financial fiduciary that in-laws not be present at such discussions, may have the opposite effect if made by a child serving as financial fiduciary.

If the initial Substantive Item procedure was utilized, such agreement procedure would appear to have limited efficacy. For in that situation, there would be no remaining Substantive Items in which a child expressed an interest and none of the remaining items would be of significant economic interest.

## Distribution by Auction

One distribution method for the remaining tangible personal property items would be by auction, either by public or private bidding, or the use of "virtual money" in a private auction. In a public auction, the attendees would be children and the general public. Children ostensibly would be equally treated from an economic standpoint, as the proceeds would be allocated to the residue of the estate and distributed along with other remaining assets proportionally among children as provided in the testamentary instrument.

However, this may not be the substantive result. Children, when competing against each other and the public in the bidding process, may have paid in excess of the fair market value of items, thereby proportionately diminishing the share they otherwise would have received in the estate. Nor is a public auction procedure without significant family harmony pit-

falls, principally because it pits children against each other in the bidding process. Children having to bid beyond the market value of an item to secure an item may resent other children who drove up the bidding price. Children who were outbid by other children may resent other children to whom items were lost in the bidding process. It can also have the possible deleterious consequence of a high-bidding stranger walking away with family heirlooms, notwithstanding the benefit of the proceeds passing to children. Thus, the economic equality of a public auction must be balanced against the not insignificant risk of family disharmony and potential distribution of family significant assets to strangers in the process.

If a closed bid silent auction is held, which may or may not have non-family invitees as well, the bids would remain sealed until all bids were in. If a child is serving as financial fiduciary, unless the bids are all opened in the presence of the other children at the close of the auction, there can be suspicions they may have been opened by the financial fiduciary prior to the financial fiduciary also making a bid. A sealed bid silent auction has the benefit over an open auction in avoiding confrontation in the bidding process, but it does not avoid the anxiety of children having to determine the purchase price necessary to outbid siblings who may have an interest in the same item, as well as possible third parties who may be additional invitees. Further, there still may be a high degree of resentment by children who have been outbid, particularly with respect to items of high sentimental interest to them, including possibly by a third-party invitee.

In a "virtual money" auction process, each child is given an equal amount of "virtual money" with which to bid on personal property items. The use of "virtual money" in the auction process is even more problematic and normally should be avoided in comparison to the foregoing auction approaches for several reasons. Although each child in this process is given an equal amount of "virtual money" to use in the bidding, it creates additional tensions in children having to strategize and compete among themselves in using their limited amount of allocated "money" to ensure they have enough left to secure remaining wanted items, thus leading to a questioning of the entire process. Moreover, although designed to put each child on an "equal monetary playing field" as opposed to an actual bidding process, there is no certain nexus between the amount of "virtual money" used in bidding and the market value of items received. Consequently, economic parity is not automatically obtained regarding the value of the items received due to there being no auction proceeds to allocate to the residue. It would only have been obtained if the fiduciary had the right to adjust economic differences among children in the items received having significant value as an advancement against their shares of the residue.

In short, even if economic parity is achieved among children regarding the proceeds of a public or private auction, the tendency of the auction process to cause anxiety among children, the potential inequity in substantive economic benefits conferred among children by the bidding process, the possible resentment of children who were outbid by siblings or a member of the general public, and the confrontational nature of the proceedings if an open bidding process is chosen, are aspects of the auction procedure that are unavoidably antithetical to the maintenance of family harmony. For the foregoing reasons, the use of the "virtual money" auction procedure appears to have even less to commend it.

Finally, if the Substantive Item initial procedure has been employed, either in conjunction with a Personal Effects List or otherwise, there would be little efficacy in the implementation of this strategy, for all items of significant financial value in which a child has an interest would have already been distributed. In that event, the lottery method below would likely be considered the more appropriate.

## Distribution by Lottery

Another distribution method is by lottery. A common lottery method is the use of a random number selection process determining the sequence of each child choosing a desired tangible personal property item during every round of the selection process. Under the basic application of this method, there is typically no monetary adjustment among the children for any disparity in the values of items distributed. This method is frequently preferred by estate planning attorneys and their clients due to its simplicity. However, unless the sequence is reversed in each subsequent round, such method would continue to favor the parties having the earlier preferences in each subsequent round.

Although a lottery procedure is equitable in its sequential random selection, absent the implementation of the initial preference procedure regarding Substantive Items by the fiduciary prior to the inception of the auction procedure, it nonetheless retains the aforementioned aspects inapposite with family harmony in both not dissuading children from selecting property based on its economic value and the possible resultant significant disparity of the value of the tangible personal property items each child receives in the process.

## Distribution by Financial Fiduciary Pursuant to Testamentary Instrument Guidelines

The final distribution method is for the testamentary instrument to provide for the financial fiduciary to distribute remaining tangible personal property items not disposed by List as fairly as practically possible, and/or as equally as possible, among children regarding their value as the fiduciary determines to be fit and proper. This is a quite common default provision, following a failure to of children to agree to their distribution among themselves under the aforementioned agreement procedure delineated in the instrument. Its popularity is probably attributable to its simplicity, typically being in the estate planning attorney's standard provisions with little to no discussion with clients as to their potential adverse import on family harmony or alternative strategies. However, from several perspectives it can be the most hazardous to family harmony, as well as the most arbitrary, when a child serves as family fiduciary.

First, a child having a financial conflict of interest would have to agree to the distribution of all items in the initial "agreement phase," compounding the family harmony detriments of its inclusion in the first instance. Second, such child is also given broad discretion as to the distribution of the remaining items between or among such child and a sibling or siblings, further compounding such negative aspects and conflicts of interest in the process.

Conversely, in the hands of an experienced and competent third-party financial fiduciary, it is probably the most protective of family harmony, for it removes a child totally from having import in the final determination of the disposition of any such items with respect to which more than one child is desirous of receiving. Moreover, if such method follows the initial Substantive Items procedure, there will be a significant amelioration of its negative aspects. Further, if the initial Substantive Item procedure had been followed, there would be no need for the "agreement phase" and the lottery procedure for the rest of the items would tend to be the more appropriate. However, independent financial fiduciaries would not be expected to welcome being burdened with this degree of discretion and attendant responsibility and the discretion accorded the fiduciary is rife with potential disagreements among children as to the final distribution. For irrespective of the party serving as fiduciary, in the absence of a prior Substantive Item preference procedure, it is very difficult to divine a method of distribution in most such circumstances that would result in property having relatively equal value being distributed between or among children and at the same time balance children's preferences in that regard.

## Disposition of Undistributed or Unwanted Items

Following application of the foregoing procedures, it is desirable for the testamentary instrument to include a provision for the disposition of all remaining items. This includes the discretion to sell such items (e.g., at an estate sale) and distribute the proceeds under the residuary clause of the instrument, as well as the discretion to donate items having a de minimis value to charitable institutions or dispose of them in any other manner the financial fiduciary should deem appropriate.

## Physical Distribution of Tangible Personal Property

The testamentary instrument should also address the financial fiduciary's responsibility in the delivery or storage of tangible personal property items. This issue can come into play when children who are not in the same geographic area as the decedent parent, either temporarily or permanently, request that items be shipped and the subject property is of a size, weight or value that such costs (including insurance) is significant, particularly in relation to the value of the property (e.g., a couch or refrigerator). Temporary absences can arise when the child is currently incapable of picking up the property (e.g., in military service overseas, temporarily disabled or in ill health, or possibly even under detention) and such child requests that the child's portion of the tangible personal property items be stored until such child is able to pick them up. The obvious issue is whether the estate is to bear the burden of either such costs.

This issue should not be left open or entirely at the discretion of the fiduciary, for as is the case with many matters involving the administration of a parent's estate, it can result in a level of family disagreements far beyond that merited by the relatively small amount of value involved. If the financial fiduciary pays such costs without authority in the testamentary instruments to charge the residuary estate share of the child directly benefiting with an advancement equal to such costs, such costs would be borne by all children, often to their consternation. Thus, the governing instrument normally should make it clear that the financial fiduciary is not required to pay the costs for the packing, shipping, or storage of such tangible personal property items passing to children. The child receiving the item would be required to either pay such costs or pick up the item within a reasonable period, say forty-five days of being notified, or the fiduciary would be authorized to sell the item, including to another child, and distribute the net proceeds to the child.

Regarding the disposition of tangible personal property items to a minor child, the testamentary instrument should provide for such items, in the discretion of the fiduciary, either to be held in any residuary trust created for such child under the instrument, by the child's conservator, or by a custodian named by the financial fiduciary under the Kansas Uniform Transfers to Minors Act, which permits such property to be held until such child attains age twenty-one. K.S.A. §§38-1706; 38-1721.

## Electronic Duplication of Family Pictures, Recordings, Letters, Records and other Documents

The increasing ease and efficiency of electronic reproduction has reduced the importance of actual possession by children of significant parental tangible and intangible personal property items consisting of family pictures, family video and audio recordings, letters, personal records and other similar type of instruments or property. Consequently, the testamentary instrument should specifically authorize the financial fiduciary to electronically duplicate any such items subject to copying and other duplication for dissemination among all children who desire them, with any attendant costs being borne by the estate. This avoids any disagreement in the bearing of such costs and mollifies potential resentment among children who did not receive the original item in the distribution process.

## Conclusion

The death of a parent is an emotionally tumultuous event for children. The administrative task of distributing tangible personal property items among children in such environment is particularly problematic and delicate, involving items of great familial interest and emotional significance to children, as well as competition for their possession and ownership. Most estate planning attorneys are aware of numerous instances in their practice in which family relationships have suffered irreparable damage in this process. Correspondingly, their clients have often had such instances in their own families. If this quite precarious administrative task is not properly and comprehensively addressed by legal counsel in the estate planning process and testamentary instruments, an enduring legacy of family disharmony can be left in its wake. ■

Look for **Part II** of this article in the March Issue of The Journal of the Kansas Bar Association

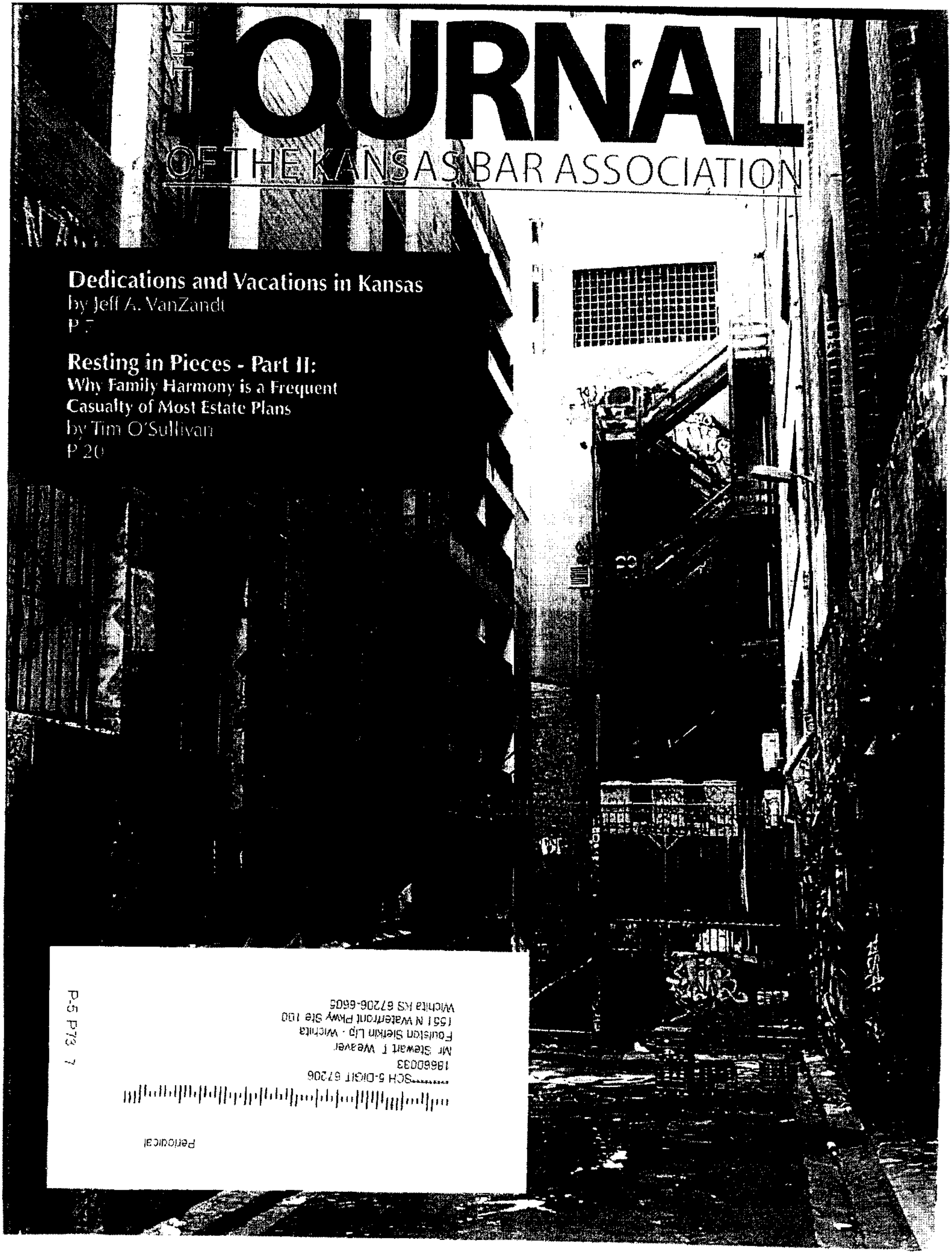

### About the Author

**Timothy O'Sullivan** is a partner in Foulston Siefkin LLP in Wichita. He graduated from Washburn University School of Law in 1975 and received an LL.M. in Taxation degree from the University of Missouri-Kansas City School of Law in 1982. Tim is a Past President of the KBA Real Property, Probate and Trust Section, the KBA Tax Section, and the Kansas Chapter of the National Academy of Elder Law Attorneys. He has also served as an adjunct professor in estate planning at the University of Miami School of Law and the University of Missouri-Kansas City School of Law, and at Washburn University School of Law for the past 25 years.

tosullivan@foulston.com

# Resting in Pieces - Part II

THE JOURNAL OF THE KANSAS BAR ASSOCIATION



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# Resting in

## Why Family Harmony is a Frequent Casualty of Most Estate Plans

**by Tim O'Sullivan**


# Part 2:

## Planning Bequests to Children of Farms and Closely Held Businesses

This land is your land, this land is my land...

Woody Guthrie

As the initial estate planning consideration involving a farm or other closely held business, a parent must determine whether the closely held business should be maintained following the parent's death or whether market conditions and family considerations discussed below militate in favor of selling the business before or after the parent's death. If it is determined that the business is to be continued by family members following the parent's death and a business succession plan put in place, a parent must carefully consider which family members will receive business interests, how the business is to be maintained, when and how family members should receive the business interest, and how the estate is to be divided among family members, particularly if there are family members who are not active in the business.

In the decision-making process, it is of first importance that parents fully understand that closely held business interests are difficult to maintain from generation to generation. The stress on family harmony in the transition of the ownership of a family farm or business can adversely impact business operations due to the conflicting values and needs of a family versus a business. The focus on family values tends to be inward, whereas the focus of a business mandates a focus on external factors in the marketplace. Compensation in a successful business tends to be based upon performance and skill level, whereas the family tends to desire equality of remuneration irrespective of these factors. Such predilections need to be carefully addressed if the success of the business succession plan is to be enhanced and family harmony preserved in the process.

Part of the tension placed on family harmony when transferring a business to descendants is also due to emotional and psychological considerations. The older generation's natural reluctance to "turn over the reins" of the business needs to be addressed. For business succession to be successful, the succeeding generation should gain practical experience in business operations prior to the death of the older generation. Additionally, sibling rivalries should be observed in the operational phases of the business by the parent so that they can be properly considered and addressed in the parent's estate planning and business succession plan.

Improper or inattentive estate planning in the area of business succession can not only increase the risk of failure of a business succession plan, it can destroy family harmony and greatly increase operational costs. The prominent issues which frequently arise in this context are the orderly transition of the management of the farm or closely held business to a child or children and the division of the estate between or among children who are active in the business with those who are not. From the outset, a parent must appreciate that there is a substantial risk of disagreements that will arise between active and non-active children (hereinafter also referenced as "active" and "passive" family members, respectively) regarding business decisions if both classes succeed to the ownership of a closely held business enterprise. This aspect results in an extremely high incidence of family disharmony, often leading to resentment, arguments, and not all that infrequently, costly litigation.

Although active children can be given voting control of the enterprise for continuity of business management purposes, from a family harmony standpoint this serves to aggravate such tensions. The selection of a few family members to manage a business places risks on family harmony greater than that of naming children as financial fiduciaries of a parent's estate. The former situation, however perilous it may be to family harmony, is transitory in nature and does not place sibling fiduciaries in an on-going superior economic position.

Passive owners may "second guess" aspects of such management decisions, including the salaries of active owners and the amount of cash in the enterprise which should be distributed to them versus the amount to be retained for future business needs. In addition to disagreements among themselves in management decisions, active family members may overvalue their contributions to the business enterprise, their merited compensation, and view passive family members as being unappreciative of their efforts in the business. In short, neither faction is likely to be totally objective, and are often far from objective, about their respective positions and how they are viewed by the other faction.

With such axioms in mind, one of the most perplexing issues attendant to a parent's transfer of an ownership interest in a closely held business to family members lies in the distribution of estate assets between active and passive family members. Frequently, active children are given a greater share of the total proportionate value of the estate, usually in the form of business interests, in consideration of their efforts. This disparity may be due to a parental view that such children have received below market compensation for their efforts during the parent's lifetime or that their expertise or creativity has enhanced the value of the business enterprise. It also may be simply due to a child choosing to stay on the farm or in the family business enterprise. In such situation, if in conversations with clients it appears such child was paid the same approximate amount as would be paid to a third party possessed of the same experience, did not add significant economic value to the family enterprise than would otherwise have been expected from another individual performing the same duties, and did not give up better economic opportunities to assist a parent in the enterprise, it would be advisable for their estate planning counsel to inquire of the client the basis for such additional allocation to ensure that such decision was well thought out in the face of an apparent lack of economic undergirding.

Whatever the rationale for such additional allocation, it is at high risk of triggering resentment and disharmony between the active children receiving such additional allocation and passive children receiving a lesser share of the estate. Passive children tend to be less than objective in their assessments of the merits of any such additional share allocation and, as noted above, active children tend to overvalue their contributions to the business enterprise and feel they should be so compensated simply for assisting a parent in its management irrespective of any accompanying economic benefits. One way to help mollify such a situation is to place the parental reasons for such additional allocation in the testamentary instrument, preferably in a revocable trust, rather than a will, due to the former not being a matter of public record. An even better way is to avoid it altogether by adequately compensating active children for their efforts during the parents' lifetime to avoid such disparity in the allocation of the parent's estate.

Even if such allocation of business interests between active and passive children is proportional based on their respective percentage ownership interests in the business, the fact that active children have a controlling voting interest will substantially increase the personal value of their proportional interests over the proportional interests of passive children. It can also increase their fair market value as well, dependent upon whether the active children alone have voting interests, their percentage voting interest, and most particularly if an active child has a controlling voting interest in the enterprise. This realization also can result in significant additional family disharmony and dissension, for parents are unlikely to increase the proportional interests in the business interests going to passive family members in consideration of such increased value.

Because active and passive children owning a closely held business are at a very high risk of incurring family disharmony, a strategy to avoid such problems, yet provide for equal shares of the estate passing among children, is to include provisions designed to balance out the equal shares of the non-business assets passing to passive children with the equal shares of the business interests passing to active family members. Nonetheless, a serious problem is presented if there are insufficient non-business assets to equalize shares of the estate going to passive children. Here, one such approach is for the parent to require active family members receiving a business interest to purchase any business interest in excess of their shares that otherwise would have been allocated to passive children, perhaps under a prescribed installment purchase method with a reasonably small interest rate so as to ease any economic burden that would otherwise by be imposed on active children. Another more family-harmony-friendly strategy not putting active and passive children into such debtor/creditor relationship is for the parent to purchase a life insurance policy on the parent, if economically feasible and not prohibited by the parent's current state of health, to provide both estate liquidity and sufficient assets to balance the shares of the estate such that the business assets may all pass to the active children.

In situations when it is determined that there is no foregoing viable alternative but for a parent to give business interests to both active and passive family members in satisfaction of their proportionate shares, parents must first select a method of providing for the management of such business assets by active family members. If the business is not already an entity, the parents would typically form a limited liability company with perhaps both voting and non-voting interests to hold the business assets. If it is already in an entity such as a limited liability company or corporation that does not have voting and non-voting interests, the entity could be recapitalized to create such interests. Passive family members may be given "put" rights such that a dissatisfied passive family member could compel the business entity (or perhaps at the option of the entity, active family members on a pro rata basis) to purchase their ownership interests in the entity, often also on an installment basis, perhaps secured by the entity or the active owners' interests in the business. Perhaps also, the purchase price may take into account a prescribed lack of marketability and lack of control discount which reduces the purchase price of the passive owners' interest in the enterprise from its otherwise pro rata fair market value. Such discount is normally appropriate, both given that the exercise of such put right places an economic burden on the active family members, such interests have a lack of marketability and fractional ownership interests in an enterprise having a fair market value significantly less than their pro rata interest in the underlying business would otherwise dictate.

However, unless the implementation of the foregoing strategies leaves passive family members with no interest in the business, it is likely only to reduce the frequency and severity of disagreements between active and passive family members. It is highly unlikely to totally extinguish them. Thus, it may also be desirable to include provisions in the governing testamentary instrument mandating mediation and binding arbitration of all disputes involving family member owners of the business enterprise. Such non-judicial proceedings are private and not a matter of public record, are typically faster in resolving such disputes, tend to be far less family-harmony-destructive and less adversarial than judicial proceedings, and can be less costly as well.

Provisions implementing "put option" strategies and mandating mediation and binding arbitration of business disputes between or among family member owners are best placed in the provisions of the governing instruments of the partnership, limited liability company or corporation owning the farm or other business enterprise.

It should go without saying that without proper comprehensive business succession planning in this most sensitive family situation, irreparable and costly family schisms are a frequent result.

## Addressing Gifts and Loans to Children

We make a living by what we get. We make a life by what we give.

Winston Churchill

Another estate planning aspect causing frequent disagreements among family members and the fiduciary of a parent's estate is the determination of whether a lifetime transfer by a parent to a child was intended to be an outright gift for the purpose of benefiting the life of a child or simply a loan. In the absence of provisions in the testamentary instrument specifically addressing this issue and the presence of ancillary instruments such as promissory notes documenting parental intent, family members and estate fiduciaries will often disagree on the amount of the transfer, whether the transfer was a loan or gift, the terms of any loan transfer (e.g., payment and interest terms), and whether the parent intended the gift or loan to have an effect on the child's share of the parent's estate, notwithstanding the absence of any authority for inter vivos gifts having any legal effect on dispositions under the testamentary instrument and loans being a part of the estate when legally unenforceable. One child's characterization of a parental transfer as a gift is often another child's characterization of the same transaction as a loan. Consequently, in the absence of provisions in the testamentary instrument addressing the issue or written evidence of the nature of the transaction, there can be fractious family disagreements, substantial legal expenses, and a skewing of the intended estate plan in the event the eventual legal resolution of the transaction should fail to comport with the decedent's actual intent regarding the transaction.

With respect to parental transfers that are clearly gifts or resolved as same, discord can sometimes arise when prior gifts are unaddressed in the testamentary instrument. Children can take umbrage when the shares of a parent's estate passing to their siblings under the testamentary instrument fail to consider substantial unequal prior gifts passing to them which either have occurred or which children believe may have occurred. Although prior gifts to estate beneficiaries do not normally legally affect the disposition of the donor's estate unless clearly stated in the testamentary instrument that they were intended as advancements, other children may argue that such legal outcome is unfair, could not have comported with the parent's intent and its omission was an oversight by the parent or an error by the attorney drafting the instrument.

Thus, it is beneficial from a family harmony perspective for the parent to state in the testamentary instrument whether any gifts the parent may have made to a child are to be considered in determining such child's share of the estate. If such is the case, which normally comports with the parental intent, such provision would be generic in nature, not referencing any specific gifts, only stating that any gifts the parent may have made to a beneficiary of the estate are not to be considered in the division of the estate.

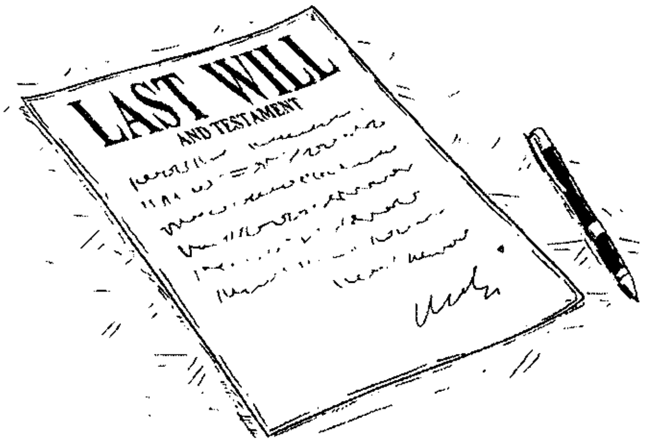
Conversely, if prior gifts to a child are to be taken into consideration in determining the child's share of the parent's estate, the parent should state in the testamentary instrument that a specific gift or an amount representing a total of such gifts to a child should be treated as an advancement against a child's share of the estate (possibly with an interest component to take into account inflation and time value of money). Going forward, the parent could also provide in the testamentary instrument that any future transfers to a child by check which are noted thereon as gifts similarly are to be considered as advancements.

By so addressing any parental gifts in the testamentary instrument, parents can avoid family acrimony and potential litigation, notwithstanding the weakness of the position, on the issue of whether parental gifts were intended as advancements against a child's share of the estate. Absent a standard practice of addressing this issue in the estate planning process, it is typically overlooked by estate planning attorneys.

With respect to loans, verbal loans to children tend to result in much greater family disharmony than the issue of whether parental gifts should be treated as advancements. The promissee, i.e., the child receiving the loan, as above noted, will often contend that the transaction was a gift, not a loan. Such child's siblings will often contend to the contrary. In short, one child's gift can be another child's loan. There are also issues frequently surrounding the amount of the loan and whether any interest on the loan was intended or nonetheless legally chargeable. Verbal loans are also more likely than written obligations to have become legally unenforceable due to having a shorter statute of limitations, i.e., three versus five years. K.S.A. §§58a-511(1); 58a-512(1).

Consequently, as a general rule the testamentary instrument normally should generically forgive any verbal loans, specifically providing that any such loans are not to be taken into account under the dispositive provisions of the testamentary instrument. If there are any outstanding verbal loans at the time of execution of the testamentary instrument which the client desires to be considered in determining a child's share of the estate as to any outstanding balance, such loans should be reduced to promissory notes, which can be simple demand notes, having the parent or the trustee of the parent's revocable trust as promissee. Normally, when requested by a parent, children will execute a promissory note as evidence of a prior verbal loan due to parental disfavor or potential adverse consequences in the parent's testamentary disposition to them should they decline. In the unusual circumstance when a child should refuse to do so or a parent does not wish to confront a child to whom money has been lent, assuming the parent does not want to include testamentary provisions reducing such child's share as a result of such child refusing to execute a promissory note, the amount owing could be specifically forgiven in the testamentary instrument at death and a specific amount in its stead treated as an advancement against such child's share of the estate.

With respect to written loans to a child, assuming they comport with parental intent, the provisions of the instrument should provide that any loans evidenced by a written instrument are to be fully taken into account in determining the promissor's share of the trust estate at their full unpaid balance and allocated to such beneficiary in satisfaction thereof up to the full amount of such share. Further, the provisions of the instrument should additionally provide that such consequences will ensue irrespective of whether the note is legally enforceable at the time of its disposition (e.g., the statute of limitations has run on the note) and place the burden is on the promissor child in establishing any prior payments. The client would then be best advised not to make any future loans to children that the client wants taken into account in determining the child's share of the estate unless




similarly evidenced by a promissory note.

Such statements of parental intent regarding verbal and written loans in the testamentary instrument and the use of promissory notes when loans are to be considered in determining a child's share of the estate can reduce strains on family harmony, lessen administrative costs and legal fees, and avoid a distortion in the intended estate plan should the legal treatment of loans to family members be inconsistent with actual parental intent. As with the treatment of prior gifts, this issue likely does not commonly arise in estate planning conferences and even less frequently receives proactive treatment in the testamentary instrument.

Gift-giving itself can also serve as a basis of family disharmony during a parent's lifetime. Parents may wish to make gifts to their descendants yearly to reduce the size of their taxable estate, to satisfy an economic need of a child or other descendant, or merely for their sheer personal satisfaction in seeing a descendant's enjoyment of the gift. Regardless of motive, when parents give money to both children and grandchildren, it is difficult to devise a method perceived to be fair and equitable by descendants. For example, gifts or distributions made outright to all descendants (children and grandchildren) on an equal per capita basis designed to maximize the benefit of the annual gift tax exclusion for federal estate tax purposes frequently results in a family unit consisting of a child and such child's descendants receiving a greater amount than other family units having a lesser number of descendants. If the parent wishes to have a cumulative equal distribution among family units considering both lifetime gifts and post-death transfers under their testamentary instrument, adjustments can be made to achieve this goal under its provisions. In the event of any such adjustments, the provisions of such instrument should also state the rationale therefore for family harmony purposes. However, either method of eventual distribution of the estate (equal amounts of the estate to each child or equally to each child with cumulative gifts to family units being treated as an advancement against each child's share of the estate) may leave a child feeling that such child or such child's family cumulatively was being unfairly penalized by a parent merely due to having more or less descendants than a sibling.

There are other potential family harmony drawbacks to making outright gifts to children. Depending on the size of the gift, a parent may experience more than minor disappointment should there be unwise or excessive expenditures of the gifted property or its management by the donee. A parent also may become dismayed by the lack of appreciation of the gift by a donee or a child's expectancy that such gifts are of a routine nature.

Gifting substantial amounts for other than medical or educational purposes also can have a negative impact on personal ambition, and financial independence may be adversely affected by such outright gifts. As a rule, descendants that receive significant gifts in their formative and early adult years tend to be less financially responsible, underachieve, and possess less self-esteem than those that financially achieve on their own initiative. A parent can become quite disenchanted with a child's lack of ambition fostered by such gifts. Two books which trenchantly discuss this dynamic are The Millionaire Next Door, authored by Thomas J. Stanley, Ph.D. and William B. Danko, Ph.D. and Estate Planning for the Healthy Wealthy Family, authored by Stanley D. Neeleman, J.D., Carla B. Garrity, Ph.D., and Mitchell A. Baris, Ph.D.

Also, should the parent ever cease or significantly reduce periodic gifts to a child or grandchild, particularly if the donee has come to financially rely on such gifts, the donee may become resentful or pressure for their continuance. This risk is increased by a periodic routine pattern of gifting which can create an enhanced air of expectancy (e.g., gifts made in a specific amount every Christmas). The child may begin to feel entitled to the gift, perhaps even having incurred expenditures in anticipation of its receipt. Finally, a pattern of gifting may also lead a donee to consider the inheritance of the donor's assets as an entitlement, often leading to unwise expenditures in reliance thereof. Such an expectancy can heighten intra-family tensions and disharmony during the donor's lifetime, as well as following the donor's death.

Rather than make a substantial outright gift (or series of gifts) to a child or other descendant and potentially present such adverse consequences, including family disharmony, it thus may be advisable for a parent to instead make such gift in trust for the benefit of the donee. In a properly drafted trust, although the specifics are well beyond the scope of this article, governmental benefits such as Medicaid can be maximized for beneficiaries, assets protected against creditors and beneficiary mismanagement, and a "sprinkle clause" can be included to allow trust income distributed to beneficiaries to be taxed at their income tax brackets. This option also is often not considered sufficiently in the estate planning process.

Many of the foregoing factors applying to lifetime gifts are equally applicable to outright bequests under the testamentary instrument. Large bequests liberally benefiting children or grandchildren in early adulthood can similarly stifle maturational development, personal ambition, and achievement of financial independence. As with lifetime gifts, leaving such bequests in a properly structured trust can obviate these undesirable tendencies and consequences.

The loaning of money by a parent to a child can likewise foster family disharmony during a parent's lifetime. Adverse consequences can quickly arise if the child breaches the agreement. Not surprisingly, such loans are frequently in default. This may occur because the child lacks the ability to repay the loan or the child views its obligation under a loan from a parent far less seriously than it would with a commercial loan. Parents can quickly become dismayed and feel they are being taken advantage of when children fail to timely make loan payments having no rational basis for a default.

## Addressing a Child's Potential Claim for Parental Care

It is not all that uncommon for family disharmony to also result from disagreements surrounding whether a child who assisted with the elder care of a parent in a non-fiduciary capacity (not as a trustee of a revocable trust or agent under a power of attorney) should be compensated by the parent's estate. With respect to fiduciary services, for clarification of parental intent purposes, the governing instrument should specify whether payment for such fiduciary services was intended, notwithstanding that such services were otherwise entitled to be compensated under the law, particularly for services authorized thereunder when the parent was not under a disability, and the manner in which payments are to be determined outside of a trusteeship, e.g., in the same manner as a guardian or conservator with respect to services as an agent or attorney in fact under a health care or financial power of attorney, respectively.

In many circumstances, a child has spent considerable time in a non-fiduciary capacity caring for a parent (e.g., providing transportation, assisting in household care, cooking meals, paying bills, etc.), often in-residence with a parent. Following the parent's death, in the absence of a specific bequest in the testamentary instrument in consideration for such care, the child may claim that the parent intended for the child to be compensated for such care, that the parent owed the child a specific amount for such care, that the parent promised to provide for a bequest under the testamentary instrument for such care, that the child is otherwise entitled to be compensated for such care from the parent's estate, and sometimes even that fairness demands that the child should be allocated a greater amount of the estate than otherwise provided thereunder in consideration therefor or their siblings should simply agree to such greater share. Such assertions sometimes even

manifest themselves in a legal claim for compensation against the parent's estate. Even in the absence of a legal claim, considerable strain can be placed on family harmony resulting simply from such assertions, with the child seeking compensation often considered by siblings to be motivated strictly by greed and such child in turn considering such siblings to be quite unappreciative of the care such child provided their parent.

To avoid such a family imbroglio, if a parent intends to prefer such child in appreciation of such care, the parent should preferably make transfers to the child during the parent's lifetime outside the observation of such child's siblings and note such purpose in the parent's records that such transfers were strictly gifts to benefit the child and not intended as wages or compensation (to rebut any implication that such payments were taxable in nature). If this is not financially feasible, the parent may provide for an additional bequest to the child in the testamentary instrument in consideration of such care, noting preferably under the provisions of the parent's testamentary instrument, as opposed to under a separate writing, the reason for such additional bequest.

In the vast majority of situations in which the parent would not want a child to be compensated over and above any compensation paid, or gift made, by the parent during lifetime, the parent should generically state in the provisions of the testamentary instrument that in the absence of a written agreement so providing, it was the parent's assumption that any such care or services not provided by a child in a formal fiduciary capacity were made purely out of generosity and affection, not in anticipation of any economic benefit.

Nonetheless, in order to create a chilling effect against any possible claim of such nature by such a child against the estate, the provision would further provide that should any beneficiary (i.e., intentionally not singling out children) make a claim against the probate estate of the decedent for any care or service the beneficiary may have provided to the parent, any amount actually allowed on such claim would result in a "dollar for dollar" reduction of the beneficiary's share that would otherwise have been the case in the absence of such claim. Such beneficiary would also be out legal fees expended in pursuit of the claim and such claim in that context would likely be considered compensation subject to income taxation. In short, such provisions should result in a "poison pill" in the event a child makes such a claim, for whether such child prevails or not, such child will have received a net diminished share of a parent's estate than would otherwise have been the case in the absence thereof.

As noted above, while a parent may want to avoid a caregiver child's bringing a claim against the estate, the parent may still want to give a specific bequest to such child in the testamentary instrument in appreciation for that care. In that event, the parent's bequest should indicate such was the reason for such bequest and such decision was the parent's alone. Otherwise, a caregiver child is more likely to be blamed by a sibling for having influenced such parent to make the bequest and the Internal Revenue Service might conceivably take the position in any audit of the caregiver's income tax return that the parent and child had an agreement that such bequest was meant to be in lieu of compensation during the parent's life.

## Minimizing Adverse Effect of Intended Disparity in Children's Shares

Children have no legal right in any state to inherit property from a parent. Lawmakers have long decided that as children normally have had no role in the accumulation of assets in a parent's estate (other than, of course, diminishing it by parental support during their formative years), they should have no inherent right in its disposition. Consequently, viewed objectively, children should be appreciative as to any amount they receive under a parent's estate plan as purely a gift. However, this expectation often proves to be unrealistic under concrete circumstances. Thus, if a parent is conferring unequal monetary or economic benefits between or among children under the parent's estate plan, the impact upon family harmony engendered by such disparate treatment should be considered.

Notwithstanding being devoid of an inheritance right to a parent's estate, children nonetheless often view it as an entitlement right, or at its most basic level, that a parent simply "owes it to me." As with the appointment of a child as fiduciary of a parent's estate, they also tend to view what they receive in relation to siblings as their parents' last full measure of their merit as a child. Thus, should parents provide for an unequal economic benefit among children under their estate plan, to ameliorate any resulting family disharmony, it is normally advisable for the parent to provide in the testamentary instrument the reason for such disparity and unequivocally state that the decision was the parent's alone.

By not leaving such rationale in doubt, such statement may help reduce, albeit probably not totally avoid, a disaffected sibling's feelings of resentment. For example, if the parent states his or her desire to give a child a larger bequest due to a greater economic need than other children, such intention should be so expressed, although unless perhaps if it was due to a disability, other children may nonetheless view this as a penalty for their personal ambition and success. If such greater benefit to a child is due to the child having been of much greater assistance or comfort to the parent, as discussed above, such intent should also be delineated.

On the other hand, there certainly are converse situations where a parent does not wish to make a bequest to an estranged or disaffected child due to such circumstances as a perceived failure in ambition, unacceptable lifestyle, or a poor or detached relationship with the parent. In that situation, a parent may be inclined to threaten to disinherit such child absent a substantial change toward more desired behavior. However, such threatening is unlikely to produce a positive change in the child's behavior. Instead, the relationship between the child and the parent, as well as with such child's siblings, is more likely to become even more hardened as a result and the disparate treatment of the child will be the last enduring memory such child will have of the child's parent. Nonetheless, even such acknowledgement by the parent is understandably not likely to dissuade a parent from disinheriting such child held in disfavor as being undeserving.

If the only reason for reducing a child's share is the parent's belief that such bequest would be imprudently managed by the child, which is often the case, parents often choose to simply reduce the child's share or totally disinherit the child. In doing so, they frequently have failed to consider the normally better alternative, both from a family harmony and property management perspective, of making a bequest of an amount in trust for the benefit of the child to ensure that the money will be distributed to the child by the trustee, in the trustee's discretion, to satisfy specific health, education, maintenance and support needs of the child after considering the child's other resources, including even the child's ability to engage in gainful employment prior to attainment of a certain age (e.g., 65). Moreover, the trust provisions can provide incentives for desirable changes in the child's behavior (e.g., very conservative for maintenance and support needs prior to reaching a certain age, providing for "matching provisions" for the child's earned income, or a bequest upon attaining a college degree). For family harmony reasons, a competent third party, such as a corporate trustee, rather than another family member, would best be named to serve as trustee of such trust, even more so if the family member to be so named holds a remainder interest in the trust upon the child's death.

If a parent, after considering the foregoing nonetheless decides to provide for a disparity in shares going to children or in the manner such shares are going to children (e.g., the parent is having one child's share being held in trust and managed by a third party trustee), the parent should consider strategies which minimize both family disharmony and an unwarranted challenge by the adversely affected child or children. First, as noted above, the rationale for doing so should either be included in the testamentary instrument or in a separate written statement signed by the parent. If a revocable trust is chosen as the primary testamentary instrument, the statement should be included therein, for revocable trusts, as opposed to wills, do not have to be filed of public record. Such clear and unambiguous statement should assist in rebutting any claim by a child that such disparity was inadvertent, a mistake, or did not reflect the true intent of the parent. Moreover, the parent should additionally state that such decision was not influenced by any other person to militate against any undue influence allegation.

Second, the parent may include an in terrorem or "no contest" provision in the testamentary instrument, providing that certain legal challenges by a child to provisions of the instrument would result in a lapsing of the child's share under the testamentary instrument. Their efficacy is beyond the scope of this article. However, such provision could only be effective if the bequest to the child is large enough such that the child is unwilling to risk such a lapse. In any event, such provisions should be narrowly drafted to accomplish the client's objectives. For example, if the goal is to create a substantial disincentive to a child challenging the child's share of the estate or the manner in which it is being distributed to such beneficiary (e.g., in trust rather than outright to be managed by a third party trustee for an extended period and possibly for the lifetime of the child), such provisions should not extend to any other matters, such as seeking a judicial resolution of ambiguities in the instrument or challenging a fiduciary's fees or any other action in the administration of the estate.

Unfortunately, such provisions are typically overbroad and used routinely as a singular "one size fits all" elixir in avoiding family disharmony. Used in that capacity, they are not well served. They are designed only to dissuade specious challenges to the estate plan in the foregoing limited types of situations and serve no general purpose in furthering family harmony in the administration of the estate. To the contrary, when they incorporate overbroad language in their application and are utilized to also apply to administrative decision-making, they serve to both exacerbate family disharmony when a child is serving as financial fiduciary and can distort the intended estate plan by stultifying legitimate challenges in the administration of the estate.

## Avoiding Unintended Disparity in Children's Shares

There are also frequent situations in which a child may inadvertently receive an amount by virtue of a parent's death in excess of that intended by a parent. For example, property a parent owns in joint tenancy with a child or with respect to which a child is named the primary beneficiary passes to such surviving child as joint tenant or beneficiary outside the provisions of the parent's testamentary instrument. This typically results in the child who is the surviving joint tenant or beneficiary on an asset receiving amounts in addition to the child's share of the parent's estate.

This may simply result from parents not understanding that their testamentary instrument does not govern joint tenancy or beneficiary property (unless the beneficiary was the revocable trust or estate of the parent), a quite common misunderstanding. There are numerous other situations prone to this result. A parent may name each child as a beneficiary on separate accounts or assets of relatively equal value, without realizing that a child would be disinherited if the account was cashed in, a circumstance which may occur should the parent subsequently incur a disability and money is needed for the parent's care. Another example is a child who is named as a beneficiary on an asset which has all children named as beneficiaries predeceasing the parent, with the asset, in the absence of also having named contingent beneficiaries, devolving to the other children listed as beneficiaries, thereby disinheriting the predeceased child's descendants in the process. It may further result from a child being named as a joint tenant on a parent's account for the sole purpose of assisting the parent in the payment of bills, without the parent realizing that the account would pass outright to the child upon the parent's death and not under the provisions of the parent's testamentary instrument. Finally, it may occur simply due to the parent's not properly changing beneficiary designations or joint tenancy ownership after executing their testamentary instrument to comport with their estate plan or having passed away prior to their effectuation.

When any joint tenancy or beneficiary designation property passes outside the provisions of a testamentary instrument to a child, issues of parental intent and a potential resultant distortion of the estate plan can create substantial family disharmony as well as administrative and legal costs due to challenges by disenfranchised children. The child benefiting from such succession in ownership is likely to argue that such succession was intended by the parent, e.g., to benefit them for having cared for, or attended to the needs of, the parent. The other children, most stringently if the parent's testamentary instrument provided for the children to receive equal shares of the estate, are likely to argue that such disposition was not intended and thus the joint tenancy or beneficiary asset should be considered an asset governed like all other parental assets under the provisions of the parent's testamentary instrument. Absent evidence of a constructive trust, the surviving joint tenant or beneficiary so receiving property outside the testamentary instrument clearly has the legal upper hand, as the beneficiary designation or survivorship property right of joint tenancy would obviously otherwise govern the disposition of the subject property. Whatever the legal consequence, family harmony, as well as preservation of the value of the estate, are likely casualties.

To avoid an unintended consequence and family disharmony whatever the parental intent, such intent should be expressed in the testamentary instrument. Thus, if the intent of the parent is that all property in which the parent has ownership passes upon the death of the parent as provided under the delineated shares of their testamentary instrument, which is normally the case, its provisions should provide that any property passing outside its provisions to a beneficiary of the estate, whether by joint tenancy or beneficiary designation, is to be treated as an "advancement" against the joint tenant's or beneficiary's share of the estate in the same manner it would have been treated had it been held in the estate of the parent at the time of the parent's death and passed to them as part of their share of the estate. In the less common converse situation where the parent does not intend for joint tenancy or beneficiary designation property to be considered in determining a beneficiary's share of the estate, the testamentary instrument provisions would provide, in conformity with the normal legal consequence, that any property, or perhaps only specific property, passing outside its provisions through joint tenancy or by beneficiary designation to a beneficiary is not to be given any consideration in determining a beneficiary's share of the estate.

### Consideration of Mediation and Arbitration Provisions

An ounce of mediation is worth a pound of arbitration and a ton of litigation.

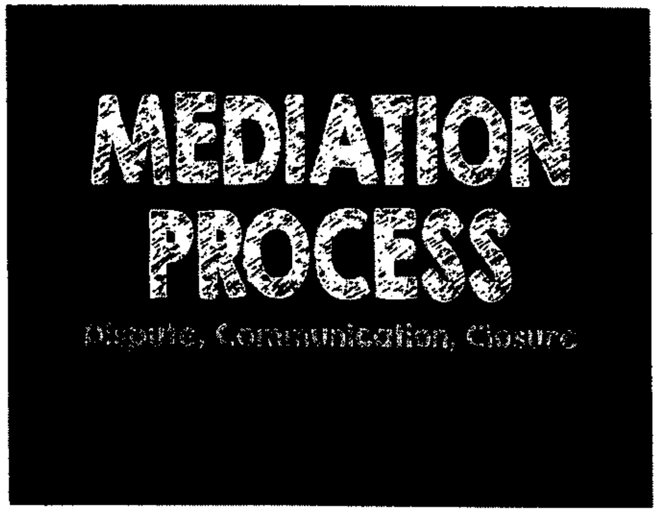
Joseph Grynbaum

Conflict is inevitable, but combat is optional.

Max Lucado

The inclusion of mediation and arbitration provisions in the testamentary instrument can avoid publicly litigating family disputes, particularly disruptive if the estate and controversy involves a family business, and thus greatly assist in preserving family harmony. While binding mediation and arbitration provisions in testamentary instruments are not advisable in every circumstance, they unquestionably are worthy of consideration in issues and controversies involving a family member on each side of an estate issue. Due to adverse effects on both privacy and family harmony, such litigation can be even more deleterious in the estate planning context than it is in business contexts which frequently include such provisions. Yet, mediation and arbitration provisions in testamentary instruments are quite rare.

As mediation and arbitration must normally be by agreement of the parties, unless such provisions are statutorily authorized to be enforceable, it can be questionable whether




they are enforceable. There has been a split among the relatively few appellate courts, none in Kansas, that have looked at the issue of their common law enforceability when included under provisions of a testamentary instrument. The better argument would appear to be that by accepting an interest in the estate, the beneficiary impliedly has contractually accepted the enforceability of such conditions as well. Moreover, a descendant has no legal right to a share of the parent's estate and a parent should be able to place conditions on a receipt of a child's share of the estate. Further, mediation and arbitration provisions advance desirable public policy goals of preserving family harmony and reducing public expenditures in the judicial process. Such factors buttress the legal position that such provisions should be legally enforceable notwithstanding the absence of any statutory authority for their enforcement.

Fortunately, Kansas is one of a minority of states that now statutorily recognize the enforcement of mediation and arbitration provisions in revocable trusts. K.S.A. §58a-205. Nonetheless, to further enhance their enforceability, particularly with regard to such provisions in wills in which they have not been similarly statutorily sanctioned, a specific provision should be included in a revocable trust that mandates mediation of disputes involving family members, which normally have a high success rate, followed by binding arbitration if mediation should fail to settle the dispute. A Special Trustee or Trust Protector could be authorized under the provisions of a revocable trust, as generally sanctioned by provisions of the Kansas Uniform Trust Code, to amend the trust provisions to reduce a non-consenting beneficiary's share of the trust estate by a certain percentage (e.g., say one-third), in the event a beneficiary should knowingly ignore such provision and institute a judicial resolution of the issue. K.S.A. §58a-808(c). Such authority would also best be extended to the selection of the mediator and arbitrator(s), and the number of mediators, if the parties cannot agree, as well as any procedural rules to be applied in any such proceedings to the extent not otherwise dictated under the provisions of the testamentary instrument.

The alternative dispute resolution (or ADR) approach is less formal and contentious, can be much less costly, normally achieves a faster result, and avoids the subject matter and proceeding being of public record. It is particularly valuable as a required alternative in resolving family disputes in the administration of trusts and estates due to its assuaging effect on potential family disharmony. The potential downside is that an arbitrator's decision constitutes a binding and final resolution of the issue and there are few grounds for appeal. Picking a knowledgeable and experienced mediator or arbitrator is key, e.g., a highly knowledgeable, reputable and experienced estate planning attorney. It also is typically wise to exclude contested matters involving a family member and a professional third party, such as a corporate fiduciary, except at the option of a affected family members. A non-judicial procedure in many such circumstances tends to favor a third party that typically would prefer that a contested matter not be of public record.

## Whether to Advise Children of the Estate Plan

It's not me who can't keep a secret. It's the people I tell that can't.

Abraham Lincoln

The considerations involved in a parent's decision whether to advise a child or children of the estate plan extend far beyond whether children will subsequently inform aspects of the plan to others the parent does not want to know, such as another child, in-laws or grandchildren. It is much more dependent upon the specifics of the estate plan, the particular family situation involved, a proper evaluation of the benefits and detriments in making such disclosure, and most particularly, its impact on family harmony.

For estates holding farms and closely held businesses which are passing to children, it is normally advisable to involve children in the business succession part of the estate plan. As discussed above, this allows family harmony issues to be appropriately discussed and effectively tested while the parent is living. In the absence thereof, there would be no opportunity for parents to make appropriate adjustments to the estate plan. It also minimizes the risk of crafting a business succession plan based on certain assumptions about children's strengths and weaknesses that might prove to be incorrect.

However, despite advice to the contrary disseminated "on line" and rendered by many financial and other professionals, including a large segment of estate planning attorneys, the author believes for the reasons discussed below a parent is normally ill-advised in disclosing the estate plan to children in almost all other situations. Rather than "clearing the air" and "avoiding surprises," the oft-purveyed aphorism for such disclosure, for a legion of reasons it will almost certainly instead carry with it an immediate and severe risk to family harmony.

First, children are usually ill-suited by their background and experience, normally not even having a comprehensive estate plan themselves, to be able to analyze, understand or appreciate the elements of their parent's estate plan. Nor, typically possessed of at least some semblance of emotional conflicts of interest with siblings, along with the impact of family dynamics, sibling rivalries, and potential financial conflicts of interest regarding their desired or expected share of their parent's estate, can children be expected to be objective in evaluating a parent's estate plan in any material respect.

Moving to the substance of such disclosure, if a parent is going outside the family for a financial fiduciary to administer the estate due to family harmony considerations, a child may question parental motives in so doing, greatly underestimate the family harmony risk in having a child serve in such capacity, greatly overestimate the cost of a third party administering the estate, grossly understate the burden such role places on a child, incorrectly view the administration of the estate as a family member, and thus lean toward cajoling or pressuring parents that a child should be appointed as financial fiduciary. This usually engenders a disagreement among siblings as to which child should serve in such capacity.

The better strategy is to include a provision in the testamentary instrument, as discussed infra, providing that the parent: (a) was not going outside the family for a financial fiduciary due to any concern that a child could not properly manage the administration of the estate, but strictly due to family harmony being the parent's most important goal; (b) did not want to take any risk in that regard by naming a child to serve in such capacity; (c) did not wish to impose a burden upon a child in serving in such capacity, including taking time away from the job or personal or family life in fulfilling their duties with respect thereto; and (d) did not want to have to choose which child or children to serve in such capacity. Absent such provision, children are also likely to conclude that the failure of a parent to name any of them as a financial fiduciary was based on mistrust.

Alternatively, if a parent has chosen instead to name a specific child or children to serve in a fiduciary capacity, disclosure of such decision may immediately result in discontent among, if not blatant jealousy by, other children.

A parent's decision to give more of the parent's estate to one child in recognition of such child's contribution to the farm or other business enterprise, or due to a greater economic need, is often unappreciated by other children, sometimes even if the economic need relates to a disability. Should the estate plan include a significant charitable bequest, children may object, concluding in essence that "charity begins at home." Also, it is not an isolated instance in which children even inquire about intentionally omitted aspects of their estate or estate plan in the disclosure, including the size of the parent's estate.

Further, by choosing to discuss an estate plan with children, a parent may enhance a child's feeling of entitlement to the parent's assets. Following such disclosure, a child may request "a part of my inheritance" during the parent's lifetime, when "I can enjoy and use it." Additionally, such disclosure often inadvertently opens the door to a full panoply of "pressured requests" by children to make changes in the parent's estate plan, often designed, as one might expect, to benefit themselves, which suggestions typically contravene the interests of other children, all the while placing considerable stress on family harmony. Occasionally, even in-laws have been known to have the temerity to make impertinent inquiries, such as inquiring as to any provisions for them in the estate plan or their net worth. If the assets of the parent's estate plan are significant, such disclosure may change a child's spending and saving habits, perhaps becoming less prudent, relying instead on their future "inheritance" for retirement funds, notwithstanding a surviving parent may live well beyond a child's attainment of retirement age with no certainty as to the nature or value of their assets or testamentary intent at that time.

Also, married children frequently express a desire that should they predecease a parent, they would prefer "their share" to alternatively pass to their spouse. This desire runs contrary to that of most all parents. As estate planning attorneys well know, parents normally desire for a predeceased child's share to pass instead to the predeceased child's children, or if none, to their other children. They have the obvious concern that if a deceased child's share passes to an in-law, it is likely to be to the substantial economic detriment of such child's descendants. For in addition to expenditures of such assets by an in-law, such assets are exposed to the creditor claims of such spouse and possible distribution to, or subject to the divorce or inheritance claim of, a subsequent spouse or pressure of a subsequent spouse to also provide for their children. Nor do parents normally want to incur additional attorney fees in providing for a distribution to a child's spouse under their estate plan in the highly unlikely event a child should predecease them. Finally, parents tend to be of the view that it is the responsibility of their child, not them, to provide for a son-in-law or daughter-in-law. Nonetheless, the pressure exerted upon a parent by a child to make such provision can cause significant family disharmony should a parent decline to do so. Such disharmony would then tend to extend to the affected in-law, even sometimes resulting in the withholding of contact with their grandchildren in the subject family.

Children also may pressure a parent to prefer the child over other children regarding the shares of their estates due to a provincial view that they are "more deserving" or a sibling "doesn't need the assets" due to being of greater wealth. Further, knowledge of a parent's desire to protect assets from mismanagement by a child or undesirable spousal influences by retaining assets in trust for them with third party trust administration can be expected to result in an immediate estrangement with the affected child.

In the event assets are being left in trust for the benefit of a child solely to protect trust assets from the claims of third parties (e.g., estate taxes, spousal and creditor claims), with the child serving as sole trustee, the disclosure of even this aspect of the estate plan can adversely affect family harmony, although typically to a considerably lesser degree. Once again, this can be the subject of considerable consternation by an in-law if informed of such aspect. A child simply may not fully appreciate that the plan was devised solely for the purpose of protecting the child from third party claims or minimizing taxes. The child may suspect ulterior motives or feel they do not have unfettered access to trust funds. The child may even disagree that such protection is necessary and thus desire an outright distribution. Should a child inform their spouse of the intended asset protection benefits in the event of a divorce, the risk of such potential disharmony is likely to be even greater with the child's spouse, with the aforesaid possible additional adverse ramifications.

At its core, there can be a considerable disparity between-and thus incompatibility with-the estate planning goals held by a parent with those of a child. Should the parents' goals surface during the parent's lifetime through a disclosure of the parent's estate plan, disharmony may not only result between a child and parent, and among children, but also between a parent and son-in-law or daughter-in-law. Moreover, any resultant disharmony occasioned by such disclosure will arise during the parents' lifetime, causing undue anxiety to the parent and among children, possibly instilling in a parent a diminished view of a dissenting child, and create an already deleterious environment regarding family harmony that could well extend beyond a parent's death.

When the parent's disclosure of the estate plan results in a disagreement with children as to elements of the plan, the parent is faced with the choice of either changing the plan to satisfy a dissenting child and possibly disenfranchising other children in the process, or retaining the current plan which is congruent with the parent's goals and which the parent has determined is in the children's best interests. If the latter route is chosen, the disagreeing children may forever hold their parent in disfavor for "not respecting" their wishes. If more than one child has inconsistent desires with respect to making changes in the estate plan, e.g., two children each wishing to serve as sole trustee instead of a corporate trustee, the

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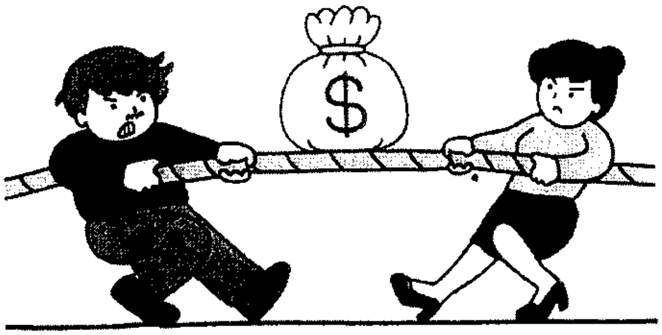



problem is compounded, for even if a parent was otherwise amenable to changing the plan, the wishes of both children are incapable of being satisfied.

A final significant drawback to informing children of the estate plan is that it can put parents in an almost untenable position should they later amend the estate plan in a manner significantly affecting a child's interest, e.g., changing the financial fiduciaries so as to alter the role of children in such capacities, changing the shares of the estate passing to children or grandchildren, changing the terms of trusts that are to hold assets for children, etc. What does the parent do then? Does the parent tell children of the change or simply remain silent? If the former route is taken, disapproval and resultant family disharmony may be the immediate reaction by a disaffected child, both against the parent and siblings. If the latter route is chosen, children only learning of such change following the parent's death may forever hold their parent in disfavor, viewing such change as a parental betrayal greatly intensified by the parent's silence. They may also suspect such change was wrought by an advantaged sibling's influence on a parent.

The bottom line is that in circumstances when the children are in agreement with the plan, no benefit to family harmony was achieved by advising them. If family-harmony-friendly strategies and provisions have been included in the estate plan, the risk of family disharmony in the administration of an estate likely will have been already reduced to the maximum extent possible, with little to no possible benefit in having discourse with children concerning its elements. Should a child inquire of parents as to their estate plan, parents need only state that they have a comprehensive plan designed to minimize taxes and administrative costs and provide for an equitable distribution among the beneficiaries of their estate. Should any additional unwanted invasive inquiries be made, parents should simply state that family harmony is their most important goal and that no beneficial purpose would be served by any further disclosure.

In short, the above frequently voiced well-worn "feel good" adage of consultants and a large segment of estate planners that such disclosure will further family harmony by "avoiding surprises" and "clearing the air" is normally without merit except under family business succession plans. The surprises that such disclosure is intended to avoid are more than elusive, with the parent being put at high risk of being unpleasantly surprised. Moreover, the "clear air" that existed prior to such disclosure can quickly become miasmic as a result of such disclosure. Such rationale simply will not sustain objective scrutiny in realistic, modern day family settings, if it ever did.

In family situations involving children from a prior marriage and a surviving parent who has remarried, children from the prior marriage are often concerned that assets accumulated during the marriage of their parents will be dissipated in favor of a stepparent or the stepparent's children. This concern is frequently so strong that children are unable to accept the parent's spouse as a member of the family, thereby creating a strain in the parent-child relationship. Such situation calls for a slight variance from the foregoing disclosure recommendations. If a parent has entered into a premarital agreement prior to the marriage, or the stepparent has consented to the parent's estate plan, a simple and brief statement to children stating the interests of the deceased parent have been preserved and protected in the parent's estate plan and that the parent desires for children to be accepting of the parent's spouse should suffice to minimize family disharmony resulting from this aspect as much as feasible under the circumstances. Any further explanation of the estate plan would normally be undesirable for the same reasons discussed above regarding its potentially negative impact upon family harmony, only to be emotionally exacerbated by the presence of a new spouse of a parent.

In the circumstance where a child is named as a health care agent, it is normally advisable that such child be informed and given a copy of the health care power of attorney, as well as a copy of the living will. Health care decisions can be time sensitive, and assuming the health care power of attorney is effective immediately, this procedure avoids any undue delay should the child be called upon to make a health care decision for a parent. If a child is named a financial fiduciary under the testamentary instrument or durable power of attorney, such disclosure would only atypically be time sensitive. Consequently, there is normally no compelling temporal need for prior disclosure to a child of any aspects of the plan governing asset management, only a means of timely access to the subject instruments when the time arises for their implementation.

In sum, the considerations listed above warrant a careful assessment by the parent of any benefits to be derived by the disclosure of their estate plan to their children when juxtaposed with its substantial risks to family harmony. If the above family harmony provisions are incorporated in testamentary instruments and appropriate strategies addressed in the estate plan, the vast majority of family harmony risks will already have been properly attenuated to the extent feasible so as to be of minimal risk. If they have not, no disclosure of the estate plan is likely to have any significant beneficial effect on their reduction, while at the same time carrying a significant risk of family disharmony in such effort while a parent is living, which may well endure following the passing of the parent. Further, as discussed above, such disclosure also risks non-objective unsophisticated children placing pressures on a parent to revise the parent's desired estate plan in their favor, which revisions are likely not only to be antithetical to their parents' desires, but also often to the desires of their siblings as well.

In the majority of situations in which an informed parent would be expected to conclude that the clear and present risks of such disclosure outweigh any potential benefit, the far better option is to reduce to writing for post-death disclosure the factors the parent considered when creating the estate plan, best by their inclusion in the above-noted "personal declaration" provision in the testamentary instrument in the manner discussed in the subsequent section. Such post-death disclosure should foster in children an understanding of the parent's goals under the estate plan without parents having to incur the significant risk to family harmony that would attend the disclosure of their estate plan during their lifetime.

Even when a parent determines it to be inadvisable to inform a child of the parent's estate plan during lifetime (other than perhaps a child being named as health care agent), in the absence of any other close advisor it may nonetheless be desirable to list a child as an additional signatory (and being so advised by the parent) on the parent's safe deposit box. This permits the child to gain access to important estate planning documents upon a parent's disability or death (or if such parent's spouse is the first named fiduciary, in such circumstance if the parent's spouse is likewise disabled or deceased).

In the situation when a parent has named a third-party financial fiduciary, that child would typically be the child named as health care agent. The child would be instructed to gain access to the safe deposit box when the parent, or both parents, as the case may be, are unable to manage the parent's finances due to a mental disability or has died and to follow the directions in the sealed envelope with the child's name on it. The written directions in the envelope would indicate the identity of third-party fiduciary administering the parent's estate to whom or which the original estate planning documents in the additional large sealed manila envelope in the safe deposit box are to be delivered. In the alternative situation when a child is named financial agent, the instructions for the child would be to open the envelope in the safe deposit box addressed to the child and secure immediate legal advice as to the child's duties as financial fiduciary in the management of the estate under the provisions of the original estate planning documents in the box.

In either case, the note would also inform the child of the law firm that drafted the documents and that such firm has electronic copies of the executed estate planning documents to preclude any possibility that the child might choose to destroy the existing estate planning documents should the envelope be opened and the child determine its provisions were not as the child desired. In keeping with the foregoing discussion, absent a business succession plan, for family harmony reasons in neither situation would the child need to be advised beforehand of any aspect of the estate plan, including the name of the financial fiduciary.

Prior to concluding discussion of whether children should be advised of the estate plan, another family harmony aspect related thereto is worth mentioning. In addition to the estate planning advantages of revocable trusts discussed above being more adept than wills in several respects in their ability to incorporate certain family harmony strategies, unlike wills, neither the provisions of the trust nor the assets it holds are a matter of record. Particularly with respect to married couples leaving their assets either outright or in trust for their spouse upon their death for asset management protection and tax purposes, doing so under a testamentary trust created under a will, due to its public record aspect, will unavoidably result in children having access to information about the assets in the probate estate of the predeceased spouse and the terms of the planned disposition of the remaining trust assets upon the death of the surviving parent among children. This obviously can compromise family harmony during the lifetime of the surviving spouse as a result of such indirect disclosure.

Conversely, under provisions of the Kansas Uniform Trust Code, all otherwise statutorily required notices of the revocable trust provisions and accountings of its administration to current and remainder beneficiaries are automatically waived if there are no current and remainder beneficiaries of assets left in trust by the predeceased spouse for the benefit of the surviving spouse other than the surviving spouse and descendants of the surviving spouse. K.S.A. § 58a-813(d). Further, even if there are other remainder beneficiaries, such as a charity or stepchild, such notices can be specifically waived in the instrument. K.S.A. §58a-105(b). The same is true with respect to sub-trusts created for children. *Id*. Because revocable trusts and the assets in the trust estate are not a matter of public record, children cannot do an "end around" such waivers as they can with the public record aspect of wills and accompanying inventory of the estate, thus preserving the privacy of the estate plan and its underlying assets from undesired access by trust beneficiaries until the death of a surviving spouse.

## Evolution of the Author's Practice in Addressing Family Harmony Issues

Having previously revised prior long-standing approaches in counseling clients regarding the choice of a financial fiduciary, approximately two decades ago the author's firm turned its attention to pursuing other root causes of most family disharmony in the estate planning process outlined above that experience had demonstrated, and then developed strategies that hopefully remedied them. Structural changes to estate planning instruments were then designed and implemented to emphasize family harmony as an over-arching estate planning goal and to minimize factors deleterious to its maintenance following a parent's disability or death, some of which, as discussed herein, also served to preserve the integrity of dispositive provisions as well. In that process, it was determined that revocable trusts, as opposed to wills, were clearly the preferred testamentary instrument, for in addition to its advantages in many other respects, as opposed to wills it was the more facile instrument in utilizing such strategies (e.g., the incorporation of fiduciary discharger provisions, efficacy in including mediation and arbitrations provisions, not being a matter of public record, etc.).

Toward that end, in the first article of the trust instrument following an initial "family declaration" paragraph listing family members and their birthdates, the second paragraph sets out the primacy of the family harmony goal, followed by preserving the integrity of the intended disposition of the estate, and the reduction of taxes and administrative costs, further noting that the subsequent paragraphs that follow in such initial article are supportive of furthering those three noted goals. Subsequent titled paragraphs then incorporate the above-discussed strategies and provisions that appropriately address them, including the treatment of gifts and loans; in terrorem clauses; the entitlement of children serving as a fiduciary to compensation; the reasons for appointing a non-family member as a subsequent fiduciary of the revocable trust; compensation issues relating to non-fiduciary services provided to a parent by a trust beneficiary; the treatment and effect of property passing to a beneficiary outside the provisions of the trust instrument on such beneficiary's share of the trust estate; the reason for any disparity in children's trust shares; and mediation and arbitration provisions. Other provisions in subsequent articles of the testamentary instrument address the other family harmony strategies addressed herein, including the distribution of tangible personal property, "trustee dischargers" and children serving as trustee having the authority to name a successor corporate trustee and resign.

The comprehensive implementation of the foregoing salutary strategies and inclusion of protective provisions in testamentary instruments, in conjunction with appropriate client counseling, has resulted in reducing family disharmony in the estate planning process and the administration of trusts and estates of the firm's clients in multi-child families by an estimated eighty percent from that which heretofore had occurred in their absence. At the same time, it has reduced the severity of such family disharmony in a significant percentage of the balance of such situations.

## Conclusion

For every complex problem there is an answer that is clear, simple and wrong.

H. L. Mencken

There is nothing like the death of a moneyed member of the family to show people as they really are, virtuous or conniving, generous or grasping.

Jesse Dukinminier and Stanley M. Johanson (1972)

Most estate planners know full well that the myriad of complex estate planning issues presented in the estate planning process is not amenable to a simple solution. Nonetheless, notwithstanding the high priority most clients would place on maintaining family harmony in that process, estate planning attorneys traditionally have oversimplified, overlooked or otherwise minimized this aspect. Instead, the focus has been almost entirely on factors relating to the proper disposition of their property upon their death and the achievement of ancillary goals, such as minimizing taxes, asset protection, governmental resource planning and using trusts in the management of assets for beneficiaries, leaving most of the family harmony enhancing strategies discussed herein either totally lacking in consideration or addressed little more than perfunctorily.

Although such other estate planning facets are certainly important and are at the technical heart of the estate planning process, the all too frequent detritus from such failure has been a high incidence of significant family disharmony following the death or disability of a parent, substantial attorney fees and other administration costs being incurred resolving or addressing otherwise mostly avoidable contentious matters in the administration of the estate, and damages to the integrity of the estate plan resulting from a skewed distribution of their clients' estates from that intended by parents. In short, when such adverse circumstances arise, there will have been a fundamental failure in the preservation of this most valued of intangible family assets, as well as collaterally damaging other important facets and goals of clients in what may have otherwise been in all other respects a well-devised estate plan. Given that the vast majority of such highly adverse consequences is avoidable in the estate planning process and the accompanying inclusion of appropriate provisions in the testamentary instrument, it should be safe to opine that estate planning processes and the estate plans that devolve therefrom which fail to adequately address and protect this important estate planning facet are unquestionably flawed.

Excepting individuals who do not engage an estate planning attorney in their estate planning, there appears to be little doubt but that a clear majority of the family disharmony in the estate planning process is occasioned by errors of omission, not of commission, by estate planning counsel. Estate planning attorneys have been long-standing unwitting protagonists in such disharmony due to our collective failure to implement a more comprehensive holistic approach to the estate planning process by practicing "preventive legal medicine" regarding the preservation of family harmony in the estate planning process in much the same way holistic approaches to health matters have evolved in the medical field.

It is thus long past time for a sea change in the collective focus of our profession on this issue. The author submits there is every reason to conclude that estate planning attorneys who incorporate the family harmony enhancing strategies discussed herein in their practices will achieve positive results consonant with those of the author's firm. As a welcome incident thereto, they should also find their clients to be highly appreciative of their attorney's considered emphasis throughout the estate planning process on this preeminent family value. ■

## About the Author


**Timothy O'Sullivan** is a partner in Foulston Siefkin LLP in Wichita. He graduated from Washburn University School of Law in 1975 and received an LL.M. in Taxation from the University of Missouri-Kansas City School of Law in 1982. Tim is a Past President of the KBA Real Property, Probate and Trust Section, the KBA Tax Section, and the Kansas Chapter of the National Academy of Elder Law Attorneys. He has also served as an adjunct professor in estate planning at the University of Miami School of Law and the University of Missouri-Kansas City School of Law, and at Washburn University School of Law for the past 25 years.

tosullivan@foulston.com

# Should Simple Wills Be an Endangered Species?

# SHOULD SIMPLE WILLS BE AN ENDANGERED SPECIES?

I. Evolution of RT's Being Primary Testamentary Instrument

A. Primarily Probate Avoidance

B. Advantages of Wills over RT's Minimized by Legislation

1. Naming Guardians and Conservator

2. Use of Tangible Personal Property Memoranda

3. Same Competency Test for Execution and construction of provisions as Wills (KUTC)

II. Increasing Use of Joint Simple Spousal Revocable Trusts

A. Either Spouse may Singly Amend or Revoke Trust

B. Advantages

1.Simplicity

2. Immediate Access to Trust Estate by Either Spouse During Lifetime and at Death

3. As with all RT's, privacy as to disposition of trust estate

B. Disadvantages

1. No Asset Protection Benefits During Lifetime or Following Death for Surviving Spouse

2. Adverse Effects on Medicaid Planning

a. All assets a resource to both spouses

b. All assets of any nature held in RT a countable resource

3. No estate tax planning

4. Limits on assets receiving a "step up" in basis at death

C. Target Clients: Married Clients and Single Clients not interested in Asset Protection, Remarriage of Surviving Spouse

Plan Integrity Protection, or Medicaid Estate Tax Planning (due to young age, large amount of assets of have good LTC policy)

a. Young non-affluent married couples
b. Older married couples with no living descendants
c. Single persons leaving assets to charities or not desiring asset protection for assets left to beneficiaries

D. Advantages of Joint RT w/ two "pour over" Wills versus Simple Wills
1. Can Fund at any time
2. Can Name RT as Beneficiary of Life Insurance to make Funds available almost immediately at death to pay bills and provide for young beneficiaries
3. Surviving Spouse Does not need to create a separate RT following death of predeceased spouse to avoid probate
4. Amendments to Dispositive Provisions can be Effectuated with single simple Amendment to Joint RT, even while both spouses are living, rather than two codicils to Wills
5. Practitioners need not update two sets of forms
6. Privacy as to Disposition of Estate, even if RT not fully funded, and greater protection against creditor claims against the estate
7. Can use with Declaration of Trust Ownership to ensure more fully funded RT

III. Hybrid Joint Revocable Trust Concept

A. Equal Ownership in trust estate/ both Grantors must agree to amend or revoke unless disabled
B. Either spouse has a power of appointment to appoint the entire trust estate to the creditors of such spouse's estate and to a sophisticated Family Trust already created under provisions of the Joint Trust for that purpose under the provisions of the Trust; each spouse could execute it conditional on being the predeceased spouse
C. Provides flexibility to achieve asset protection and Medicaid eligibility goals, as well as have prospect of achieving a full "step up" in basis of

the entire trust estate as circumstances and asset factors militate in favor of such change over time

D. Potential IRC 1014(e) issues involved

IV. Consider Unfunded RT for Single Persons w/ "pour over Will"

A. Advantages to Clients over Simple Will

1. Privacy as to Disposition of Estate even if left unfunded
2. Can subsequently employ beneficiary designations to avoid probate or provide immediate liquidity
3. Leaves open option of funding by client later w/o having to create an RT should probate avoidance become preferable

B. Advantage to Practitioners

1. Likewise, as with joint RT, avoids having to have and update two sets of forms
2. Relieves attorney of exposure to potential asserted responsibility for an RT not having been fully funded

# Consideration of Mediation and Arbitration in Wills & Trusts

Supporting Your Success

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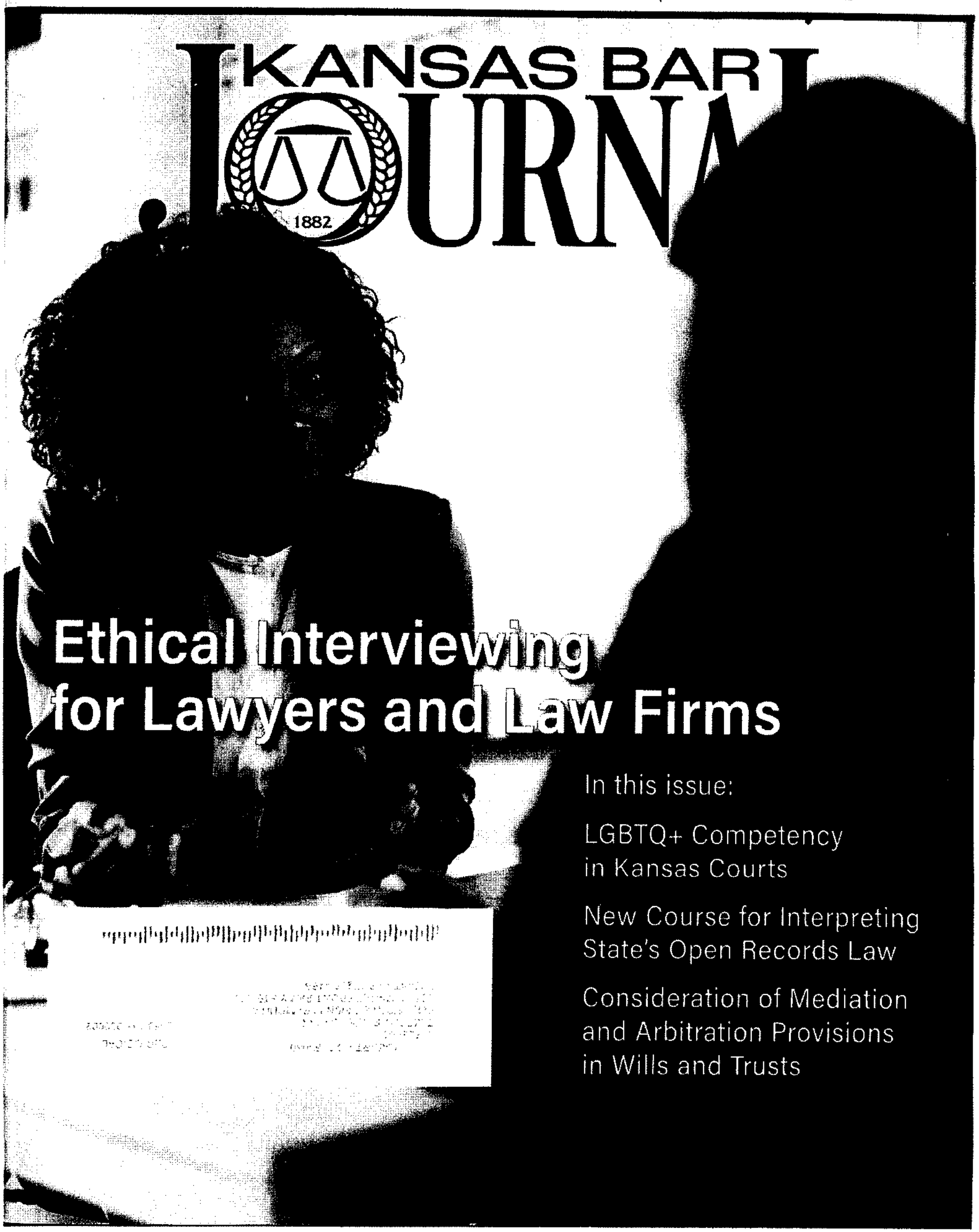
# KANSAS BAR JOURNAL



# Ethical Interviewing for Lawyers and Law Firms

In this issue:

LGBTQ+ Competency in Kansas Courts

New Course for Interpreting State's Open Records Law

Consideration of Mediation and Arbitration Provisions in Wills and Trusts

# Consideration of Mediation and Arbitration Provisions in Wills and Trusts

*By Tim O'Sullivan and Wyatt Hoch*

"An ounce of mediation is worth a pound of arbitration and a ton of litigation." — Joseph Grynbaum

"Conflict is inevitable. But combat is optional." — Max Lucado

## Introduction

George Washington made a will shortly before he died, bequeathing property to various relatives. Sociological historians have taken much interest in the disposition of his slaves, including decreeing freedom for many of them to occur upon the death of the survivor of Martha and him. Legal scholars have found an intriguing arbitration provision in his will mandating that all disputes be decided by "three impartial and intelligent men" known for their "probity and good understanding," whose decision would be binding as if given by the Supreme Court of the United States. There were no established procedures for arbitration in Washington's time, although it was frequently used in commercial disputes. Since then, the search for extrajudicial means of resolving legal disputes has evolved, mostly in a commercial context and as a means of judicial preferences in avoiding trials of pending litigation matters.

As a part of this evolutionary process, over the past several decades in the United States there has been a clear trend to more proactively advocate alternative dispute resolution (ADR), such as mediation and arbitration, to resolve a full range of disputes outside of judicial systems for a variety of reasons, not the least of which has been to reduce the caseload and attendant burgeoning costs and administrative burdens on the country's court systems. The increasing use of ADR includes contracts mandating their usage, courts so mandating under statutory authority, and courts or litigating attorneys requesting that parties mediate pending matters, either prior to, at the commencement thereof, or in the throes of, the litigation of disputes. Estate and trust disputes have certainly not stood apart from this trend. State courts have been called upon with some frequency to address the question of whether mandatory ADR provisions in a will or trust are enforceable against non-signatories of the instrument in the event of a dispute. In the absence of legislation, as more fully addressed below, courts largely have been quite reticent to enforce mandatory arbitration or mediation provisions against non-signatories to the estate planning instrument. Implementing statutes addressing their enforceability are of relatively recent origin.

This article will analyze this trend, its importance to the Kansas estate planning practitioner, and put it in its proper perspective as a tool in the devolution of property under wills and trusts, most particularly its impact on family members of the decedent. Toward that end, the initial section is a compendium of the common law decisions addressing this issue. The next section outlines model acts and state statutes, including those in Kansas, that have addressed the enforceability of will and trust provisions mandating ADR of disputes and their limitations. The third section is an analysis of the relative benefits and potential detriments of ADR procedures to clients in resolving disputes. The fourth section will discuss the results of a recent 2021 survey of members of the KBA Real Estate, Property and Trust section — the second-largest section of the Kansas Bar Association — on aspects of ADR, including their efficacy, cost effectiveness, effect on family harmony, and the frequency of the inclusion of provisions that mandate them in wills and trusts. The final section will discuss considerations in the inclusion of mediation and arbitration provisions in revocable trusts, the current predominant estate planning instrument in the devolution of property at death, and an attachment containing a sample mediation and arbitration provision for consideration of its inclusion in Kansas trust instruments.

## I. Common Law Decisions

There have been two principal legal theories espoused for the enforceability of mandatory mediation and arbitration provisions in wills and trusts even in the absence of their statutory sanctioning: the "benefit theory," which argues that a beneficiary who is accepting a gift should be estopped from objecting to satisfying the condition precedent for its acceptance required by the donor; and the "donor intent theory," which argues that the intent of the donor/settlor/testator in incorporating such a requirement should be carried out absent any affront to public policy, as children normally have no legal right to inherit property from a parent. Another theory, the "contract theory," has been employed in differing contexts either to deny or grant their acceptance. In one context it can be employed to deny such provisions as not meeting requisite contractual requirements. In another context, it can be utilized with the "benefit theory" to find in essence an implied contract that is enforceable. One would thus expect a mixed judicial acceptance, which to date has only marginally been its fate. The Texas Supreme Court in *Rachal v. Reitz* is the singular state appellate court to date that has held ADR provisions in a trust instrument are enforceable. The case involved a suit by a beneficiary of an irrevocable trust against the trustee, alleging misappropriation of trust assets and failure to provide an accounting.[1] In response, the trustee moved to compel arbitration under the mandatory arbitration provision of the trust.[2] The Texas Supreme Court held that the arbitration provision in the irrevocable trust was enforceable against the beneficiary.[3]

The cynosure of the court's decision was whether the arbitration provision was valid under the Texas Arbitration Act, which provides that "agreement[s] to arbitrate" are generally enforceable.[4] The court concluded that language was broader than "contracts to arbitrate," and therefore the arbitration provision need not meet all elements of a valid contract.[5] Rather, it need only have mutual consent to be a valid agreement under the Texas Arbitration Act.[6] The court concluded that the beneficiaries and trustee mutually assented to the arbitration provision, even though the beneficiary did not sign it, because the doctrine of "direct benefits estoppel" states that a non-signatory assents to an agreement, constituting an implied acceptance, if he has received or is seeking benefits under that agreement.[7] Because the beneficiary was seeking benefits under the irrevocable trust, he was deemed to have assented to the arbitration provision contained therein.[8] Accordingly, under the "benefit theory," such implied assent fulfilled the contractual statutory requirement and the arbitration provision was valid and enforceable.[9] The Texas Supreme Court adopted the "direct benefits estoppel" concept from the Federal Arbitration Act even though there is no counterpart under the Texas Arbitration Act, sans any discussion as to whether the federal act preempted state law in that respect. At its essence, the court's rationale paralleled that of implied-at-law contracts, finding an implied assent to arbitrate disputes in the acceptance of benefits under the provisions of the instrument. This avoids vitiating the decedent's intent in reposing such arbitration requirement in the settlor's trust by finding an implied, albeit not expressly overt, condition for a beneficiary's acceptance of benefits under the instrument, thereby honoring the intent of the settlor as a separate basis for its decision.

Other cases have demurred from accepting the reasoning of *Rachal v. Reitz*, finding ADR provisions in trusts and wills to be unenforceable. In *Schoneberger v. Oelze*, the Arizona Court of Appeals held that a trust was not a contract within the meaning of the Arizona Arbitration Act, and therefore was not enforceable under that act.[10] The Arizona Arbitration Act differed from the Texas Arbitration Act in that it required the arbitration provision be in a "written contract" rather than just a "written agreement."[11] In employing the contract theory against the validity of the arbitration provision, the court found that a trust was not a contract due to it lacking the fundamental mutual assent on which an enforceable arbitration provision rests.[12] The court did not consider the trustee's arguments, à la *Rachal*, that the beneficiary was estopped from denying the arbitration provision after accepting the benefits under the trust; rather, it concluded the lack of a written contract was determinative.[13]

Similarly, in *In Re Calomiris*, the District of Columbia Court of Appeals held that an arbitration provision in a will establishing a marital trust was not a written contract to submit to arbitration under the District of Columbia Arbitration Act.[14] The court followed *Schoneberger* in concluding that an arbitration provision in a will did not exhibit the requisite mutual assent to be a valid arbitration agreement.[15]

Several California cases make unclear the state of the law in that jurisdiction. In *Diaz v. Bukey*, the California Court of Appeals held that a trust was not a contract, as required to be enforceable under the California Arbitration Act.[16] In so doing, the court concluded that the beneficiary was not equitably estopped from challenging the arbitration provision even though he had received benefits under the trust.[17] This case, however, was vacated and remanded by the California Supreme Court with instructions to reconsider in light of a different decision.[18] Instead, the case was dismissed pursuant to stipulation by the parties.[19]

The California Court of Appeals did not consider the question again until *McArthur v. McArthur*. The *McArthur* court reached the same conclusion as the *Diaz* court: the arbitration provision contained in the trust was not enforceable.[20] However, it did so in a fundamentally different context. In *McArthur*, the arbitration provision was contained in a trust that the beneficiary alleged was invalid.[21] The court noted that even the *Rachal* court would not have enforced ▶

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an arbitration provision to determine the validity of the instrument.[22] Other courts have echoed this conclusion.[23] This survey of the caselaw underscores the fact that, absent a statutory sanctioning, the status of ADR provisions in wills and trusts is subject to vigorous dispute. Courts may not be able to recognize the enforceability of such provisions because of the language of their state's general arbitration statute, or they may just be disinclined to enforce them because of a lack of mutual assent or public policy issues. Fortunately, for those espousing acceptance of ADR provisions, several states have recently enacted statutes providing a degree of clarity on the issue of enforceability.

## II. State Statutes Sanctioning ADR Provisions in Wills and Trusts

Amid these varied opinions on the enforceability of mandatory ADR provisions in wills and trusts, the American College of Trust and Estate Counsel commissioned a task force to study the issue. On Sept. 16, 2006, the task force issued its report.[24] The report contained the Model Act that state legislatures could use to define the enforceability of mediation and arbitration provisions in wills and trusts.[25] Since the creation of this Model Act, nine states have adopted some version of it, though there is some significant variation among the statutes enacted.[26] There are four key areas where the statutes may differ, including: (1) whether the statute applies to both wills and trusts; (2) whether the statute applies to both arbitration and mediation provisions; (3) what categories of parties are covered by the statute; and (4) how the statute treats disputes regarding the validity of the trust or will. The various statutory approaches to the enforceability of mediation and arbitration provisions in wills and trusts, both with respect to the Model Act or otherwise, are in the discussion that follows.

### A. Florida, Nevada, and Ohio

Florida was the first state to enact the key provisions of the Model Act.[27]

Other jurisdictions have also closely followed the Model Act and the Florida statute but diverge in some areas. Nevada diverges from the Act in that it also covers disputes involving "settlor of a non-testamentary trust."[28] Further, the Nevada act includes a non-exhaustive list of issues an arbitration provision in a will or trust may include, and specifies that the court is authorized to appoint a guardian ad litem to represent the interests of a person with limited capacity during the arbitration proceedings.[29] Finally, Ohio replicates the Model Act in nearly all respects, except that it only applies to arbitration provisions in non-testamentary trusts, i.e., not testamentary trusts or wills.[30]

### B. Kansas and Missouri

In 2014, the Missouri General Assembly passed its own statute regarding the enforceability of ADR provisions in wills and trusts.[31] In 2018, the Kansas Legislature closely modeled its own statute after Missouri's. The Kansas statute, which diverges from the Model Act in several key aspects, follows in its entirety:

> (a)(1) Except as provided in subsection (a)(2), a provision in a trust instrument requiring the mediation or arbitration of disputes between or among beneficiaries, a fiduciary, a person granted nonfiduciary powers under the trust instrument, or any combination thereof, is enforceable.
>
> (2) A provision in a trust instrument requiring the mediation or arbitration of a dispute relating to the validity of a trust is not enforceable, unless all interested persons to the dispute consent to mediation or arbitration of such dispute.
>
> (b) This section shall be part of and supplemental to the Kansas uniform trust code.[32]

Like the Model Act, the Kansas and Missouri statutes expressly state that disputes regarding the validity of the trust are not subject to the mediation or arbitration provision unless all parties consent to such resolution of the dispute.[33] However, unlike the Model Act, the Kansas and Missouri statutes contemplate that both mediation and arbitration provisions in trusts will generally be enforceable. But they both only apply to trusts, not wills.[34] Further, they extend beyond the Model Act in covering disputes involving "a person granted nonfiduciary powers under the trust instrument."[35] Anecdotally based on comments by the proponents of the

Missouri and Kansas statutes, the omission of their application to will provisions appears to have been motivated by a desire to reduce possible opposition by conservative traditionalists and a recognition that such omission was not especially material, given that the dominant estate planning instrument in the devolution of property at death has become revocable trusts, not wills.

**C. Arizona**

In January 2009, the Arizona State Legislature passed a statute dealing with the enforceability of ADR provisions in trusts. This statute superseded *Schoneberger v. Oelze*, discussed *supra*.[36]

It is clear that the statute only applies to ADR provisions in trusts, not wills.[37] The statute is likely best interpreted to apply to both arbitration and mediation provisions in trusts, as the only guiding language in the statute provides that the trust's specified procedures for dispute resolution must be "reasonable," and it is likely that both arbitration and mediation are generally reasonable.[38] Additionally, the statute is not clear regarding which types of parties are covered by any ADR provision; the language specifies only that the trust may provide procedures for disputes between the trustee and "interested persons."[39] Interested persons are not defined in the statute.[40] Given the ambiguities noted above, the practical application of this statute depends on the interpretation of the courts.[41]

**D. New Hampshire**

In 2014, New Hampshire adopted an extensive statute dealing with the enforceability of ADR provisions in trusts, which was amended in 2017.

**E. South Dakota**

In 2015, South Dakota passed its own enforceability statute.[42] The statute covers disputes "between or among the beneficiaries, a fiduciary under the will or trust, or any combination of them."

**F. Colorado**

In January 2019, Colorado became the most recent state to address the issue of enforceability of ADR provisions in trusts.[43] The language of their statute is broad enough to encompass both arbitration and mediation provisions contained in trusts.[44]

## III. The Uniform Trust Code and Two States With Other Statutory Approaches

**A. The Uniform Trust Code**

As of 2022, 36 states[45] and the District of Colombia have enacted some model of the Uniform Trust Code (UTC), with one more state[46] having introduced its enactment into its respective state legislature. The UTC addresses ADR provisions favorably, granting as a specific power to the trustee the ability to "resolve a dispute concerning the interpretation of the trust or its administration by mediation, arbitration, or other procedure for alternative dispute resolution."[47] The comment section explains that the drafters encourage ADR and then suggests that settlors wishing to also encourage ADR "may draft to provide it."[48]

But absent a specific enforceability statute in a state's enactment of the UTC, this encouragement in and of itself does not conclusively establish that providing for mandatory ADR in resolving trust disputes is enforceable. Wisconsin adopted the above-quoted provision into its trust code but did not add a provision asserting enforceability of any included ADR provisions.[49] Thus, while the Wisconsin code encourages the use of ADR provisions, it does not assure that such provisions written into wills or trusts will be enforceable.

**B. Utah Uniform Probate Code**

Most of the states discussed above that used a variation of the Model Act are also states that have enacted the UTC.[50] Utah enacted the Uniform Trust Code and created a statute providing that wills and trusts may include provisions requiring resolution of disputes "outside of a court of record," and that such provisions are enforceable.[51] But where most states with both the UTC and a mandatory ADR enforceability provision included that provision in the UTC, Utah instead included the enforceability provision in its Uniform Probate Code Title. Enacted in 2013, the statute in its entirety reads:

(1) A will, trust, or power of attorney may include a provision, enforceable by a court, that requires the resolution of disputes between or among beneficiaries and fiduciaries of the will, trust, or power of attorney, or any combination of those persons or entities, outside of a court of record.

(2) The resolution of disputes outside the court may include any procedure, writing, or agreement, not contrary to or prohibited by law, found or referred to in a will, trust, or power of attorney, the purpose of which is to resolve disputes between or among the beneficiaries and fiduciaries of a will, trust,

or power of attorney, or any combination of those persons or entities, outside of a court of record.

(3) Unless terms in a dispute resolution procedure, writing, or agreement require binding arbitration, nothing in the writing or agreement shall prevent beneficiaries or fiduciaries, upon satisfaction of the required terms of the dispute resolution procedure, writing, or agreement, from resolution of unresolved disputes in a court of record.[52]

This statute applies to wills and trusts, appears to cover both arbitration and mediation, does not address whether disputes over instrument validity is subject to ADR, and covers beneficiaries and fiduciaries.

C. **Washington Trust and Estate Dispute Resolution Act**

Washington bears mentioning because it took a different approach when it enacted a statutory scheme in 1999 that comprehensively covers trust and estate dispute resolution.[53] It provides for any "part[y] to disputes involving trusts, estates, and non-probate assets to have access to a process for required mediation followed by arbitration," as needed.[54] In effect, it means any party to the dispute may compel mediation, then arbitration if mediation is unsuccessful. Therefore, the instrument itself need not contain a provision mandating arbitration for the parties to still have the power to force the issue. However, judicial resolution is not available unless the parties have complied with the mediation and arbitration provisions.[55]

Of the four key provisions regarding enforceability of ADR provisions, Washington's statutes cover wills and trusts, mediation, and arbitration, and apply to all the parties to the dispute. The statute defines parties expansively, including trustees, personal representatives, heirs, beneficiaries, surviving spouses or domestic partners, and guardians ad litem, among others.[56] The statute does not specifically address disputes over validity of the instrument. Note that while the statute touches on the four key areas, it still differs from other states' implementations of the Model Act because this statute does not address enforceability of ADR provisions contained *within the instrument*; Washington has simply declared by statute that ADR is available in disputes of trusts or wills.

A compendium of the substantive provisions in state statutes which have addressed the enforcement of such provisions in wills and trusts is found in Attachment A.

## Summary

Generally, to date, except in Texas, courts generally have not enforced mandatory ADR provisions in wills and trusts sans a state statute sanctioning their enforcement. To that end, as discussed above, some states — such as Kansas — have passed statutes expressly directing that such provisions are enforceable. Nonetheless, to date states that have enacted such statutes still do not provide for enforcement of mandatory ADR provisions involving disputes over the validity of a will or trust. The rationale for such omission is that ADR provisions should not be mandatory prior to determining the validity of the governing instrument that mandates their application.

The authors submit there are overarching legal principles that should sanction the enforcement of mandatory mediation and arbitration provisions in wills and trusts, even in the absence of a state law sanctioning their enforcement, which principles to date appear to have either not been shown sufficient deference by the courts or totally ignored. First, there is an inviolate principle that a testator or grantor of a trust is freely able to provide for the disposition of their property to beneficiaries of their choosing notwithstanding having a condition precedent, provided it is not violative of public policy, i.e., a conditional gift with respect to individuals or entities having no legal right to an inheritance. For example, the receipt of estate or trust property may be conditioned in the governing instrument upon a beneficiary having either achieved a high school diploma or college degree during the trust term as a condition for receiving a beneficial interest in the trust or being employed under an employment agreement. The intent of a grantor or testator in fostering family harmony through ADR not only does not violate public policy but also enhances an overarching public policy goal of using ADR to reduce the ever-increasing burden on our judicial system through resolution of disputes outside the system. Thus, the receipt of estate or trust property being conditioned upon seeking a resolution of disputes involving trust or estate issues through ADR should be deemed enforceable on its own. The issue is not a matter of parties being subject to arbitration statutes having to satisfy a legal prerequisite of reaching mutual agreement to arbitrate, but the ability and unfettered right of a testator to precondition a disposition (not inapposite with public policy) upon a beneficiary's satisfaction of the precondition to agree to arbitrate disputes.[57] Such provisions could also be favorably viewed as an implied unilateral arbitration contract.[58] Both principles would be applicable in the absence of any agreement by the party with respect to whom the condition precedent is to be enforced.

Buttressing such rationales would be the inclusion in the testator's will or grantor's trust of a penalty, say a 50% reduction in the amount of a beneficiary's interest in the estate or trust in the event of a subsequent failure of the beneficiary to so comply. As discussed later, the inclusion of such a penalty provision in trusts and wills may not only be desirable in states sanctioning such provisions in trusts and wills, but also with respect to wills in states that do not sanction such provisions in wills, thereby relying on common law enforcement. Moreover, other than requiring an affirmative act rather than refraining from an act, the principles undergirding such principle would appear to be indistinguishable from those supporting the validity of *in terrorem* clauses in wills and trusts requiring beneficiaries to eschew litigating their shares of the estate or trust, as well as perhaps administrative issues as well, or incur a forfeiture of benefits they would otherwise have received. In sum, it is not an issue of whether a person prepossessed of an independent legal right to property under the law can be compelled to enter an agreement to mediate or arbitrate a dispute in the absence of such person's agreement to do so, which appears to have been at the cynosure of the court decisions to date refusing to enforce an ADR requirement. At its base level, the issue is the right of a grantor or testator to require an ADR resolution of any dispute regarding a beneficiary, heretofore possessed of no independent property right in an estate or trust absent a grantor's or testator's beneficence; and whether such grantor or testator can impose an economic detriment for the failure to comport with such a provision.

No matter the sanctioning of mediation and arbitration provisions under statutory authority or common law, however, there can be significant issues on the breadth to which arbitration and mediation provisions in wills and trusts enable estate and trust controversies to be settled or determined in that manner. For example, depending perhaps at least in part on the drafting of such provisions, they may not address or be applicable regarding: the rights of parties who are not beneficiaries, such as spousal inheritance rights; the rights of minors, incapacitated beneficiaries, or the rights of the unborn who are not represented; and gift and estate tax implications dependent upon a resolution being "arms-length" between adverse parties or whether expenses related thereto are deductible for estate tax and income tax purposes. Nonetheless, since no party receiving benefits under a will or trust, save perhaps a surviving spouse of a testator or grantor, has an independent inheritance right which cannot be validly subject to binding mediation/arbitration provisions absent such party's consent, a will or trust must be drafted so as to also bind beneficiaries of the estate or trust whose interests were indirectly affected by the decision. However, absent perhaps the careful drafting of such provisions in the instrument, this may not be the case in resolution by mediation unless the interests of other beneficiaries were represented through virtual representation under common law or the Uniform Trust Code.

## ATTACHMENT A

STATE STATUTE CHART – Statutory Provisions Regarding Enforceability of ADR Provisions in Trusts/Wills

| | Florida | Nevada | Ohio | Kansas | Missouri | Arizona | New Hampshire | South Dakota | Colorado |
|---|---|---|---|---|---|---|---|---|---|
| Covers provisions in wills or trusts | Both | Both | Only trusts | Only trusts | Only trusts | Only trusts | Only trusts | Both | Only trusts |
| Covers mediation or arbitration provisions | Arbitration provisions | Arbitration provisions | Arbitration provisions | Explicitly covers both types of provisions | Explicitly covers both types of provisions | Not explicit, but leaves room for both | Not explicit, but leaves room for both | Arbitration provisions | Not explicit, but leaves room for both |
| Treatment of disputes re: validity of trust/will | Expressly not subject to ADR provisions | Expressly not subject to ADR provisions | Expressly not subject to ADR provisions | Expressly not subject to ADR provisions | Expressly not subject to ADR provisions | Implicitly excluded; only covers disputes re: admin and distr. | Expressly not subject to ADR provision | Expressly not subject to ADR provisions | Expressly not subject to ADR provisions |
| Covers disputes between which parties | Beneficiaries, a fiduciary, or any combination | Beneficiaries, fiduciary, settlor of a non-testamentary trust, or any combination | Beneficiaries, fiduciaries, and any combination | Beneficiary, fiduciary, any person granted non-fiduciary powers, or any combination | Beneficiary, fiduciary, any person granted nonfiduciary powers, or any combination | Trustee and interested persons | "Interested persons" | Beneficiaries, a fiduciary, or any combination | Beneficiaries and assigns |

## IV. Weighing Mandatory ADR Versus a Judicial Resolution

Whether to include mandatory mediation and arbitration provisions in wills and revocable trusts requires a careful consideration of their advantages and disadvantages, which include:

**A. Confidentiality**

The overarching advantage of both mediation and arbitration is that they are private, confidential, not a matter of public record, and therefore, in the same manner as revocable trusts, preserve privacy. Consequently, this is particularly beneficial for issues involving revocable trusts (the terms of which are otherwise not a matter of public record) or family matters and family businesses where public disclosure could have a detrimental financial effect on the good will of the business.

**B. Preserving Family Harmony**

There is little question about the importance a very high percentage of parents place on the retention of family harmony in the administration of their estate plans. And there is no question that contentious litigation among family members about aspects of a parent's estate plan can be a divisive and expensive experience for those family members. In fact, very frequently the resultant disharmony will endure throughout the remaining lives of family combatants. Mediation and arbitration are much better venues and procedures to ameliorate those adverse consequences. In many family situations, the preservation of family harmony will prove to be the overarching consideration.

**C. Finality and Alacrity**

One of the most touted advantages of arbitration is the finality of its decision or "award." This usually effectuates a substantial reduction in the costs of litigation, delays occasioned by the judicial process, and a settlement "premium" often exacted by the non-prevailing party in lower court against the prevailing party in exchange for avoiding the cost of an appeal.

On the other hand, this very facet is often cited by its detractors as a significant detriment to arbitration. Grounds for appeal of an arbitrator's decision are quite limited. Under the Kansas Arbitration Act, the district court must enforce an arbitrator's award absent one of a very short list of reasons for modification, correction, or vacatur, the most prominent of which are: (1) an award procured by corruption or fraud; (2) an arbitrator's evident display of partiality or misconduct; and

## ATTACHMENT B

RESPONSES BY REPT SECTION PRACTITIONERS TO 2020 MEDIATION/ARBITRATION SURVEY

(112 responses, or 1/3 of section)

| Question | Yes | No | N/A |
|---|---|---|---|
| Do you have mediation and arbitration options for your wills and revocable trust documents as a means of resolving family disputes involving family members? | 41 | 67 | 4 |
| If the foregoing answer is yes, do you include such options with any degree of frequency in your will or trust amendments? | 23 | 43 | 46 |
| In your experience, have you participated in mandatory or voluntary mediation of trust or estate disputes involving your clients? | 52 | 58 | 2 |
| If the foregoing answer was yes, did mediation resolve most of them? | 38 | 36 | 38 |
| Do you believe that in a high percentage of estate and trust disputes, mediation is an advisable option? | 88 | 20 | 4 |
| Do you have a favorable view of resolving estate and trust disputes through arbitration rather than litigation? | 67 | 38 | 7 |
| Do you agree that resolving trust and estate disputes involving family members through mediation tends to reduce the degree, if not the instance, of family disharmony? | 68 | 37 | 7 |
| If the foregoing answer was yes, do you feel the same with respect to arbitration of such disputes? | 25 | 38 | 49 |
| Do you believe arbitration of trust and estate disputes can be a cost-efficient method for their resolution as opposed to litigation? | 72 | 35 | 5 |

(3) a mathematical error or evident mistake in the description of property. In short, there may be little to no recourse for a bad decision by an arbitrator.

As such, the selection of the arbitrator — whether by agreement of the parties, through a third-party administrator (like the American Arbitration Association), or by a special trustee or trust protector — is likely the single-most important decision in an arbitration because it provides the best opportunity to mitigate the risk of an errant decision. The arbitrator(s) should be selected based on professional experience, reputation, involvement in relevant professional organizations, ratings by peers and respected ratings by organizations, and education in the trust and estate area.

**D. Cost Savings**

A substantial cost savings can be realized when legal issues are resolved through mediation, particularly when mediation is undertaken shortly after, if not prior to, the initiation of litigation. Arbitration also can lead to considerable cost savings as well due in large part to being a more expedited procedure with its truncated discovery aspects and considering in all events upon the number of arbitrators (the fewer, generally, the greater the cost savings), thus placing a premium on the quality of the arbitrator or arbitrators in the selection process.

## V. KBA REPT Survey

The KBA in 2021 undertook a survey of the members of its Real Estate, Probate, and Trust Section to achieve an understanding of the current views of estate planning and probate practitioners about ADR in a trust and estate environment, their efficacy in general, and the desirability of including mediation and arbitration mandates in wills and trusts. A clear majority of responders concluded that both mediation and arbitration of estate and trust disputes are desirable options; that both are more cost efficient than litigation; and that in resolving such disputes, mediation, if not necessarily arbitration, is more protective than litigation in preserving family harmony (as less than a majority of those that supported mediation as being more protective of family harmony had a similar conclusion about arbitration).

## VI. Considerations in Drafting Mediation and Arbitration Provisions

Because of the brevity of the Kansas statute confirming the enforceability of ADR provisions in trust instruments, it becomes incumbent upon practitioners to delineate with a significant level of specificity several aspects of the mediation and arbitration processes.

**A. Venue**

The venue for mediation and arbitration, absent an agreement of the parties to the contrary, is usually stated to be either the city or county of the grantor's or testator's domicile or the city or state where the post-death administration of the estate or trust is to take place.

**B. Rules of Mediation and Arbitration**

Rather than attempt to define the procedures for mediation and arbitration in manuscript provisions of the trust or will, we recommend deferring to rules established by the American Mediation Association and American Arbitration Association, akin to estate planners deferring to the Uniform Principal and Income Act in determining the income and principal of trusts. These rules may be applied whether or not a third party, like the AAA, administers the arbitration.

**C. Number of Arbitrators**

In the absence of the agreement of the participants, it is typically preferable to select a single arbitrator to reduce costs and enhance efficiency. Requiring more than one arbitrator would require at least three to avoid an impasse, thus tripling the number of paid arbitrators.

**D. Method for Selection of Mediator or Arbitrator**

We encourage counsel for the parties to select a mediator gifted in "reality testing" to get the parties to realize vulnerabilities in their positions with the goal of achieving a reasonable resolution.

A single arbitrator or panel may be selected through one of at least three processes: agreement of the parties; appointment by a special trustee or trust protector who is instructed to appoint an attorney (or attorneys, depending on the number) with estate planning knowledge, experience, reputation, and membership in professional and respected peer rating organizations; or by the process of the third-party administrator's rules.

**E. Parties Subject to ADR**

If ADR is intended principally to foster family harmony, its application could be limited only to matters in which family members are a party, either individually or as a fiduciary of a trust in which family members of the decedent are a beneficiary on both sides of the issue or issues. In other circumstances, a compelling argument can be made for making ADR strictly optional. For example, ADR could be applicable to a fiduciary-fee issue ▶

for a child serving as a fiduciary of a parent's estate but may not apply to a professional fiduciary (such as a bank or trust company) on one side of the issue and a beneficiary on the other. Independent of family harmony issues, doing so could weaken a beneficiary's leverage in settling a matter where a professional fiduciary's desire is normally to avoid tainting commercial goodwill by being involved in a public, judicial resolution of a controversy, particularly if there is a substantial risk of a result adverse to the fiduciary.

**F. Consequences for Failure to Comply**

Both the federal and state arbitration statutes include a court process to "compel" a recalcitrant party to arbitrate an estate dispute. That mechanism can be invoked either in defense to a preemptive lawsuit or as a stand-alone, declaratory-judgment type motion.

Scriveners should also consider including financial consequences for a knowing violation of an ADR mandate. For example, the trust could authorize a trust protector or special trustee to amend the trust to reduce an offending beneficiary's economic interest in the trust by a certain percentage, say 25%. For outright distributions following death, imposition of the consequence is fairly simple. But it's more difficult for interests left in trust for an offending beneficiary, other than simply providing for trustees to distribute only 75% of any mandatory distribution or discretionary distribution. Nonetheless, the very prospect of such a reduction should be sufficient in and of itself to dissuade a recalcitrant beneficiary from ignoring mandated ADR.

**G. Parties Bound/Virtual Representation**

Finally, an ADR mandate should address the inclusion (or not) of the unborn or issue of beneficiaries whose interests could be adversely affected by either mediation or arbitration of an issue. The ADR provision could either: (1) incorporate the virtual-representation provisions of the Kansas Uniform Trust Code that enable the special trustee or trust protector to name an attorney to represent all other potential current or future beneficiaries who are not so covered; or (2) simply provide that an ADR resolution is binding on all other current or future beneficiaries.

A sample provision addressing these concepts and issues, focused on matters and controversies involving family members, is included as Attachment C on page 35.

## Conclusion

Mandatory mediation and arbitration provisions in trusts are now statutorily binding in trusts under the Kansas Uniform Trust Code. Based upon the KBA REPT survey, ADR provisions are favorably viewed by most Kansas estate planning practitioners. By all indications, mediation resolves a substantial majority of estate and trust disputes when it is employed and is much less corrosive to family harmony and more cost-effective following the death of a family member (such as a parent) than seeking a judicial resolution. Arbitration of those disputes is also favorably viewed, probably for one or more of the rationales discussed above. Thus, utilizing well-crafted provisions in wills and trusts mandating mediation and, that failing, then arbitration should reduce the damage to family harmony, be more economical than litigation, and keep the dispute out of the public record. Since ADR for will disputes has not yet been statutorily sanctioned in Kansas, if challenged, practitioners would have to persuade a Kansas court to enforce the testator's intent in a case of first impression. ◆

*NOTE: The authors would like to thank Jake Schmidt and Lauren Watson (summer associates at Foulston Siefkin in 2020 and 2021, respectively) and Foulston Siefkin associate Sarah Buchanan for their substantial contributions to this article.*

*Tim O'Sullivan represents clients primarily in connection with their estate and tax planning and the administration of trusts and estates. He graduated from St. Louis University and the Washburn School of Law, and he received an LL.M. in taxation from the University of Missouri-Kansas City School of Law. He has served as an adjunct professor in estate planning at the Washburn School of Law for 30 years and has been actively involved through the Kansas Bar Association in studying, drafting, and lobbying for legislative proposals affecting estate planning, many of which have been enacted into law.*

*Wyatt Hoch is a partner in Foulston Siefkin LLP and has practiced in the firm's Wichita office for 40 years. He is a Fellow of the American College of Construction Lawyers, the leader of the firm's construction-law practice, and has served on the American Arbitration Association's national panel of arbitrators for construction industry cases for nearly 25 years.*

## ATTACHMENT C
SAMPLE TRUST MEDIATION/ARBITRATION PROVISION

**Resolving Controversies Through Mediation and Arbitration.** [DO NOT USE IF THERE IS NO SPECIAL TRUSTEE (or Trust PROTECTOR) OR MODIFY IF SOMEONE OTHER THAN THE SPECIAL TRUSTEE IS ACTING IN THE SAME CAPCITY WHERE SUCH TERM IS REFERENCED HEREUNDER] As maintaining family harmony is a material purpose of all trusts created hereunder, supplemented by my desire to minimize trust administrative costs, preserve privacy concerning any trust administration or trust interpretation issues, and promote a prompt and final resolution of disputes involving beneficiaries of the trust estate, I direct and require, as a general rule, subject only to specific limited exceptions provided below in this Paragraph, any disagreement with respect to the interpretation of the provisions of this Trust Agreement, the administration of any trust created under this Trust Agreement, or the disposition of any assets of any trust estate created hereunder, shall be resolved not through judicial means, but to the extent not resolved through mediation, exclusively resolved by arbitration under the Arbitration Rules for Wills and Trusts of the American Arbitration Association. Such Arbitration Rules for Wills and Trusts of the American Arbitration Association may be applicable either under the auspices of the American Arbitration Association or separately from the American Arbitration Association, but expressly pursuant to its Arbitration Rules for Wills and Trusts then in effect. My intent in this regard shall be expressly effectuated under, and made subject to, the following provisions of this Paragraph.

(1) **Exceptions.** The following situations and matters shall not be subject to the mandatory arbitration and mediation provisions of this Paragraph:
   (a) Any matter prohibited by law from being subject to the provisions of this Paragraph;
   (b) Issues surrounding my competency;
   (c) Matters involving the removal of, or the imposition of personal liability on, a Trustee who is not my spouse or a descendant of my parents or my spouse's parents;
   (d) Any matter in which my spouse and a descendant of mine, or descendants of mine, are not adverse parties; or
   (e) Any matter in which the provisions of this Paragraph are waived by all parties in interest.

(2) **Role of Special Trustee.** In addition to other authority reposed in the Special Trustee in this Trust Agreement, including construing the provisions of this Paragraph, reposed in the Special Trustee is the following additional authority:
   (a) **Authority to Reduce Beneficiary's Trust Share.** In the event any beneficiary of the trust estate contravenes my foregoing expressed intent by not agreeing that unresolved issue(s) involved in the interpretation of the provisions of this Trust Agreement, the administration of its provisions, or the disposition of any assets of the trust estate of any trust estate created hereunder should be submitted to an arbitrator under the provisions of this Paragraph, I request, empower and direct the Special Trustee, to amend the provisions of this Trust Agreement to the extent necessary to reduce such beneficiary's beneficial interest in the trust estate by an amount the Special Trustee determines to approximate fifty percent (50%), *[specifically excepting the MARITAL TRUST]; provided however, I would not expect such Special Trustee to reduce such beneficiary's beneficial interest in the trust estate if the Special Trustee determines there are equitable compelling circumstances for not exercising such authority, e.g., the beneficiary initiated a legal action in contravention of the provisions of this Paragraph in the absence of actual knowledge of such provisions and subsequently dismissed such legal action upon becoming aware of the provisions of this Paragraph;
   (b) **Removing Trustee.** If the only party or parties who are not in agreement to the submission of the foregoing issues to binding arbitration as required under this Paragraph is, or are, a Trustee or Trustees, to remove such Trustee or Trustees and appoint a successor Trustee or Co-Trustees who will agree to submit the issues involved to arbitration under the provisions of this subparagraph;
   (c) **Appointing Arbitrator.** The appointment of an arbitrator other than the Special Trustee shall be an experienced practicing attorney having at least ten (10) years of extensive experience with trust and estate legal issues and who is a member of the American College of Trust and Estate Counsel (ACTEC), recognized in Best Lawyers in America in the areas of estate planning or trusts and estates, or otherwise determined to be held in high esteem by trust and estate and estate planning practitioners in the state of Kansas;
   (d) **Role of American Arbitration Association.** To determine whether the subject issue(s) shall be resolved under the direct auspices of the American Arbitration Association or separately under the Arbitration Rules for Wills and Trusts of the American Arbitration Association; and
   (e) **Interpretation of American Arbitration Association Rules.** If the subject issue(s) is or are not to be resolved under the direct auspices of the American Arbitration Association, the authority to resolve any issue with respect ▶

to the interpretation or implementation of the governing rules of the Arbitration Rules for Wills and Trusts of the American Arbitration Association.

(3) **Mediation as a Condition Precedent.** Unless the appointed arbitrator determines mediation of the issues confronting the parties to be highly unlikely to be resolved by mediation, or the parties already have done so unsuccessfully in resolving the issues involved, the parties must first submit the subject unresolved issues to mediation. Unless all parties agree to a different mediator, such mediator shall be appointed by the Special Trustee, which mediator so appointed shall be a mediator other than the Special Trustee. Such mediation shall be conducted and administered in accordance with the Commercial Mediation Rules of the American Arbitration Association. If any party does not agree to submit such issues to a mediation proceeding, unless all other parties similarly demur, the arbitrator shall rule against the position of any recalcitrant party. If all such parties demur from participating in such mediation or such mediation proceeding does not resolve the issues involved, the matter shall then proceed to a formal arbitration proceeding.

(4) **Substantive Law.** In resolving the substantive issues involved, the arbitrator shall apply the substantive law (and the law of remedies, if applicable) of the laws of the state the provisions of this Trust Agreement dictate are to be applied.

(5) **Venue.** The venue of any mediation or arbitration shall be ____________ County, Kansas, unless the parties agree otherwise or the Special Trustee determines a different venue is in the best interest of the parties and the trust estate.

(6) **Arbitrator Decision Binding.** Absent a showing of fraud, the decision of the arbitrator under this Paragraph shall be final and binding on the Trustee and all current and future beneficiaries having an interest all trusts created under this Trust Agreement impacted by such decision and not subject to appeal to any court with respect to all such parties who may have an interest in the trust estate, including unborn or incapacitated persons, such as minors or Disabled persons. Judgment upon the arbitrator's award may be entered in any court having jurisdiction thereof.

References


1. *Rachal v. Reitz,* 403 S.W.3d 840, 842 (Tex. 2013).
2. *Id.*
3. *Id.*
4. *Id.* at 844–45.
5. *Id.* at 845.
6. *Id.*
7. *Id.* at 846.
8. *Id.*
9. *Id.*
10. *Schoneberger v. Oelze, 96 P.3d 1078, 1079 (Ariz. Ct. App. 2004), superseded by statute,* ARIZ. REV. STAT. ANN. § 14-10205 (West, Westlaw through May 9, 2022 of the Second Reg. Sess.).
11. *Compare id. with Rachal, 403 S.W.3d at 843.*
12. *Schoneberger,* 96 P.3d at 1083.
13. *Id.* at 1082.
14. *In re Calomiris,* 894 A.2d 408, 409 (D.C. 2006).
15. *Id.* at 409–10.
16. *Diaz v. Bukey,* 125 Cal. Rptr. 3d 610, 612 (Cal. Ct. App. 2011), *vacated,* 287 P.3d 67 (Cal. 2012).
17. *Id.* at 613.
18. *Diaz v. Bukey,* 287 P.3d 67 (Cal. 2012). The California Supreme Court instructed the Court of Appeals to reconsider Diaz in light of its decision in *Pinnacle Museum Tower Association. v. Pinnacle Market Development (US) LLC.* 282 P.3d 1217, 1227 (2012). In *Pinnacle,* the court held that an arbitration provision contained in recorded declaration covenants, conditions, and restrictions associated with real estate was enforceable against non-signatories. *Id.* at 1228. The court emphasized that the declaration was created as part of a detailed statutory scheme under which "each owner of a condominium unit either has expressly consented or is deemed by law to have agreed to the terms in a recorded declaration." *Id.* Absent a similar statutory scheme, it seems unlikely lower California courts would apply Pinnacle to arbitration provisions in trusts to find them enforceable. *See McArthur v. McArthur,* 168 Cal. Rptr. 3d 785, 792–93 (Cal. Ct. App. 2014).
19. *McArthur,* 168 Cal. Rptr. 3d at 789 n.5.
20. *Id.* at 787.
21. *Id.*
22. *Id.* at 790.
23. *See In re Fellman,* 604 A.2d 263, 265 (Pa. 1992); *Gibbons v. Anderson,* 575 S.W.3d 144, 150 (Ark. Ct. App. 2019); *Boyle v. Anderson,* 871 S.E. 2d 226, 230 (Va. 2022). (upholding the decision of the trial court, summarily concluding that because access to the courts is a constitutional right under the Virginia constitution, and such constitutional right by beneficiaries of a revocable trust could only be waived under the Virginia Uniform Arbitration Act by a written agreement, that an arbitration provision in a revocable trust was not binding upon beneficiaries of the trust because the revocable trust was not a written contract).
24. *ACTEC Arbitration Task Force Report,* MINNESOTA STATE BAR ASSOCIATION (Sept. 18, 2006), https://www.mnbar.org/docs/default-source/sections/actec-arbitration-task-force-report.pdf?sfvrsn=2 [hereinafter *Model Act*].
25. *Id.*
26. FLA. STAT. ANN. § 731.401 (West, Westlaw through 2022 Second Reg. Sess.); Nev. Rev. Stat. Ann. § 164.930 (West, Westlaw through 2021 end of 33rd Special Sess.); K.S.A. 58a-205 (West, Westlaw through 2022 Reg. Sess.); Mo. ANN. STAT. § 456.2-205 (West, Westlaw through 2021 First Reg. Sess. and First Extraordinary Sess.); ARIZ. REV. STAT. ANN. § 14-10205; S.D. CODIFIED LAWS § 55-1-54 (West, Westlaw through 2022 Reg. Sess.); COLO REV. STAT. § 15-5-113 (West. Westlaw through May 6, 2022 of the 2022 Second Reg. Sess.) OHIO REV. CODE ANN. § 5802.05 (West, Westlaw through File 100 of the 134th Gen. Assemb.).
27. FLA. STAT. ANN. § 731.401.
28. NEV. REV. STAT. ANN. § 164.930 (1).
29. *Id* § 164.930(3), (4).
30. OHIO REV. CODE ANN. § 5802.05(A).

31. Mo. Ann. Stat. § 456.2-205.
32. K.S.A. 58a-205 (West 2018).
33. *Id.* § 58a-205(a)(2); *Id.* § 456.2-205(2).
34. *Id.* § 58a-205(a)(1); Mo. Ann. Stat. § 456.2-205(1).
35. *Id.* § 58a-205(a)(1); *Id.* § 456.2-205(1).
36. 96 P.3d 1078 (Ariz. Ct. App. 2004), *superseded by statute*, Ariz. Rev. Stat. Ann. § 14-10205.
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. S.D. Codified Laws § 55-1-54.
43. Colo Rev. Stat. Ann. § 15-5-113.
44. *Id.*
45. Alabama, Arizona, Arkansas, Colorado, Connecticut, District of Columbia, Florida, Hawaii, Illinois, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming. Unif. Law Comm'n, *Trust Code, https://www.uniformlaws.org/committees/community-home?CommunityKey=193ff839-7955-4846-8f3c-ce74ac23938d (last visited May 10, 2022).*
46. New York. *Id.*
47. Unif. Tr. Code § 816(23) (Unif. L. Comm'n 2010).
48. *Id.* advisory committee's cmt. to § 816.
49. Wis. Stat. Ann. § 701.0816 (West 2016).
50. Nevada and South Dakota used the Model Act but have not enacted the UTC.
51. Utah Code Ann. § 75-1-312 (West, Westlaw through General Legislation effective through May 3, 2022).
52. *Id.*
53. Wash. Rev. Code §§ 11.96A.260–11.96A.320 (West, Westlaw through 2022 Reg. Sess.)
54. *Id.* § 11.96A.260.
55. *Id.* § 11.96A.280.
56. *Id.* § 11.96A.030.
57. *See* Gary Spitko, *The Will as an Implied Unilateral Arbitration Contract*, 68 Fla. L. Rev. 49, 78–80 (2016).
58. *Id.*; S. I. Strong, *International Implications of the Will as an Implied Unilateral Arbitration Contract*, 68 Fla. L. Rev. Forum 1, 1 (2016).

# Discretion and Support Documents

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**Drafting Support and Discretionary Trusts: Navigating the Perils and Possibilities**

## *Introduction*

As estate planning attorneys are well aware, there has been a greatly reduced need for estate and other transfer tax planning in recent years due to unprecedented increases in the federal "applicable exclusion amount" for gift and estate tax purposes, as well as the related generation-skipping tax exemption. This situation has aided in sparking a change in focus on the purposes of long-term third-party trusts (trusts created for a beneficiary other than the settlor), which in decades past had been primarily utilized in an estate tax planning context. As a result, there has been an increased usage of such trusts to provide an economic benefit of greater magnitude and having a wider impact on the vast majority of estate and trust beneficiaries—that of asset protection.

Included under the umbrella of asset protection are: protection from creditor claims (whether contract, tort, or governmental in nature) against a trust beneficiary; protection from a claim of a spouse incident to a marital dissolution or forced inheritance; protection from the trust estate being considered a disqualifying resource for purposes of determining eligibility for governmental benefits such as Medicaid and Supplemental Security Income (SSI); and avoidance of being subject to an estate recovery claim against the assets of a Medicaid recipient by the state for benefits paid to a trust beneficiary. For such asset protection to be afforded throughout a beneficiary's lifetime and to protect against potential estate claims at death, it is axiomatic that the trust must not only have a term that extends through the beneficiary's entire lifetime, but provide for the disposition of the trust estate at death outside of the probate process for the remaining trust estate, either through default provisions or the exercise of limited powers of appointment.

Such expanded use of long-term trusts for asset protection purposes is in addition to their centuries-old employment as: an asset management vehicle to protect spendthrift or disabled beneficiaries from themselves; holding assets in trust for younger beneficiaries for a term ending at an age in adulthood the settlor has predetermined such beneficiaries should have sufficient emotional and financial maturity to prudently manage the trust estate; and the ancillary benefit of utilizing the conduit nature of trusts for income tax purposes to be able to distribute income of the trust during its term to descendants of a primary beneficiary to take advantage of potentially lower income tax brackets.

To fully implement such asset protection goals, trusts normally should not provide for mandatory distributions to beneficiaries, because such distributions would thereby be exposed not only to third-party claims, but also would be considered a disqualifying resource of a beneficiary who might otherwise qualify for available governmental resource benefits. Nor do mandatory distributions satisfy a settlor's or testator's goals of relating distributions to a beneficiary's age level, such beneficiary's then-current maturational or motivational or responsibility level, or psychological or other personal aspects of a beneficiary, such as being bipolar or a drug dependency. It is these potentially deleterious and inflexible aspects of mandatory distribution trusts, either during the trust term or upon its termination during the lifetime of the primary beneficiary, that make them an inadvisable estate planning device in the vast majority of circumstances, absent provisions obviating their applicability in deleterious circumstances that would risk present exposure of the distributions to third party claims, such as creditor, or cause a disqualification of the beneficiary for governmental resource benefits, or exposure of assets to a beneficiary not able to competently manage the property. Avoiding such detriments, while guarding against arbitrary decision-making by the trustee in determining the propriety of making trust distributions, requires giving the trustee a desired level of discretion in making distributions based on a defined need-based support standard, as well as consideration of having the property continuing to be held in a lifetime generation-skipping trust for asset protection purposes, often with the beneficiary serving as sole trustee upon achieving a desired age.

Despite its importance, it is probably safe to conclude that most attorneys devote insufficient time in discussing with their clients, let alone fully considering themselves, a multi-faceted question having a great economical and personal consequence to beneficiaries of trusts, and the goals of their clients who choose them as an appropriate vehicle for the disposition of their property. That question is: "What should be the applicable trust distribution standard and accompanying factors to be considered by the trustee in deciding whether to make a discretionary distribution to a beneficiary, and the amount thereof?" The answer requires consideration of such facets as: (a) the appropriate distribution standard; (b) whether a specific distribution standard should be defined with more particularity; (c) whether a distribution standard should be conservatively construed relating to the age of the beneficiary; (d) what, if any, specific outside resources of a beneficiary should be considered in the trustee's exercise of discretion in making a distribution pursuant to a standard; (e) the trustee's degree of discretion in making a trust distribution; (f) the priority of multiple current beneficiaries as to trust distributions; and (g) the legal ability of current and remainder beneficiaries under the subject distribution provisions to compel or challenge distribution determinations of the trustee so as to ensure the trustee exercises discretion the trustee possesses in a manner properly effectuating the intent of the settlor.

Learned trust commentator and educator Professor Edward C. Halbach, Jr. stated almost sixty years ago that "too frequently the trust instruments provide no guidance as to the purpose and scope of the discretionary power reposed in a trustee. [The trustee] should be informed of the purposes of the trust, the factors he is to consider, and the general frame of mind in which the settlor wishes him to act." Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 Colum. L. Rev. 1425, 1433–34. Professor Halbach went on to conclude that this failure on the part of estate planning attorneys "is one of the most neglected aspects of estate planning." *Id.* at 1434. Notwithstanding his critical perspicacious observation, there has been a paucity of articles, writings, and seminar presentations on this topic since its publication. Correspondingly, it is not surprising that there likewise appears to have been little improvement in the focus in general of estate planning practice of attorneys on this issue in the ensuing decades since Professor Halbach made his insightful observation.

The foregoing multi-faced question is normally of far lesser importance to a settlor in situations where the principal beneficiary is to initially serve as sole trustee. In that case, the settlor typically would have either little concern such authority will be exercised imprudently or has simply chosen not to protect the beneficiary against injudicious decision-making. Consequently, the principal intent and central focus of the settlor is to protect the beneficiary from third-party claims.

Thus, such settlors will normally desire to afford the trustee/beneficiary the greatest amount of flexibility and control with respect to trust distributions and other aspects of trust administration without compromising desired asset protection. Nonetheless, it must be kept in mind that a third party may be called upon to displace the beneficiary from serving as trustee should the beneficiary suffer a disability preventing the beneficiary from serving, or continuing to serve, as trustee. Further, there may be subsequent sub-trusts following the death of the current beneficiary receiving the remaining trust estate of situations in which the primary beneficiary may not be able to serve as trustee, e.g. being under a disability or not having obtained a required age. Consequently, such foregoing question, even if not initially expected to be relevant, may nonetheless later become relevant in a high percentage of trusts and thus be in need of being addressed in the trust provisions.

Estate planning attorneys typically have several "boilerplate" provisions touching upon at least some of the facets attendant to the foregoing complex question; unfortunately, however, many of such "one size fits all" provisions are far too general or routinely employed by practitioners irrespective of the particular circumstances being addressed or the intent of the settlor. Thus, due to the typical modicum of time devoted to the issues involved in such foregoing question, and the frequent dearth of form provisions needed to comprehensively address the issues involved, most estate planning attorneys do not sufficiently consider: (a) how governing legal principles will impact the discretion afforded the trustee; (b) whether such provisions will ensure the effectuation of the client's full intent in creating the trust; (c) whether such provisions should be modified or supplemented with other additional provisions that need be included to effectuate such intent; (d) whether the trust provisions provide the desired degree of asset protection for trust beneficiaries; and (e) whether the trust provisions provide sufficient legal redress to trust beneficiaries to ensure the settlor's intent is not vitiated by arbitrary actions or inactions of the trustee.

The frequent result of this lack of consideration is the employment of distribution standards providing insufficient asset protection of the trust estate, a trustee being overindulgent or overly parsimonious in the amount or purpose of distributions to a beneficiary, and amorphous or obtuse distribution standards engendering contentious and costly disagreements among competing beneficiaries or between beneficiaries and trustees as to the settlor's actual dispositive intent. All of this can leave a trustee with no clear understanding of the settlor's intent and beneficiaries without sufficient legal redress to compel a trustee to make, or not make (in the case of a remainder beneficiary), a distribution to a beneficiary that does or does not comport with the settlor's or testator's intent. Should such disagreements involve a beneficiary and another family member serving as trustee, family harmony becomes a frequent collateral casualty.

With the foregoing context in focus, this article first examines the "playing field" involving the three basic categories of non-mandatory distribution trusts and their associated distribution standards and accompanying trustee discretion: discretionary trusts, support trusts, and hybrid trusts (often referred to as "discretionary support trusts"). With this undergirding, discussion turns to the various permutations within each category, and the impact the discretion attached thereto has on the rights and liabilities of trustees and beneficiaries, as well as third-party claims and "need-based" government benefits. The analysis concludes by examining drafting considerations in delineating distribution standards and the level of discretion to be reposed in a trustee and providing examples illustrative of such considerations.

As a prefatory disclaimer, due to space limitations and being primarily ancillary to such discussion, drafting considerations and suggestions relating to transfer tax planning, including federal estate tax, will not be addressed on more than a cursory basis. Nonetheless, it is important to note that estate planning attorneys desirous of avoiding the inclusion of the trust estate in a third-party beneficiary's taxable estate must avoid reposing a general power of appointment in such beneficiary under Section 2041 of the Internal Revenue Code. This typically means that if the beneficiary is serving as trustee and the exercise of such authority is not predicated upon the approval of a beneficiary who has an adverse interest or the approval of the settlor with respect to an inter vivos trust, distributions to such beneficiary must be pursuant to an "ascertainable standard" enforceable by the courts relating to the beneficiary's health, education, maintenance, and support, and the trustee must not possess the authority to make distributions that would satisfy a duty of support or other legal obligation of the trustee owing to any person. 26 U.S.C. § 2041(b)(1); Reg. § 20.2041-1(c)(1); Bittker & Lokken, *Federal Taxation of Income, Estates, and Gifts* § 128.2.1. As the reader will come to realize in the ensuing discussion, discretionary distributions pursuant to an ascertainable standard when a beneficiary is serving as sole trustee, thus avoiding a beneficiary possessing a general power of appointment, are equally efficacious in achieving asset protection goals.

Additionally, in order to avoid inclusion of the death benefit of a life insurance policy in the insured's estate, a beneficiary also must not have an incident of ownership in a life insurance policy (e.g., while serving as trustee) on the life of such beneficiary which is part of the trust estate, which incidents causing inclusion can be of a lesser interest than a general power of appointment yet result in inclusion of the policy proceeds in the insured's taxable estate. 26 U.S.C. § 2042.

Notwithstanding transfer tax issues not being a cynosure of the discussion hereunder, it nonetheless should be stated, and as will be made clear in the discussion that follows, that such avoidance of inclusion of the trust estate in the estate of a trust beneficiary under the foregoing Code provisions can be effectuated through appropriate drafting without significantly compromising any of the asset protection and other attendant goals addressed in this article, even should a beneficiary also be serving as sole trustee. In any event, with the current "applicable exclusion amount" for estate taxation and generation-skipping tax exemption both being historically quite high, and likely to remain so for at least the foreseeable future, an emphasis on estate tax and other transfer tax planning in long-term trusts is not likely to impact more than a small percentage of the population. Thus, asset protection planning, governmental resource planning and employing the appropriate distribution standard will be of primary consideration.

Further, for ease of reference, references to a settlor of a trust in such discussion shall additionally refer to a testator creating a testamentary trust.

## A. Basic Types of Trust Distribution Standards

Before discussing distribution standards and the appropriate degree of discretion to be reposed in a trustee, there is a need for understanding such standards and how they differ in their import and judicial construction. These disparate standards and typical accompanying discretion reposed in a trustee can be categorized as three basic types of trusts: pure discretionary trusts, pure support trusts, and hybrid trusts.

Such three types of trusts all may have a single current beneficiary or multiple current beneficiaries (termed a "blended trust"). An example of a blended trust would be a single trust providing for distributions to the settlor's child and such child's issue. An additional example would be a trust authorizing distributions among the settlor's children (sometimes termed a "pot trust"), typically until there is no child under a certain age, upon which event the trust would typically divide into separate shares for each child. The term "blended trusts" does not include a single trust which internally creates separate trust shares for each beneficiary, each having a separate definable interest such that distributions to any one beneficiary do not impact the amount of the trust shares of the other beneficiaries. In that type of trust, such separate trust shares in essence create the same beneficial interest in the beneficiaries as would have separate trusts with a singular beneficiary.

It is important to point out that all three types of trusts, as opposed to mandatory distribution trusts, involve at least some level of discretion in making a trust distribution, varying both in the degree of such discretion and the purpose of the trust.

### 1. Pure Discretionary Trusts

Pure discretionary trusts employ terms authorizing a trustee, in non-compulsory broad discretionary wording, such as "is authorized" or "may," to make distributions, perhaps even in the trustee's "sole," "absolute," or "uncontrolled" discretion, for the benefit of the beneficiary not tied to any specific standard having a defined legally enforceable meaning, e.g., "what the trustee determines to be in the beneficiary's best interests." When such verbiage is literally construed, discretionary trusts ostensibly repose virtually untrammeled authority in the trustee regarding the timing of distributions, the purposes for a distribution, and the amount of a distribution to a single beneficiary or multiple beneficiaries.

Kansas' common law has long recognized the broad nature of trustee authority in discretionary trusts. *See Watts v. McKay*, 160 Kan. 377, 162 P.2d 82 (1945). In *Watts*, the Kansas Supreme Court determined a discretionary trust was created such that the beneficiary's ex-wife could not "stand in the shoes" of the beneficiary and be able to compel a trust distribution to satisfy the beneficiary's alimony obligation due to the trustee's discretion in determining and making distributions. *Id.* at 385, 162 P.2d at 88.

At their essence, distributions from pure discretionary trusts are thus based on whether a trustee believes a distribution to a beneficiary is appropriate. *Simpson v. State Dep't of Soc. and Rehab. Servs.*, 21 Kan. App. 2d 680, 684, 906 P.2d 174, 178 (1995). In *Simpson*, the central issue was whether the trust was a pure discretionary trust such that the beneficiary could not compel a distribution, thereby precluding the trust estate from being a resource for public medical assistance. The trust provided:

> "The Trustees shall have the *absolute discretion*, at any time and from time to time, to make unequal payments or distributions to or among any one or more of said group [of beneficiaries] *and to exclude any one or more of them from any such payment or distribution.*" [Italics supplied for emphasis.]

*Id.* at 682–84, 906 P.2d at 177–79.

Regarding this distribution standard, the Court stated:

> "We cannot imagine a better example of a discretionary trust. No one beneficiary of the Trust has the *right* to any distribution. The trustees have *absolute discretion* as to whom they will make distributions and may exclude any one or more of the beneficiaries from any payment or distribution. The discretion placed in the trustees is total and absolute." [Italics supplied for emphasis.]

*Id.*

The beneficiaries of the blended trust in *Simpson* consisted of the subject beneficiary, Margaret, (who was applying for public medical benefits, i.e., Medicaid), Margaret's spouse, Margaret's issue, and the spouse(s) of such issue. There was no distribution standard related to the purpose of the trust (e.g., the maintenance and support of the beneficiary) in the trust instrument. Moreover, the trust provisions expressly provided that the trustee could exclude any one or more of such beneficiaries from receiving any distributions, both such aspects leading the Court to conclude that the trust reposed very expansive authority in the trustee. Indeed, the foregoing language utilized by the Court in defining the subject distribution standard would tend to indicate that the trustee's discretion in making distributions to the trust beneficiaries was unfettered in any respect.

In a pure discretionary trust, traditionally under common law a beneficiary may not compel the trustee to distribute trust funds absent a burdensome showing that the trustee abused the trustee's discretion in failing to make a distribution, typically by acting dishonestly or with an improper motive. *Restatement (Second) of Trusts*, § 187, comment e (1959); *Ridgell v. Ridgell*, 960 S.W.2d 144, 147–48 (Tex. App. 1997); *State St. Bank & Trust Co. v. Reiser*, 389 N.E.2d 768, 770 (Mass. App. Ct. 1979); *Brent v. State of Md. Cent. Collection Unit*, 537 A.2d 227, 233–34 (Md. 1988); *Simonsen v. Bremby*, 679 F. App'x. 57, *60 (2d. Cir. 2017). The court in *State St. Bank* cited *Restatement (Second) of Trusts*, § 187, comment j, which provides that where such adjectives as "absolute" or "unlimited" or "uncontrolled" modify the term "discretion," the trustees may act unreasonably, so long as not dishonestly, from a motive divorced from the purposes of the trust, or from a failure to use the trustee's judgment. *State St. Bank*, 389 N.E.2d at 770.

In Scott & Fratcher, *The Law of Trusts*, § 187 (4th ed. 1989), the authors state generally that "The real question is whether it appears that the trustee is acting in that state of mind in which it was contemplated by the settlor that he would act." Obviously, if it is a pure discretionary trust, there is no indication as to the settlor's state of mind, any guidelines outlining the trustee's desired exercise of such discretion, or any fettering of such discretion. Thus, the discretion accorded to the trustee would not only make the settlor's state of mind irrelevant, but also would appear to make any parol evidence in such regard inadmissible, such dictate being broad, clear in nature and unambiguous. Thus, the authors go on to state, in concurrence with the above iterated position of the *Restatement (Second) of Trusts* position on the issue, that in a pure discretionary trust, the trustee may act unreasonably, so long as the trustee does not act in bad faith, for an improper purpose, or with an improper motive. *Id.* at § 187.2.

Other types of trusts provide for trust distributions to be tied to a standard, usually related to a support need of the beneficiary. Such trusts, when the distribution standard is not accompanied by discretionary language reposed in the trustee, are typically termed "pure support trusts" discussed in the following section.

As discussed in the subsequent section thereafter, where a trust employs discretionary language in connection with a stated distribution standard, such as support, the trust then becomes what is termed a "hybrid trust."

## 2. Pure Support Trusts

A settlor creating support trusts typically does so to provide for the support needs of one or more beneficiaries. It utilizes an "external standard" that has a definable meaning enforceable by a court relating to delineated needs of trust beneficiaries. Typically, the support standard relates to the health, education, maintenance, and support needs of beneficiaries, termed an "ascertainable standard" often referenced in an abbreviated manner as a "HEMS" standard. When broadened beyond such "external standard" to include such purposes as "welfare," "happiness" or "comfort" of a given beneficiary or beneficiaries, both the trust purpose and amounts intended to be distributed can be interpreted as so amorphous as to no longer be subject to being circumscribed by the courts as an "external standard."

Thus, in a pure support trust the settlor directs the trustee to make distributions of trust income and/or principal pursuant to a standard that relates to a support need of trust beneficiaries. *See Restatement (Second) of Trusts*, § 154; *First Nat'l Bank of Md. v. Dep't of Health and Mental Hygiene*, 399 A.2d 891, 893 (Md. 1979); *Duckett v. Enomoto*, 117 A.F.T.R.2d (RIA) 2016-1358 (D. Ariz. 2016). Under a "support standard," the trustee's discretion to make distributions is not unfettered, but instead limited to the timing, manner, and amount of distributions in satisfying the support standard. *Eckes v. Richland Cty. Soc. Servs.*, 621 N.W.2d 851, 856 (N.D. 2001).

In *Godfrey v. Chandley*, the trust provided that the trustee "shall pay . . . such portion of the net income from the trust as may be necessary for [my wife's] support, health, and maintenance." 248 Kan. 975, 978, 811 P.2d 1248, 1251 (1991). The Kansas Supreme Court held that such language required the trustee to make income payments to the surviving spouse if such payments were necessary for her support, health, and maintenance. *Id.* at 982, 811 P.2d at 1253. The trustee had no discretion whether to make such distributions. Instead, the trustee only had discretion in determining whether the contemplated distributions met the standard and whether the distribution was in the appropriate amount. However, this does not mean that such trustee may not consider other factors in determining the amount of such distribution delineated in the trust instrument. For example, the trust may provide that the trustee may or shall consider the other resources available to the beneficiary in satisfying such need prior to making an otherwise required distribution or limit the amount of such distribution for any given purpose. Even in the absence thereof, such consideration may not be considered an abuse of discretion, for the availability of such other resources may obviate the need. Moreover, as above noted, the trustee would also normally be expected to be accorded a reasonable degree of discretion as to the level of such support.

As also noted above, the beneficiary of a support trust can compel the trustee to make distributions under circumstances dictated by the standard of distribution. *Restatement (Second) of Trusts*, § 128, comments d and e; *Tannen v. Tannen*, 3 A.3d 1229, 1239 (N.J. Super. Ct. App. Div. 2010). As more fully discussed below, this also meant that absent a spendthrift clause or a statutory provision to the contrary, a creditor under common law could compel a distribution for the beneficiary's support in circumstances where the debtor/beneficiary could also compel a distribution.

Due to limitations in the trustee's discretion imposed by the terms of the trust instrument in a support trust and the defined need to be satisfied, the trustee's decision-making regarding non-mandatory distributions in a pure support trust is far more circumspect judicially than it is under a pure discretionary trust. The issue before the court in such circumstance is whether the trustee's discretion in either making or failing to make a distribution for the delineated support needs of a beneficiary fell within reasonable limits, as well as was the trustee's decision as to the appropriateness of the amount of such distribution, subject to any accompanying trust provisions, such as definitions in the trust instrument as to support needs, any other related factors delineated in the trust instrument, e.g., such as other resources and the age and maturity level of the beneficiary, and any appropriate factors to be considered irrespective of whether delineated in the instrument, e.g., whether the amount that would remain in the trust after such contemplated distribution would be sufficient to appropriately satisfy any future delineated need of the beneficiary during the remaining trust term.

Courts are understandably averse to substituting their judgment for that of the trustee in such situations. To do so would invite litigating an almost limitless myriad of situations involving the exercise of trustee discretion coming before a court. Instead, a court will not interfere with a trustee's determination unless it is so far outside the bounds of normalcy in consideration of the distribution standard so as to be patently unreasonable or arbitrary. *In re Esther Caplan Trust*, 228 Ariz. 182, 186, 265 P.3d 364, 368 (2011); *In re Estate of McInerny*, 289 Ill. App. 3d 589, 600–01, 682 N.E.2d 284, 291 (1997).

Kansas traditionally has followed the *Second Restatement (Trusts)* approach in reviewing the discretion accorded a trustee in making such determinations. In *Jennings v. Murdock*, the Court stated:

> ". . . where the instrument creating a trust gives the trustee discretion as to its execution, a court may not control its exercise merely upon a difference of opinion as to matters of policy, and is authorized to interfere only where he acts in bad faith or his conduct is so arbitrary and unreasonable as to amount to practically the same thing. *Elward v. Elward*, 117 Kan. 458, 459, 232 Pac. 240 . . . Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion. (*Restatement of Trusts, Second, § 187.*)"

220 Kan. 182, 201, 553 P.2d 846, 862 (1976).

The *Restatement (Second) of Trusts*, § 187, comment d, suggests considering the following factors in determining whether a trustee abused the trustee's discretion in exercising or failing to exercise a distribution:

> "(1) the extent of the discretion conferred upon the trustee by the terms of the trust; (2) the purposes of the trust; (3) the nature of the power; (4) the existence or nonexistence, the definiteness or indefiniteness, of an external standard by which the reasonableness of the trustee's conduct can be judged; (5) the motives of the trustee in exercising or refraining from exercising the power; (6) the existence or nonexistence of an interest in the trustee conflicting with that of the beneficiaries."

As noted above, "external standards" referenced in the foregoing Restatement are distribution standards, such as health, education, maintenance and support, which have a defined meaning under trust common law. Consequently, they are enforceable by the courts. A court may not only compel a distribution under the facts presented should the court determine the failure to do so would constitute an abuse of such discretion given the specific external standard and other factors to be considered as delineated in the trust instrument in the exercise of such discretion, but also determine a trustee has exceeded such authority in making a distribution beyond the confines of such external standard or making an insufficient distribution in satisfaction of such standard. *In re Hafemann's Will*, 265 Wis. 641, 646, 62 N.W.2d 561, 564 (1954).

It is worth noting that the foregoing external standard terms of "health" and "maintenance" fall within a "support" standard. Broader terms, such as "happiness," "comfort" or "welfare," in the absence of additional defining language related a standard of living, are likely to have no defined, limited judicial meaning. Thus, although they do not significantly fetter the purposes for which a trustee may decide to make a distribution to a beneficiary, unless accompanied by discretionary language, they may limit the discretion of the trustee otherwise afforded in their absence in being able to withhold a trust distribution so as not to be subject to being judicially compelled to make a distribution. This would result from the much broader evinced purpose of the settlor or trustee in the intended benefit to be accorded the trust beneficiary. *See Combs v. Carey's Tr.*, 287 S.W.2d 443, 445 (Ky. 1955).

### 3. Hybrid Trusts

Hybrid trusts combine aspects of the two traditional types of non-mandatory distribution trusts, pure discretionary trusts and pure support trusts. They do so by melding distributions pursuant to an "external standard" with additional language indicating the trustee has varying degrees of discretion.

Being both heterodox in nature and typically far from precise in their phraseology regarding the discretion to be accorded the trustee, hybrid trusts pose significant problems in both their construction and efficacy in implementing the settlor's intent as to the responsibility of the trustee in satisfying a distribution standard. At its essence, the central issue presented by hybrid trusts is whether the discretion of the trustee in satisfying a distribution standard is of the same nature as in a pure discretionary trust, a pure support trust, or a hybrid discretionary standard between the two.

The resolution of this question has had particularly acute and diverse consequences historically because the *Restatement (Second) Trusts* does not recognize that the degree of discretion accorded to trustees of hybrid trusts can actually be hybrid in nature (between the broad degree of discretion accorded to the trustee in a pure discretionary trust and the more limited discretion of the trustee in a pure support trust). Thus, absent language in the trust instrument clearly delineating the degree of such discretion to be accorded in a hybrid trust, the position of courts following the *Restatement (Second) Trusts* position is that the trustee's discretion is simply a binary choice, i.e., either in the nature of that accorded in a pure discretionary trust in satisfying the external standard or, alternatively, that limited discretion accorded the trustee in a pure support trust. The charge of the courts under such Restatement is to simply determine which level of discretion more closely approximates the intent of the settlor. Perhaps one motive in the adoption of this binary position was simply a matter of adopting a "rule of convenience" that avoids a court attempting to determine the nuances of intended settlor discretion between that of a support trust and discretionary trust void of trust language with which to refine or underscore such nuances.

Thus, in the circumstance where very broad discretionary authority accompanies the support standard, such as "absolute," "unlimited" or "uncontrolled" discretion, following the *Restatement (Second) of Trusts*, Section 187, comment j, courts have historically tended to conclude that such discretion need not be exercised reasonably in satisfying the distribution standard. Therefore, the discretion accorded the trustee is essentially the same as a pure discretionary trust, albeit distributions being limited to satisfying the delineated support standard, unless there is language in the trust evincing a more limiting discretionary intent. *See In re G.B. Van Dusen Marital Tr.*, 834 N.W.2d 514, 523–24 (Minn. Ct. App. 2013) (stating that "even if the trustees have absolute, unlimited, or uncontrolled discretion, any attempt to violate the settlor's intent or the trust's purpose is considered an abuse of discretion" for which "a court should provide a remedy…") (internal quotation marks omitted). This conclusion was reached by the *Van Dusen* court because the trust included additional limiting language which in essence mandated that distributions be made in specific circumstances, providing that the trustee was to distribute principal "liberally…to enable the [widow]…to maintain…the standard of living to which she was accustomed." *Id.* at 518.

However, in the absence of additional language clearly evincing the settlor's intent to limit the otherwise broad discretionary authority accorded the trustee in a hybrid trust in making distributions to a beneficiary under a support standard, such as that present in *Van Dusen,* most particularly if more unbridled discretionary authority is included in the trust, such as providing that distributions are to be made in "the trustee's discretion," or as the "trustee deems appropriate," such support distribution standard creates a greater ambiguity regarding the settlor's intent, the polestar principle in interpreting the provisions of a trust. *Pikula v. Dep't of Soc. Serv.'s*, 321 Conn. 259, 268 (Conn. 2016) (stating that "in determining whether the assets of a testamentary trust are available to a beneficiary,... court[s] considers whether the testator intended to create a supplemental needs trust or a general support trust.")

In sum, reduced to its basics, in such situation the legal issue is whether it was the settlor's intent to repose in the trustee normal fiduciary discretion in interpreting such distribution standard comparable to that in a support trust in satisfying such distribution standard or, alternatively, was it the settlor's intent that distributions be limited to such delineated support purpose, with the trustee being possessed of discretion to the same degree as in a pure discretionary trust in deciding whether to make distributions.

Not surprisingly, due to the quite disparate language utilized in reposing trustee discretion in hybrid trusts, as well as its inherent ambiguities and typical inconsistencies, courts across the country likewise have been inconsistent in discerning settlor intent and resolving the inherent ambiguity presented by discretionary authority reposed in trustees under the provisions of hybrid trusts, even to the degree of sometimes dissimilarly interpreting very similar provisions within the same trust instrument. For example, in *Kryzsko v Ramsey County Social Services*, the trustee was given "sole discretion" to make distributions of trust principal for the beneficiary's "proper care, maintenance, support, and education." 607 N.W.2d 237, 240 (N.D. 2000). The North Dakota Court held that such terminology created a support trust. *Id.* at 244. In *First of America Trust Company v. United States*, the court paradoxically held that a trust distribution standard that "the Trustee shall pay or apply the net income and so much of the principal as the Trustee may in its sole discretion deem necessary or appropriate for the support, comfort and welfare of such of [the beneficiaries] as shall be living from time to time" created a support trust as to the income (the trust being interpreted to require the distribution of all income for the beneficiaries' support), but a pure discretionary trust as to principal distributions. No. 91-2352, 1993 U.S. Dist. LEXIS 4694, at *16-17 (C.D. Ill. March 15, 1993).

Other courts have attempted to "split the baby" by holding that hybrid distribution standards create a support trust, while departing from the position of the *Restatement (Second) of Trusts*, yet finding that the trustee is given broader discretion in determining the propriety, timing, and amount of distributions that would occur absent such discretionary language. *See Bureau of Support in Dep't of Mental Hygiene & Corr. v. Kreitzer*, 243 N.E.2d 83 (Ohio 1983); *Strojek v. Hardin Cty. Bd. of Supervisors*, 602 N.W.2d 566 (Iowa Ct. App. 1999); *Smith v. Smith*, 517 N.W.2d 394 (Neb. 1994); *In re Kinsel*, No. 08-1625, 2010 WL 446551, at *3 (Iowa Ct. App. Feb. 10, 2010) (stating that a hybrid distribution standard "contains a bedrock requirement of support, but with some topsoil of discretion."). Furthermore, in *Kreitzer* the court held that the trustee's discretion was subject to a reasonable standard. *Kreitzer*, 243 N.E.2d at 86. Clearly, hybrid trusts can blur the lines as to the degree of discretion accorded a trustee in satisfying the distribution standard.

Still other courts have indicated that the terminology is inherently ambiguous so as to permit the resolution of the settlor's intent through parol evidence. *See Bohac v. Graham*, 424 N.W.2d 144 (N.D. 1988). In *Bohac*, the trustee was authorized to distribute principal as the trustee "may deem necessary" for the beneficiary's "support, maintenance, medical expenses, care, comfort and general welfare." *Id.* at 145.

Up to this year, 2020, Kansas appellate courts had adhered strictly to the position of the *Restatement (Second) of Trusts* in finding that hybrid trusts do not create a hybrid discretionary authority. However, in resolving the issue of whether the trustee in a hybrid trust has the same level of discretion accorded a trustee in a pure discretionary trust as opposed to the substantially more limited discretion accorded a trustee in a pure support trust, the Kansas appellate courts historically have demonstrated a strong proclivity to find in favor of the former construction. That is to say, e.g., with the inclusion of a distribution standard such as "maintenance and support" in a hybrid trust, as was noted in the Kansas decisions that follow, discretion in such hybrid trusts was considered that of a pure discretionary trust with distributions being limited to the purpose of satisfying the delineated support standard.

For example, in *State ex. rel. Secretary of SRS v. Jackson*, the trust provided, in relevant part:

> "During the lifetime of Carrie Conner Jackson, the Trustees, in their uncontrolled discretion, shall pay to Carrie Conner Jackson the net income of the Trust. In addition, the Trustees may pay to Carrie Conner Jackson, from the principal of the Trust from time to time, such amount or amounts as the Trustees in their uncontrolled discretion, may determine is necessary for the purposes of her health, education, support and maintenance. The Trustees are not prohibited from invading the principal of the trust for my granddaughter, Carrie Conner Jackson, before she has exhausted her own funds."

249 Kan. 635, 639, 822 P.2d 1033, 1036 (1991).

The *Jackson* Court analyzed this provision as follows:

> "Stripped down, the provision states the Trustees shall pay the net income and, in addition, may pay from the principal. The payment of the net income is not tied to any determination of need as are payments from the principal."

*Id.* at 641, 822 P.2d at 1038.

Even though the income distribution standard was phrased in terms of the trustee's "uncontrolled discretion," the use of the word "shall" was construed by the Court to have negated the trustee's ability to use discretion in distributing trust income. Perhaps the Court gave limited applicability to the words "in their uncontrolled discretion" due to the Court's unabashed distaste, as expressed in its opinion, for estate planning strategies designed to protect the trust estate from being a resource for Medicaid purposes. In a divided opinion, the majority had to strain to resolve this palpable inconsistency in the language by construing the term "uncontrolled discretion" in a manner that ascribed such discretion only to the timing of income distribution, not as to the amount, a discretion which would have existed in the absence of such language. The minority opined that such language created an obvious ambiguity that should have been resolved by remanding the case back to the district court to determine the settlor's intent.

Had the trust used the word "may" instead of "shall," it would appear likely the Court would have held there was no requirement for the trustee to make income distributions. With respect to distribution of the principal, the State had conceded that the trustee had broad discretion (due to the use of the word "may" in conjunction with the term "uncontrolled discretion") to determine what amounts were necessary to provide for the beneficiary's health, education, support, and maintenance; consequently, given such broad discretion in making distributions of principal, the trust principal was not considered to be a resource to the beneficiary for Medicaid qualification purposes.

Despite the Court's judicial constraint imposed on the broad discretionary authority in the trust instrument regarding income distributions, this decision should be considered inconsistent, if not inapposite, with the degree of discretion afforded in a hybrid trust. First, with respect to income distributions, the subject trust was not a hybrid trust, because authorized distributions were not related to an external standard. Instead, the sole issue was resolving the inconsistency in the discretion accorded the trustee itself. Second, the Court's decision was probably attributable to both its Medicaid context and the palpable inconsistency with the inclusion of the word "shall" associated with such distribution. The position of the minority that such language created an ambiguity would appear to be the better reasoned view, favoring remanding the matter back to the district court to resolve such ambiguity. The majority may have simply been reticent to acknowledge such ambiguity in its desire to find the trust to be a resource for Medicaid purposes.

In any event, in other subsequent contexts, the Kansas appellate courts have found discretionary language to take precedence in hybrid trust situations having a prescribed support distribution standard, even if the support standard includes compulsory wording.

For example, *Myers v. Kansas Dept. of Social and Rehabilitation Services*, involved the same issue presented in *Jackson* as to whether the trust estate was an available resource for Medicaid purposes when the Trust provided:

> "During my son's lifetime, my trustee shall hold, manage, invest and reinvest, collect the income there from [sic] any [sic] pay over so much or all the net income and principal to my son as my trustee deems advisable for his care. support, maintenance, emergencies, and welfare."

254 Kan. 467, 469. 866 P.2d 1052, 1054 (1994).

In construing the foregoing terms of distribution, the Court in *Myers,* in contrast to its position in *Jackson,* held that the use of the word "shall" in this different context pertained only to management and investment functions of the trust, not to the distribution standard. *Id.* at 477, 866 P.2d at 1059. Then, in looking at the discretion imposed by the distribution standard, the Court held that because the trust provisions gave the trustees authority to make distributions for care, support, maintenance, emergencies, and welfare in terms of "so much or all the net income and principal to [the beneficiary] as my trustee deems advisable," the trust was deemed to be a pure discretionary trust as it related to the distribution standard. *Id.* The Court further held that neither the beneficiary nor a creditor of the beneficiary could compel a distribution from the trust if the trustee did not deem the distribution advisable. *Id.*

In the unpublished opinion of *Kershenbaum v. Fasbinder*, the decedent created a trust naming his sister as income beneficiary and his son as both trustee and remainder beneficiary, creating a conflict of interest with regard to his fiduciary authority. No. 97,399, 2007 Kan. App. Unpub. LEXIS 388, at *2 (Kan. Ct. App. Nov. 21, 2007). The terms of the trust provided that:

> "the testamentary trustee(s) shall pay to the beneficiaries or for their benefit, from the income or principal of that beneficiary's trust, such sum or sums, as the testamentary trustee(s) shall deem necessary or proper to provide for that beneficiary's suitable support, health and maintenance, adding any unused income to the principal at the end of each year."

*Id.*

Prior to making a distribution to his aunt, the trustee required her to provide evidence of her other sources of income, particularly as delineated on her income tax return. *Id.* His aunt refused, alleging the distribution standard was objective on its face, thus requiring her nephew as trustee to satisfy her defined needs without any requirement that she provide any additional information or the trustee's consideration of her circumstances. *Id.* Her nephew asserted that the trust was a pure discretionary trust as it related to the distribution standard and he thus had a right to request any additional information he deemed relevant, including whether she had other resources with which to satisfy such standard. prior to making a distribution. *Id.*

The Kansas Court of Appeals, in such unpublished opinion, agreed with the trustee, concluding that the trustee's authority was purely discretionary in nature. *Id.* at

*12–13. Once again, although the distribution standard of health, support, and maintenance was couched in mandatory terms such as "shall pay," the court concluded that it was required to give importance to the additional phraseology "as the testamentary trustee(s) shall deem necessary or proper." In doing so, the court found that such qualifying language in essence created a pure discretionary trust with respect to making distributions for the support, health and maintenance of the beneficiary. Thus, the trustee was afforded discretionary authority as to the timing and amount of distributions such that the trustee could request any additional information relevant to the beneficiary's financial situation, notwithstanding the vacuity of any terminology in the instrument indicating distributions were to be supplemental to the beneficiary's other resources.

The foregoing cases leave little doubt as to the Kansas appellate courts' historical proclivity in construing hybrid trusts as pure discretionary trusts as relating to the delineated support standard if such trusts contain any discretionary terminology, permissive language (e.g., "the trustee may" or "the trustee is authorized to make") or even a bare modicum of discretionary language modifying compulsory wording (e.g., "in the trustee's discretion," "as the trustee shall deem necessary" or "as the trustee shall deem advisable").

No doubt such liberal construction accorded the trustee's discretionary authority in a hybrid trust context is frequently antithetical to the actual intent of the settlor. It is inconceivable that most hybrid trusts are intended to grant such relatively unbridled authority in the trustee as interpreted by the Kansas appellate courts, leaving a beneficiary with extremely modest legal redress in compelling a distribution related to an external standard. This is particularly true when compulsory verbiage is accompanied by rather modest discretionary language in a hybrid trust context.

In recognition at least in part of this reality and the digression of some courts in not strictly adhering to the dichotomy of the *Restatement (Second) of Trusts* on this issue, the *Restatement (Third) of Trusts* abandoned the position of strict adherence to a "bright line" distinction between "support" and "discretionary" trusts in a hybrid trust context. *See Tannen v. Tannen*, 3 A.3d 1229, 1241 (N.J. Super. Ct. App. Div. 2010). The comments to the *Restatement (Third) of Trusts* § 50 (trustee discretion), § 58 (spendthrift provisions), and § 60 (ability of a creditor to "stand in the shoes" of a beneficiary and compel a distribution in the absence of a spendthrift clause) generally conclude that such distinction is artificial. Comment b to § 50 first reaffirms the general common law view that "judicial intervention is not warranted merely because the court would have differently exercised its discretion." However, the comment then goes on to provide a "reasonableness" test, stating that a court "will not interfere with the trustee's exercise of a trustee's discretionary power when that exercise is reasonable and not based upon an improper interpretation of the terms of the trust."

The Commissioners particularly state that this illogical demarcation poses specific problems in determining whether the assets of a trust in which a trustee is given discretion to make distributions to a beneficiary who is on or applying for government benefits, such as Medicaid, should be considered a "support trust" (where the assets should be deemed available to a beneficiary) versus a "pure discretionary trust" (where the assets are deemed unavailable). Instead, the comments posit that distribution standards should be treated as a continuum from being purely discretionary to providing for support-type needs, with varying degrees of discretion being accorded the trustee dependent upon the evinced intent of the settlor as gleaned primarily from the provisions of the trust instrument and secondarily from parol evidence in the event such provisions are deemed ambiguous. The uncertainty of a determination of the trustee's discretion in a hybrid trust context utilizing such *Restatement* position would cloud the availability of governmental resources, such as Medicaid, in almost every circumstance where such eligibility was predicated upon whether a beneficiary could compel a trust distribution.

Although the Kansas Court of Appeals has cited the *Restatement (Third) of Trusts* with approval in other contexts, prior to 2020 neither it nor the Kansas Supreme Court has done so in blurring the distinction between discretionary and support trusts in a hybrid trust or discretionary trust context. *See In re Breeding Trust*, 21 Kan. App. 2d 351, 899 P.2d 511 (1995) (citing the *Restatement (Third) of Trusts* with respect to a trustee's duty to successive beneficiaries). Consequently, there was no judicial indication that Kansas courts would digress from their foregoing precedents, which prior to 2020 had found a clear demarcation between support and discretionary trusts. If a Kansas appellate court adopted such "facts and circumstances" approach implicit in resolving the degree of discretion accorded to the trustee in any particular situation, there would be little certainty as to the outcome as to the degree of such discretion in any specific circumstance.

It is also worth noting that K.S.A. 58a-814, enacted in 2002 along with other provisions of the Kansas Uniform Trust Code (KUTC), provides for a "good faith" standard in reviewing discretionary language either in a pure discretionary or hybrid trust context. Such provision from the Uniform Trust Code was enacted in the KUTC with no changes. This standard appears to be less circumspect on the level of trustee discretion than the more objective "reasonableness" standard of the *Restatement (Third) of Trusts*. Such statute provides:

> "[n]otwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms "absolute," "sole" or "uncontrolled," the trustee shall exercise a discretionary power in good faith in accordance with the terms and purposes of the trust and the interests of the beneficiaries."

K.S.A. 58a-814.

Some commentators have criticized such UTC terminology. They assert it gives too much control to beneficiaries (with an asserted consequential exposure of the trust estate to third party claims and potential governmental resource disqualification), thus requiring a more circumspect test than simply determining the trustee did not act dishonestly or with improper motive under the position of the *Restatement (Second) of*

*Trusts. See, e.g.* Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust* Code, 40 Real Prop. Prob. & Tru. J. 567 (2005); Mark Merric & Steven J. Oshins, *How Will Asset Protection of Spendthrift Trusts Be Affected by the UTC?*, 31 Est. Plan. 478, 479 (2004)

These commentators have opined that a "good faith" standard is higher than simply requiring the trustee not to have acted in bad faith. If such was the case, there would appear to have to be a third alternative in between that would bridge such gap. Assuming a trustee is not acting in bad faith, if the trustee is not then acting in good faith, what possibly could be the trustee's state of mind?

If any such distinction can be made, it appears to be gossamer in nature. ". . . As noted above by the Kansas Supreme Court, where the instrument creating a trust gives the trustee discretion as to its execution, a court may not control its exercise merely upon a difference of opinion as to matters of policy, and is authorized to interfere only where he acts in bad faith or his conduct is so arbitrary and unreasonable as to amount to practically the same." (*Elward v. Elward,* 117 Kan. 458, 459, 232 Pac. 240) Consequently, discretion accorded a trustee thus can be acted upon so arbitrarily and unreasonably so as to constitute bad faith. Nonetheless, it is noteworthy that in the above-discussed *Fashinder* decision, which was decided in 2007 after the passage of K.S.A. 58a-814, the Kansas Court of Appeals did not mention such KUTC provision in continuing Kansas appellate court adherence to the position of the *Restatement (Second) of Trusts.*

However, the foregoing tenor of Kansas appellate courts on this issue took a decided turn this year in the Kansas Court of Appeals decision of *Roenne v. Miller*, Case No. 120, 054 Kan. App. LEXIS 72 (Ct.App. Oct. 2, 2020), involving a pure discretionary trust requiring a refocus of the level of discretion accorded a trustee in a discretionary trust. if not a complete reconsideration, due to a rather "at the margins" factual scenario with which the court was presented, and the ostensible level of unfettered discretion accorded the trustee. The situation in *Roenne* was a testamentary trust in which the decedent, Marie Miller, devised a one-half interest in her farm real estate to one of her sons, Brad, and the other half to another son, Mark, the latter in the form of a life estate. with such other son's descendants, if any, having the remainder interest. Mark then assigned his interest in the real estate to Brad, who acquired a fee simple interest in such other half through a quiet title action. Marie's will specifically provided it was her intent that none of her other children have any interest, either directly or indirectly. in the farm property.

The remainder of her estate, consisting exclusively of oil royalty interests of very substantial value, was left in a testamentary trust for the benefit of all five of her children, including Brad, naming him as sole trustee. Upon the death of the last beneficiary, the remaining trust estate was to be distributed per capita among her grandchildren. The trust consisted solely of her sizable oil royalty interests. The trust reposed "uncontrolled" or "exclusive" jurisdiction over the trustee's distribution of trust income and principal among the beneficiaries at any time and in any amount. Although providing that the trustee's authority was only exercisable in a fiduciary capacity, the trust provisions specifically stated such distributions were to be "strictly within the discretion of said trustee,'' and further. "at no time shall any of the beneficiaries named have the absolute right or entitlement in any of the income or principal." The trust provisions also provided that Brad could purchase and retain real property from the estate and operate a farm and further, that his determination in utilizing income and principal of the trust for such purposes was conclusive as to all concerned. *Id. at 27.*

Over the years, Brad transferred the trust income in the amount of approximately $1,300,000, and apparently some principal, for his own purposes in financing his farming operation, using the large amounts of oil income to pay down the large debts on the farm real estate, as well as for farm operations, which included the real property Marie devised to him in her will, all of which was ostensibly consonant with Marie's authorization in her will for Brad to invest in and manage farm real estate. However, Brad then subsequently distributed the entire then remaining trust estate to him, relying on legal advice and the discretionary authority accorded him by Marie under the terms of the testamentary trust. Due to the entire trust having been exhausted, the trust terminated, leaving no possible assets to pass upon its stated termination date, the death of the last surviving child, per capita among the grandchildren.

The other trust beneficiaries thereupon sued Brad, claiming breach of trust by such personal distributions of income and principal, as well as his failure to provide annual accountings, as required by the trust. The district court held in favor of Brad, focusing on the foregoing specific wording of the trust, ostensibly affording Brad untrammeled discretion in the distribution of income and principal and conflating the provisions of the will regarding not wanting the other children to have any interest in the farm real estate bequeathed to Brad and Mark with his discretionary authority to make distributions of income and principal to himself, thereby concluding there was an unstated common purpose in according Brad unfettered overarching authority in the testamentary trust to make distributions benefitting Brad's ownership in such same real property.

On appeal, the Kansas Court of Appeals, after reciting the above discussed general distinctions between support and discretionary trusts under Kansas law and finding the subject testamentary trust to be a discretionary trust, noted that a trustee who reasonably and in good faith relies on the express provisions of a trust is not liable to a beneficiary for a breach of trust to the extent the breach resulted from such reliance. *Id.at 13, citing McKinley v. Bank of America*, 279 Kan. 426, 436, 109 p.2d 3d 1146 92005.

However, although the court acknowledged that as the trust allowed Brad to make distributions to himself so as to constitute a permissible conflict of interest, it went on to conclude that relying on such foregoing express provisions of the trust ignored the fiduciary duties of loyalty, impartiality and prudence, noting that a trustee must "administer the trust consistent with the terms of the trust and solely in the interests of the beneficiaries" *Id.* at 13, citing K.S.A. 2019 Supp.58a-802(a), which the court also noted goes on to provide that a transaction involving trust property entered into by the trustee for the trustee's own personal account which is impacted by a conflict between the trustee's fiduciary and personal interests is voidable by a beneficiary unless authorized by the terms of the trust, approved by the court or consented to by the beneficiary. The court further noted the trustee's duty of impartiality under K.S.A. 58a-803 and to prudently manage the trust estate considering the purposes of the trust under K.S.A. 58a-804, *Id. at13-14,* additionally noting that the statutory requirements that a trustee act in good faith and for the benefit of the beneficiaries is not waivable under the provisions of the trust, citing K.S.A.58a-105 and the above discussed provisions of K.S.A. 58a-814 limiting the import of trustee discretion couched in terms of "absolute," "uncontrolled" or "sole," limiting such authority to that exercised in good faith and in accordance with the purposes of the trust. The court went on to conclude that such limiting language in the Kansas UTC was consonant with that of *Restatement (Third) Trusts* §87, comment d, pp.245-247, and would appear to be adopted therefrom.

In the interim, the decision has been appealed to the Kansas Supreme Court, which the authors expect likely will be affirmed if the appeal is granted. Although, as above noted, the Kansas Supreme Court has not cited the Third Restatement on the degree of discretion accorded a trustee in a hybrid trust to date, its concepts are tangentially paralleled in the aforesaid statutory provisions of the Kansas Uniform Trust Code, providing for a "good faith" standard and the rather egregious factual circumstances in *Roenne* will likely compel it to do so. If the appeal is accepted, the obligatory focus of the Court will have on their impact on the degree of discretion the court will impose on what would otherwise be a pure discretionary trust in a circumstance where the purpose of the trust and the intended discretion of the trustee was not clear in its provisions. If the decision is affirmed, its presence will also undoubtedly have an impact on every hybrid trust decision in the future due to the trust purpose being explicitly stated by its hybrid nature, for if such trustee discretion was truly virtually unfettered, it would be more in the nature of a power of appointment imposing no fiduciary responsibilities. However, it is important to note that the degree of scrutiny given the trustee's discretion in *Roenne* was no doubt heightened by the fact that such discretion impacted the duty of impartiality due to such discretion being exercisable for the trustee's personal benefit, a situation which would not be present in the high percentage of situations which involve a third party trustee. The bottom line is that *Roenne* is likely to result in the trustee discretion in hybrid trusts falling in a "yet to be defined" continuum somewhere between that previously accorded pure discretionary trusts under the Second Restatement to that of pure support trusts, depending on governing provisions of the trust and the underlying circumstances of the beneficiary, and perhaps more in favor of the latter. It will present additional challenges for estate planners to assiduously draft hybrid trusts that comport with their client's intent and thus avoid its construction having to be determined by the vicissitudes of judicial construction of inadequately enunciated provisions as to the purpose of the trust, the factors to take into account in making a distribution, and the degree of discretion to be accorded the trustee.

## B. Considerations in Selecting a Distribution Standard

### 1. Achieving Client Intent

The client's intent thus should be the primary consideration in determining whether a trust should be drafted as a pure discretionary trust, a pure support trust or a hybrid trust. Historically, the settlor's intent has always been the controlling force in governing trust law the polestar principle guiding all aspects in the construction of trust provisions. *See, e.g.*, *Splain v. Hogard*, G033278, G033720, 2005 Cal. App. Unpub. LEXIS 2533 (Cal. Ct. App. Mar. 22, 2005); *Pikula v. Dep't of Soc. Serv.'s*, 321 Conn. 259, 268 (Conn. 2016) (stating that "in determining whether the assets of a testamentary trust are available to a beneficiary, ... this court considers whether the testator intended to create a supplemental needs trust or a general support trust."). Thus, the key is drafting trust provisions which clearly evince such intent. Most often, the chosen vehicle will be a hybrid trust.

The predilection of most clients and their attorneys is to give the trustee broad discretion in making distributions for any purpose. On its face, this would appear to be understandable. Reposing broad discretion in a trustee with little to no specificity regarding whether, when, and how to make distributions of income and principal would have appeal at least at first blush in providing flexibility in addressing and considering the changing circumstances of beneficiaries.

Unfortunately, however, such broad discretion carries with it the ever present very high risk that the trustee's decision-making will not comport with the intent of the settlor in a high percentage of circumstances, for the frequency, amount and nature of trust distributions would then be almost wholly dependent upon the idiosyncratic personal values of the trustee administering the trust. The net result is all too often the desired flexibility in creating a hybrid or discretionary trust may amount to simply having substituted the values, including an element of caprice, of a trustee for those of the settlor.

Consequently, reposing broad discretionary authority in a trustee in making trust distributions, most particularly when such discretion is lacking in specificity as to factors to be considered in exercising such discretion, is a poor substitute for attorneys being knowledgeable as to the legal importance of various distribution factors, discussing those factors in detail with their clients, and including pertinent provisions in their trust instruments designed to effectuate such intent by listing the factors and considerations which militate in favor of both making and withholding a trust distribution. Such factors and goals of the settlor, many of which are almost universally held by settlors, are then required to be considered by the trustee when applied to such changing circumstances of a beneficiary. To not do so not only carries with it the aforementioned high risk that the trustee's discretion in making distributions will not comport with the intent of the settlor, it is likely to also result in much higher administrative costs and attorney fees in addressing and resolving the much greater frequency of issues that are likely to arise between trustees and beneficiaries as to the intent of the settlor due to such lack of specificity. The *Roenne* decision greatly enhances this risk, for it likely will almost certainly enhance judicial circumspection of the discretion of a trustee in hybrid trust contexts.

Just as important as providing more specific distribution standards to guide trustees' distribution decisions in a manner consistent with the values of the settlor is the resultant enforcement mechanism in the event a trustee impermissibly strays from such intent. This means eschewing provisions defining the purpose of distributions in overly broad terms beyond an external standard. It also means not reposing overly broad discretionary authority in a trustee in satisfying such purposes. Such discretion can leave beneficiaries with little legal redress to compel a distribution even if such distribution would be consistent with prescribed purposes. This is because such broad discretion in making a distribution in hybrid trusts, as interpreted in Kansas appellate decisions, may permit the trustee to withhold a distribution notwithstanding it might otherwise be merited as falling squarely within such defined purposes.

As noted above, the problems that arise from such inartful drafting of trust instruments, particularly in the discretion afforded to a trustee, are more acute in Kansas than many other states. Up to the *Roenne* decision, this was due to a Kansas judicial ethos in which, as discussed above, Kansas appellate courts had not adopted the position of the *Restatement (Third) of Trusts* in finding a continuum between pure discretionary and support trusts in a hybrid trust context. Instead, as above noted, Kansas appellate courts had adhered to construing hybrid trusts under the strained binary choice of the *Restatement (Second) of Trusts* as pure discretionary trusts in making distributions under the support standard, thereby affording a much more constricted legal redress to disaffected beneficiaries. Irrespective of the fate of *Roenne* on appeal, it is nonetheless likely to make the discretion accorded trustees in hybrid trusts more circumspect and highly vulnerable to challenge in the absence of purposeful and precise trust drafting.

Thus, scriveners must operate under the assumption that Kansas courts will continue to deem language that would have led to a construction of a pure discretionary trust, in the absence of the addition of support language, to remain quite broad in the trustee's discretion in making distributions, albeit now under the likely more circumspect manner enunciated in *Roenne*. However, such judicial discretion given the trustee in most hybrid trusts, albeit probably more constrained, will nonetheless likely continue to be far beyond what most settlors would have envisioned or intended. Moreover, there is little certainty as to the degree of discretion accorded trustees in the context of most hybrid trusts not only due to a lack of preciseness in drafting approach, but as compounded by the lack of certainty as to where in the discretionary continuum any given language as applied to the subject circumstances might fall.

It is thus quite evident from the foregoing case law that estate planning attorneys will clearly place trustees and beneficiaries in a "stygian morass" as to exercise of trustee discretion in hybrid trusts when employing words such as "sole," "absolute" or "uncontrolled" relating to the trustee's discretion, and to a lesser extent "in the trustee's discretion," without also including additional refining language relating to the degree of such intended discretion. Accordingly, to avoid such indeterminate consequences as to the manner in which a trustee will exercise such broad discretion, some attorneys espouse including such broad discretionary terminology while advising clients to consider leaving a "letter of wishes" for the trustee that expounds on the client's philosophies regarding the types of distributions that the client deems appropriate. Such a letter is intended to provide guidance to the trustee to give the trustee some assurance that distributions are being made in accordance with the settlor's wishes. *See* Alexander A. Bove & Melissa Langa, *Distinguishing Discretion in Discretionary Trusts - The Letter of Wishes*, (Mass. Lawyers Weekly, January 23, 2006). The authors therein suggest that such "wishes" be merely precatory in nature to not limit the discretion of the trustee. *Id.*

However, the authors believe it imperative for such intent to be incorporated in the terms of the trust instrument and not made merely precatory in nature. A separate letter may be misplaced or lost by a client or trustee, or even possibly destroyed by a disaffected trust beneficiary who happens upon the letter following the death or disability of the settlor or testator. In addition, the beneficiary may not know of its existence (or possibly even not have a legal right to discovery of such letter if it is merely precatory in nature) when determining the intent of the settlor and the beneficiary's enforceable rights. Finally, such a letter, if precatory, would not be required to be considered by a trustee in making a distribution, thus not ensuring the intent of the settlor is effectuated and possibly thereby leaving a disaffected beneficiary with limited or no redress in such circumstance.

Moreover, there would also be the issue of its legal importance as to the trustee's discretion, as well as its admissibility in court under the parol evidence rule. As noted above, unlike courts in other jurisdictions, Kansas appellate courts to date have not found any inherent ambiguity by combining discretionary trust and support trust language in hybrid trusts. They instead find the trustee's discretion controlling if the trust otherwise would have been construed as a pure discretionary trust in the absence of support trust language. Minus a judicial finding of ambiguity in the actual trust language itself, not in its application to the subject circumstances, such a letter is not likely to be legally admissible as evidence of the settlor's intent.

Nor may it be admissible in any circumstance where it was clearly precatory in nature, because it would not be controlling on the trustee's administration of the trust. Although such lack of admissibility would not preclude the trustee from using the letter as guidance in exercising discretion, it would not be binding on the trustee. Overall, if it is important enough to be intended as a guide to the settlor's wishes, it should be incorporated in the trust instrument and thus be enforceable by the beneficiary after giving proper deference to the level of discretion accorded to the trustee under the trust instrument. In sum, a "letter of wishes" is no substitute for more precise drafting of the trust instrument, including expressions of intent directly in the instrument.

If it is a matter of privacy regarding a settlor's comments, possibly of a pejorative nature, regarding the aspects of a beneficiary, such as a beneficiary's psychological aspects or character (i.e., lack of motivation, spendthrift tendencies, financial naïveté, lack of candor, married to an abusive spouse, etc.), with respect to which the settlor simply desires the trustee be made aware so as to the motivation behind the distribution standard and factors to be taken into account regarding a given beneficiary, such comments could simply be included in a separate confidential letter to the trustee. In that manner, they would not be embarrassing to a beneficiary. Such factors could then be listed as factors to be taken into account in the trustee deciding to make a distribution to a beneficiary, with such factors being listed as considerations for every beneficiary in the trustee making a discretionary distribution. For if not confidential, such disclosure, especially to a child beneficiary, could also negatively impact self-esteem, being hurtful as a parent's final "report card" on their child's individual worth and unnecessarily adversely affect a post-death filial view of a deceased parent.

It is also important to note the "flip side" of a current beneficiary being able to compel a distribution is the ability of a remainder beneficiary to challenge such distribution. That is to say, more clearly stating a client's intent in the trust document and not making the trustee's discretion in that regard unfettered increases the ability of remainder beneficiaries to challenge any such distribution to the extent it exceeds the trustee's authority. The Kansas Supreme Court, in quoting with approval the *Restatement (Third) of Trusts* § 232, stated:

> "If a trust is created for beneficiaries in succession, the trustee is under a duty to the successive beneficiaries to act with due regard to their respective interests . . . The extent of a trustee's duty to successor beneficiaries is determined from the trust's purposes, terms, and obligations when viewed in light of the circumstances of the trust and the relevant circumstances of its beneficiaries."

*In re Breeding Trust*, 21 Kan. App. 2d 351, 356, 899 P.2d 511, 515 (1995); *see also Midwest Trust Co. v. Ong*, No. 106.744, 2013 WL 310353, at *4 (Kan. Ct. App. Jan. 18, 2013).

In many situations such judicial oversight comports with the settlor's intent to place the interests of remainder beneficiaries on a par with that of current beneficiaries. However, in other situations it does not, with such intent being primarily focused on the current beneficiary or beneficiaries, e.g., a spouse over children or perhaps a child over the child's descendants. This is particularly true in situations where assets are being left in trust strictly for asset protection purposes, with the current beneficiary serving as sole trustee.

This latter preference is often accompanied by a desire of the settlor for remainder beneficiaries to not have to be made aware of the provisions of the trust, its management, or the amount held in trust for their later benefit under governing law, including provisions of the Kansas Uniform Trust Code. Such settlors may have a fear of beneficiaries making unreasonable objections to its management and such disclosure fostering family disharmony. They also may have concerns that such disclosures would be a motivational disincentive to their own educational and work pursuits, engender feelings of entitlement, encourage beneficiaries to seek current distributions from the trust should a remainder beneficiary also be a current beneficiary, create current dissatisfaction in remainder beneficiaries with the shares or manner in which the remainder interest is being left to them, and even a fear that a remainder beneficiary may pressure a current beneficiary to change a remainder beneficiary's interest in their favor should the current beneficiary possess a limited power of appointment under the instrument which permits such current beneficiary to do so.

In such situations, such awareness can be avoided by the trust instrument specifically waiving the normal obligation of the trustee to provide a copy of the trust instrument and accountings to remainder beneficiaries during the term of the trust under the provisions of the KUTC. K.S.A. 58a-105(b). Such waiver would not have been permissible had Kansas, like many other states, adopted the pure form of the Uniform Trust Code (UTC) not permitting such a waiver.

Nonetheless, protection from disclosure through such a waiver would be vitiated under a testamentary trust, for as opposed to a revocable trust being the primary instrument for the post-death disposition of asset, beneficiaries would nonetheless have access to the instrument by either being given notice in a probate procedure as an heir at law or otherwise due to the will being a matter of public record. To the extent there might be any concern of a settlor that such non-disclosure would thereby permit an improper administration of the trust disadvantageous to the remainder beneficiaries that would not be subject to legal redress by disaffected remainder beneficiaries due to their lack of knowledge as to aspects of the trust and its administration, such concerns can be assuaged by the appointment of a corporate fiduciary as sole trustee or co-trustee to ensure proper administrative compliance perhaps in conjunction with naming an unrelated named Special Trustee of Trust Protector to oversee its administration and being entitled to accountings with the authority to appoint a different corporate trustee.

The Drafting Considerations section below outlines with specificity provisions that are typically desirable for consideration for inclusion in the trust instrument. Such provisions can provide desired flexibility in the administration of the trust while at the same time ensuring that the settlor's specific intent is outlined for the trustee to implement and reposing the desired legal redress in current and remainder beneficiaries if it is not.

## 2. Medicaid Qualification

Choosing a distribution standard is critical when a trust beneficiary is receiving, or may become eligible to receive, Medicaid or other government benefits such as SSI. Any mandatory distribution will be considered a resource for such purposes. SSA Programs Operational Manual System SI 01120.200.D.

Moreover, a pure support trust is normally considered a countable resource of someone who is receiving or applying for Medicaid benefits. Because the trustee of a support trust has a legally enforceable responsibility to make distributions of income and/or principal to or for the benefit of the beneficiary for support or maintenance, such assets are deemed to be available to the beneficiary and are counted when a beneficiary makes application for Medicaid or a similar program. In *Miller v. Kansas Dept. of Social and Rehabilitation Services,* 275 Kan. 349, 64 P.3d 395 (2003), the Kansas Supreme Court observed:

> "A support trust exists when the trustee is required to inquire into the basic support needs of the beneficiary and to provide for those needs. . . . Eligibility for Medicaid depends on the assets 'available' to the applicant, and the support trust is always considered such an available asset."

*Id.* at 354.

In almost all states, the assets of a pure discretionary trust are not considered a countable resource of a trust beneficiary when that beneficiary applies for Medicaid or similar government programs, such as supplemental security income or SSI. This is because the beneficiary is deemed to have no right to compel distributions from the trust to the beneficiary or for his benefit. This was the position of the Kansas Supreme Court in the three aforesaid Kansas appellate cases, *Jackson, Simpson,* and *Myers,* which addressed the issue. Given Kansas' failure to adopt the continuum position of the *Third Restatement* prior to the *Roenne* decision, and its long-standing predilection to find a hybrid trust that has any discretionary language to be a pure discretionary trust regarding the support standard, almost any hybrid trust that contains discretionary language would have been expected to be found to be unavailable to the beneficiary in Kansas due to the beneficiary not being able to compel a distribution. Even under *Roenne,* a hybrid trust would not necessarily be found to be an available resource, to the extent the support need of a beneficiary would otherwise have been satisfied by Medicaid in the absence of its availability. Arguably, not making the distribution in such situation would be in the best interests of the beneficiary by preserving the principal for the later or supplemental needs of the beneficiary.

However, such heretofore common law Kansas position was statutorily repealed in 2004, when the Kansas legislature enacted K.S.A. 39-709(e)(3). This statute, in the absence of required supplemental language delineated thereunder, makes assets of a pure discretionary trust a countable resource of a Medicaid applicant, notwithstanding the inability of such applicant to compel a distribution, to the extent that, using the full extent of his discretion, a trustee may make distributions to or for the benefit of the beneficiary. Such statute provides:

> "(e)(3) . . . (A) Resources from trusts shall be considered when determining eligibility of a trust beneficiary for medical assistance.

Medical assistance is to be secondary to all resources, including trusts, that may be available to an applicant or recipient of medical assistance.

(B) If a trust has discretionary language, the trust shall be considered to be an available resource to the extent, using the full extent of discretion, the trustee may make any of the income or principal available to the applicant or recipient of medical assistance. Any such discretionary trust shall be considered an available resource unless: (i) At the time of creation or amendment of the trust, the trust states a clear intent that the trust is supplemental to public assistance; and (ii) the trust: (a) Is funded from resources of a person who, at the time of such funding, owed no duty of support to the applicant or recipient of medical assistance; or (b) is funded not more than nominally from resources of a person while that person owed a duty of support to the applicant or recipient of medical assistance.

(C) For the purposes of this paragraph, "public assistance" includes, but is not limited to, medicaid, medical assistance or title XIX of the social security act."

In light of this statute, being a pure discretionary trust in and of itself no longer precludes the trust estate from being a resource for Medicaid purposes in Kansas, even if the beneficiary may not be able to legally compel a trust distribution. Such statute now requires the inclusion of additional trust language not previously required stating that the intent of the settlor is that the trust be considered supplemental to benefits that may be available to a trust beneficiary from public assistance such as Medicaid. It is important to note that the foregoing statutory requirement does not appear to require that the trust be a pure discretionary trust with respect to the discretionary language, only that the trust have "discretionary language." Thus, a hybrid trust containing such supplementary language would appear to suffice. Such intent might be expressed as follows:

Supplemental to Governmental Resources. To the extent the Trustee is given the discretion to make a distribution of income or principal of a Trust created hereunder for any beneficiary's health, education, support, or maintenance, notwithstanding any provision in this Trust Agreement to the contrary, it is my intent that such Trust income or principal shall be supplemental to any resources available for such needs from public assistance provided from any local, regional, state or federal government or agency (such as Medicaid, medical assistance or any other benefits provided under Title XIX of the Social Security Act) or from private agencies, it being my express purpose and intent that such Trust income or principal not be utilized for such purposes to the extent such needs are otherwise provided for from all such other resources. Thus, in the event of a disability or diminished capacity of a beneficiary such that governmental or private resources would otherwise be available to provide for such beneficiary's support, maintenance, health or educational needs, and provided the Trustee hereunder is otherwise authorized to make distributions of income or principal to such beneficiary for any such needs, which discretion, provided the beneficiary is not serving as a Trustee, shall be sole and absolute and not subject to judicial challenge by the beneficiary in the event it need be in order for the trust estate to not be considered an available resource regarding such aforesaid governmental and other resources, the Trustee shall distribute funds supplemental to such other resources to or for the beneficiary's benefit for: differentials in cost between housing and shelter or shared and private rooms, dental care, supplemental nursing care and other health services not provided, sophisticated or experimental medical diagnostic work or treatment (including non-medically necessary procedures), programs of non-rehabilitative and private rehabilitative training where government assistance programs are not available or are insufficient, travel and outings (including necessary or desirable companions), cultural and entertainment experiences (such as athletic activities, camping, contests and movies, plays, musicals, and symphonies), and entertainment and communication equipment and services (such as radios, mp3 players, dvrs and the like, television sets, mobile and landline telephones, television cable services, and streaming video services). No part of the principal or income of any Trust hereunder shall be used to supplant or replace any public assistance benefits received by or through any county, state, federal or other governmental agency, including but not limited to benefits from Medicaid, medical assistance or benefits available under Title XIX of the Social Security Act. The foregoing provisions of this Paragraph shall supersede all other provisions of this Trust Agreement to the contrary to the extent necessary to effectuate my foregoing expressed intent.

This provision provides flexibility in any hybrid trust, permitting any trust beneficiary who may not currently be eligible for Medicaid benefits to become so eligible should such need arise in the future. Note that the above provision only makes trust distributions totally discretionary if need be for the trust estate not to be considered a resource for public assistance purposes. This has two benefits. First, it permits the beneficiary to be able to compel a distribution and have enforceable rights in all circumstances in which the beneficiary was not receiving, or otherwise eligible to receive, governmental assistance, and probably in Kansas even if the beneficiary was receiving governmental assistance. Second, it should ensure the beneficiary will be eligible for governmental assistance should the beneficiary either reside in another jurisdiction which might require the trust to be a pure discretionary trust in order for the trust not to be considered an available resource to the beneficiary or should Kansas change its law in the future to so require.

Finally, it should be noted that the specific supplemental needs delineated in such example provision following the colon, although perhaps desirable if the beneficiary is already receiving governmental assistance when the trust is drafted for guideline purposes, are not necessary in Kansas and almost every other state which require only that the beneficiary not be able to compel a trust distribution, i.e., a pure discretionary trust or a hybrid trust construed under governing trust law to be a pure discretionary trust pursuant to an external standard for the trust estate to not be considered an available resource to the beneficiary. Thus, an abbreviated form of such above provision without specific examples of supplemental needs nonetheless should suffice to make any discretionary trust, even a hybrid trust containing discretionary language, to not be a resource for Medicaid purposes in Kansas, and in any similar jurisdiction as well, should any beneficiary at any time be otherwise eligible for Medicaid.

### 3. Creditor Protection

As alluded to in the introduction, estate planners today routinely advise their clients regarding the creditor protection benefits of lifetime asset protection trusts for the beneficiaries of their estate. This trend has been driven by a more litigious society, a reflexive desire by clients to seek asset protection, and, in the face of increases in the estate tax applicable exclusion amount in the last decade, a shift in the focus by estate planners toward the asset protection benefits afforded by such third-party trusts.

However, as more fully addressed below, under common law, particularly in the absence of a spendthrift provision restricting the attachment by a creditor of a beneficiary's interest in the trust or the assignment by the beneficiary of such interest while in the trust, the asset protection benefits desired by clients was in peril if the distribution standard set forth in the trust document was an external standard, enforceable by the courts, in which the beneficiary was the trustee or the discretion of the trustee with respect to trust distributions under governing law was less than that accorded the trustee under a pure discretionary trust.

Such creditor exposure is at its zenith with mandatory distribution trusts. A mandatory distribution trust is one in which trust distributions are required to be made at a specific time or within a specific time period. Examples include income distributions required to be made on a periodic basis and terminating distributions when the primary beneficiary attains a certain age or dies during the trust term. Absent the inclusion of a spendthrift provision in such trusts, there is no creditor protection afforded such mandatory distributions. They are an unrestricted property right, and as such, in the absence of a valid spendthrift provision preventing their attachment by creditors prior to a distribution thereof being received by a beneficiary, are subject to attachment by creditors prior to a distribution to the beneficiary. See *Bogert's The Law of Trusts and Trustees* § 222 (June 2018 Update). In short, in such a circumstance, the vested creditor of a beneficiary, such as a judgment creditor or governmental tax lien holder, could attach the beneficial interest of the debtor beneficiary in the trust estate, thereby precluding any distribution of the trust estate to or for the benefit of the beneficiary without prior satisfaction of such debt amount. Fortunately, spendthrift provisions are rather routine in most trusts, thereby militating against such attachment.

In the absence of a valid spendthrift clause, as more fully discussed below, there was a similar exposure to creditors in pure support trusts where distributions are required to be made by the trustee pursuant to an external standard (such as for health, education, support and maintenance) not then subject to other delineated trust factors which would permit the trustee to abjure from making a distribution (e.g., the beneficiary's age, maturity, availability of other resources, etc.), most particularly creditors who or which were seeking payment for an external standard need, such as a hospital bill. Such creditors normally could legally compel a distribution to satisfy such need.

On the other hand, as long as the beneficiary was not serving as sole trustee, such exposure to creditors at common law was minimal with a pure discretionary trust. Under common law, a creditor of a beneficiary of a trust not requiring mandatory distributions could reach trust assets held in a trust only in the aforementioned limited circumstance where the beneficiary could legally compel the trustee to make a trust distribution to the beneficiary, e.g., a support trust or hybrid trust in which the discretion of the trustee was in the nature of a support trust. However, if the beneficiary was serving as sole trustee of a pure discretionary trust, the trustee's broad discretionary authority would amount to a general power of appointment, potentially exposing the entire trust estate to the claims of any creditor of the trustee/beneficiary and to its exercise by a trustee in bankruptcy. *Restatement (Third) of Trusts § 60, Comment g.*

In the converse situation where the beneficiary was not serving as sole trustee, normally the beneficiary of a pure discretionary trust would only be able to compel a trust distribution if the beneficiary could demonstrate that the trustee abused the trustee's very broad discretion in failing to make a distribution. *Restatement (Second) of Trusts*, § 187, comment e; *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. App. 1997); *State Street Bank and Trust Company v. Reiser*, 389 N.E.2d 768 (Mass. 1979); *Brent v. State of Maryland Central Collection Unit*, 537 A.2d 227 (Md. 1988). Due to such very broad discretion, such right to compel a distribution by such beneficiary is largely absent in a pure discretionary trust.

If a beneficiary cannot compel a trust distribution because the trustee has absolute discretion whether, when, and how to make distributions, the beneficiary has no property right that a creditor can reach. *See Bogert's The Law of Trusts and Trustees § 228 (June 2018 Update).* Because a beneficiary has no discernible property interest in a pure discretionary trust, the courts will often imply that the settlor intended for a creditor to be unable to attach the beneficiary's interest, i.e., the trust was intended to be spendthrift in nature. As such, it would have the same effect as if a spendthrift clause had been included in the trust instrument even in the absence thereof. *Id.*

Consequently, in such a trust a creditor would be unable to attach the interest of the beneficiary in the trust so as to preclude the trustee from making a distribution to the beneficiary without first satisfying the claim of the creditor. See, e.g., *2A Scott & Fratcher, The Law of Trusts*, § 152.4, at 110 and § 155 at 157 (4th ed. 1989). *But, see,* *Wilcox v. Gentry*, 254 Kan. 411, 867 P.2d 281 (1994), in which a creditor was permitted to attach the interest of a trust beneficiary in a trust that did not include a spendthrift provision where the trustee was given sole discretion (with no distribution standard) to distribute income and principal for the benefit of the beneficiary. Citing *Restatement (Second) of Trusts*. § 155(2), which provides that a trustee may not pay to or for the beneficiary any part of the income or principal after being served with process of a creditor attachment in a trust that has no valid restraint on alienation effectuated by a spendthrift clause, the Court held that no payments could be made, even indirectly, for the beneficiary's benefit after attachment of the beneficiary's interest without first satisfying the debt of the attaching creditor. The Court did not address the issue of whether such trust. nonetheless, as with some other courts, should have been considered an implied spendthrift trust due to it being a pure discretionary trust.

The *Restatement (Second) of Trusts* § 155(1) (1959), concerning discretionary trusts, states as follows:

> "[I]f by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal."

Comment b of this subsection, addressing a pure discretionary trust situation, provides:

> "A trust containing such a provision as is stated in this Section a 'discretionary trust' is to be distinguished from a spendthrift trust and from a trust for support. In a discretionary trust it is the nature of the beneficiary's interest rather than a provision forbidding alienation which prevents the transfer of the beneficiary's interest. The rule stated in this Section is not dependent upon a prohibition of alienation by the settlor; but the transferee or creditor cannot compel the trustee to pay anything to him because the beneficiary could not compel payment to himself on application for his own benefit."

As noted above in *Wilcox v. Gentry, supra, Restatement (Second) of Trusts* § 155(2) provides that in the absence of "a valid restraint on alienation," i.e., a spendthrift clause restricting assignments of trust interests in favor of creditors and attachments of a beneficiary's beneficial interest in the trust, an indirect payment actually made should be treated in the same manner as a direct payment so as to be subject to creditor attachment.

Thus, if there is no explicit spendthrift provision, and spendthrift protection would not otherwise be implied due to the broad discretionary nature of trust distributions, a creditor is free to attach the beneficiary's interest in the trust. However, a creditor has no greater right to compel a distribution in such circumstance than does the beneficiary whose interest was attached. Thus, the limited effect of a valid creditor attachment of a beneficiary's interest in a pure discretionary trust not having a spendthrift clause is that a trustee may not make distributions to or for the benefit of a beneficiary without first satisfying the obligation of the beneficiary/debtor to an attaching creditor.

By way of contrast, as noted above, with a pure support trust the beneficiary can compel the trustee to make distributions under circumstances dictated by the standard, (i.e., where it would be an abuse of the discretion afforded the trustee to not make the distribution). *Restatement (Second) of Trusts*, § 128, comments d and e. This means a creditor under common law normally could "stand in the shoes" of a beneficiary and compel a distribution for the beneficiary's support in circumstances where the debtor/beneficiary could have compelled such a distribution. This exposure was rectified by including a valid spendthrift clause, for permitting a creditor to stand in the shoes of a beneficiary would be violative of the literal terms of the spendthrift provision. *Schreiber v. Kellogg*, 50 F.3d 264, 267 (3d Cir. 1995); *First Nw. Tr. Co. of S.D. v. Internal Revenue Serv.*, 622 F.2d 387, 391 (8th Cir. 1980); *In re Watts*, 160 Kan. 377, 383, 162 P.2d 82, 87 (Kan. 1945).

The problem of exposing the assets of a pure support trust to creditors was exacerbated under common law if the beneficiary was serving as sole trustee, for in that situation a creditor's ability to compel a trust distribution would appear to be even greater. Instead of the normal standard as to whether it would be an abuse of discretion for the trustee to not make a distribution, the standard in such situation would likely be whether it would be an abuse of discretion for the trustee to make the distribution. In effect, the reach of a creditor of a trustee/beneficiary, absent the presence of a spendthrift clause, would likely be the greatest amount the trustee could distribute without abusing the trustee's discretion, as opposed to the minimum amount the trustee who was not the beneficiary would be required to make without abusing such discretion.

If the beneficiary was serving as sole trustee and the distribution standard was not an external standard, a spendthrift clause would not provide any protection in any event, because the trustee/beneficiary would in effect have a general power of appointment exercisable by the beneficiary's creditors or a trustee in bankruptcy. However, even if the distribution standard was an external standard, at common law there is at least some risk that even with a spendthrift clause a court would consider such external distribution standard similarly as a property right, such that the creditor could reach, or compel, a distribution, unaffected by a spendthrift clause up to the amount the trustee/beneficiary could have distributed to himself or herself without abusing such discretion. Indeed, the *Restatement (Third) of Trusts,* section 60, comment g at p. 412 has taken just such liberal view on this issue, far beyond what most courts (other than a few isolated court decisions, mostly involving bankruptcy situations) have concluded to date was reachable in this situation. It remains to be seen if a significant number of additional courts will adopt this position.

This situation of exposure of the trust estate to a creditor claim of a beneficiary markedly changes with a blended trust. Due to having multiple beneficiaries, assuming each has a relatively equal beneficial interest in trust distributions, the lack of a definable interest in any one beneficiary normally in and of itself establishes proof of lack of assignability. This typically prevents a creditor from attaching a beneficiary's interest in a blended trust, even if there is no spendthrift clause, for such beneficiary's beneficial interest in the trust estate would be indeterminable. Likewise, this lack of a definable interest, coupled with trustee discretion, makes it extremely difficult for creditors or purported assignees to compel a trust distribution. *Bogert's The Law of Trusts and Trustees* § 230 (June 2018 Update). If the trust provisions give the trustee discretion to exclude any particular beneficiary from a trust distribution, it is considered proof of a restriction on any voluntary or involuntary alienation of the beneficiary's interest for the same reasons as exist in a pure discretionary trust. *Id.* In other circumstances, irrespective of whether the courts have viewed the interest of any one beneficiary as either not being distinct enough to permit its alienation or that the trust is owned collectively by the class and thus only the class can alienate it for class debts, the judicial outcome has been that neither a voluntary alienee nor a creditor of one member of the class may compel the trustee to pay over to the creditor any income or principal. *Id.*

As discussed above, the *Restatement (Third) of Trusts,* as well as the Kansas Uniform Trust Code, has abandoned the adherence to a bright line distinction between support and discretionary trusts. Instead, it views as a continuum the differences between pure discretionary and pure support trusts, with varying degrees of discretion to be accorded to the trustee dependent upon the intent of the settlor as gleaned first from the provisions of the trust instrument and secondarily from parol evidence in the event such provisions are ambiguous, which would quite frequently be occasioned.

Much of the opprobrium regarding the *Third Restatement's* continuum position on hybrid trusts has been directed at its Comments, which some commentators assert materially change the position of Section 187, comment j, of the *Second Restatement.* This *Second Restatement* comment provides that provisions of a trust may evince an intent that the trustee's discretion need not be exercised reasonably, such as by including the words "absolute," "unlimited" or "uncontrolled" in describing such discretion. Such commentators are concerned, if not alarmed, from both an emphasis on the perspective of a beneficiary rather than the settlor, as well as from a creditor protection standpoint, that should a court adopt the *Third Restatement* position, the comments to the *Third Restatement* may require a finding of reasonableness regarding all trustee distribution decisions and thereby not only confer enforceable rights in beneficiaries that heretofore did not exist, but also such rights would thereby extend a creditor's ability to reach such beneficial interest.

Whether such fears are merited requires a careful analysis of the Comments to the *Third Restatement* that such commentators find most objectionable. Comment e to § 60 of the *Third Restatement* provides that a creditor of a beneficiary may not compel a trust distribution if the beneficiary/debtor could not compel such distribution. It goes on to state that "It is rare, however, that the beneficiary's circumstances, the terms of the discretionary power and the purposes of the trust would leave a beneficiary so powerless." The Comment on Section (2): d of § 50 of the *Third Restatement* states that "Reasonably definite or objective standards serve to assure a beneficiary some minimum level of benefits, even when other standards are included to grant broad latitude with respect to additional benefits."

Most important to such concerns, however, is the Comment on Subsection (1): b, § 50, which provides that "It is not necessary, however, that the terms of the trust provide specific standards in order for the trustee's good-faith discretion to be found unreasonable and thus constitute an abuse of discretion. . . . a general standard of reasonableness or at least good-faith judgment will apply to the trustee . . . based on the extent of the trustee's discretion, the various beneficial interests created, the beneficiaries' circumstances and relationships to the settlor, and the general purposes of the trust." In short, even in a pure discretionary trust that has no standard, at least a "good-faith" requirement is imposed on the trustee by the *Third Restatement* position as indicated in its Comments.

Due to the *Roenne* decision and the related provisions of the Kansas Uniform Trust Code discussed above, adoption of the *Third Restatement* common law position presents at least some concern in the concomitant expanded rights of beneficiaries to compel a distribution in hybrid and discretionary trusts. To be sure, attempting to discern the intent of the settlor, particularly in the face of the ubiquity of imprecise drafting, has always been the central focus of the courts. Moreover, few settlors would probably have intended that a trustee could leave a beneficiary of a hybrid trust providing for distributions for support destitute with no legal remedy, despite the discretionary language in the trust instrument. The *Restatement* authors were correct in commenting, with the bracketed words inserted, that "It is rare, however, that the beneficiary's circumstances, the terms of the discretionary power, and the purposes of the trust [were intended to] leave the beneficiary so powerless."

As concluded trenchantly some 75 years ago by Judge Learned Hand, no trust language, however strong, can entirely remove a power held in trust from judicial review; otherwise "the power would not be held in trust at all." *Stix v. Commissioner,* 152 F.2d 562, 563 [34 AFTR 611] (2d Cir. 1945). Such authority reposed in a trustee would otherwise be tantamount to a power of appointment. As stated in General Comment *a* to §50 of the *Third Restatement (Trusts)*:

> "A trustee's discretionary power with respect to trust benefits is to be distinguished from a power of appointment. The latter is not subject to fiduciary obligations and may be exercised within the scope of the power...(Tax law generally does not categorize powers in this manner, and even traditional property-law distinctions between fiduciary powers and powers of appointment may be difficult to draw; this is especially so because a true power of appointment can be conferred upon one who is also a trustee, although a power that runs with the office of trustee is strongly presumed to be a fiduciary power.)"

However, as such the differences between the *Second Restatement* and *Third Restatement* positions with respect to the degree of discretion afforded a trustee in a pure discretionary trust, or in a hybrid trust determined to be a discretionary trust under the *Second Restatement* with respect to distributions under a support standard, would appear to be at the margins with respect to the degree of such discretion to be accorded a trustee. The *Second Restatement* would afford the trustee broad discretion only marginally, and at times perhaps indecipherably, less than that accorded a holder of a power of appointment. Hence, the aforementioned decisions concluding, as most particularly evident in governmental resource contexts, that a beneficiary cannot compel a distribution from such trusts under such standard, precluding the trust estate from being a disqualifying resource for governmental benefits such as Medicaid.

The *Third Restatement,* on the other hand, presents a much more circumspect perspective at the cost of venturing into a factual and legal quagmire in attempting to ascertain where in such continuum between support trusts and discretionary trusts the settlor, despite the palpable lack of clarity and specificity in the subject language, really intended for a given trust to fall. This would appear to lean more toward a support trust in hybrid trusts having discretionary language with a support standard. Moreover, such "reasonableness" standard would also appear to be a more expansive standard than the above-noted "good faith" standard of the KUTC, albeit an unreasonable position under Kansas law, could be considered to be so arbitrary so as to not be in "good faith."

Although the *Third Restatement* authors are adopting the position of a small minority of states (e.g., Ohio, Pennsylvania and Connecticut) that have adopted a "good faith" or "reasonableness" standard with respect to the exercise of discretionary authority in a hybrid trust or discretionary trust not tied to a standard, the authors believe such position was adopted at least in part to "bail out" the probable true intent of settlors whose estate planning attorneys frequently fall into the pitfall of relying on imprecise drafting in lieu of delineating more precisely their client's intent and employing overly broad discretionary language in the pursuit of flexibility.

Even under such *Third Restatement* position, in the quite uncommon situation where untrammeled discretion was nonetheless desired by a settlor, precise drafting should still be able to create a pure discretionary trust with absolute discretion as to distributions, even where distributions are tied to a support standard in a hybrid trust context. This would be effectuated by specifically removing any "good faith" or "reasonableness" requirement regarding the trustee's discretion irrespective of the circumstances of the beneficiaries, their need for such distribution, or the condition in which they could be left in the absence of such distribution. It would be underscored by also clearly evincing an intent that such authority may be exercised or not exercised unbridled by any fiduciary responsibilities. In doing so, the trustee, although possessed of other fiduciary duties with respect to other aspects of the management of the trust, such as investments, should thus possess unfettered discretion in the nature of a power of appointment with respect to trust distributions.

However, by bringing such issue to the fore with clients, one would expect most clients to eschew the incorporation of such unbridled verbiage as not being consistent with their true intent. As the *Third Restatement* acknowledges, such intent of a settlor to leave a beneficiary without remedy in such situation, particularly with respect to hybrid trusts, would be a rare intended circumstance. Nonetheless, it certainly does not preclude such a result, albeit normally highly inadvisable, in quite unusual circumstances where such intent has been made abundantly clear, thus having converted such authority into the nature of a power of appointment exercisable sans any fiduciary constraints.

Whatever enforceable rights a beneficiary might have under a "good faith" standard as incorporated in the UTC and KUTC, or seemingly even stronger "reasonableness" standard under the *Third Restatement* position to be able to compel a distribution will nonetheless not be directly accessible by creditors in Kansas with respect to a trust having a valid spendthrift clause. Under provisions of the KUTC, Kansas eliminated any common law creditor exceptions to the efficacy of spendthrift clauses in protecting the trust estate from the claims of creditors of a beneficiary of a third-party trust. K.S.A. 58a-502.

Moreover, irrespective of whether a trust has a spendthrift clause precluding the attachment by a creditor of the beneficiary's beneficial interest in a trust, § 502(d) of the KUTC, as does § 504(a) of the UTC, provides protection against creditors being able to "stand in the shoes" of a beneficiary and compel distributions from a trust, a long mainstay under common law rights of creditors providing necessaries to a beneficiary. It does so by providing that where trust distributions are subject to the discretion of the trustee, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if the discretion is expressed in the form of a standard of distribution and the trustee has abused such discretion.

Kansas did not include the exception under § 504(c) of the UTC which permitted courts to order a distribution to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's spouse, former spouse or child up to the amount that the beneficiary could compel the trustee to distribute if the trustee had not complied with the standard or had abused the trustee's discretion. Such exception in the UTC was consistent with § 503 of the UTC, which excluded such judgments or court orders from being protected by a spendthrift clause, along with federal or state claims, none of which the KUTC incorporated. Nonetheless, claims under federal law would still preempt any lack of such exception under state law.

Section 504(a) of the UTC further provided that if the trustee's or co-trustee's discretion to make distributions for the trustee's or co-trustee's own benefit is limited by a standard, a creditor may not reach or compel distribution of the beneficial interest in the trust of such fiduciary except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as a trustee or co-trustee (i.e., the exceptions under § 504(c) of the UTC would be applicable). Kansas also did not incorporate such provision in the KUTC, thus providing no exceptions to its import.

Because the provisions of the UTC expressly provide under § 106 that it is to be supplemented by common law to the extent not inconsistent with its provisions, the Commissioners were concerned that because the UTC provisions did not specifically address the situation of a beneficiary serving as trustee or co-trustee of a trust having an ascertainable or external standard, a court's adoption of the position of the *Third Restatement (Trusts)* could vitiate such asset protection. If that occurred, a court could consider such external distribution standard as a property right, similar to a mandatory trust distribution, such that the creditor could reach, or compel, a distribution, unaffected by a spendthrift clause up to the amount the trustee/beneficiary could have distributed to himself or herself without abusing such discretion.

Section 504(e) was thus added by the Uniform Commissioners to the UTC in 2004 to ensure that any common law adoption of such *Restatement* position could not "preempt" the provisions of § 504(b) in the circumstance where a beneficiary was serving as co-trustee or sole trustee of a trust that authorized the trustee to make distributions for the beneficiary's health, education, support and/or maintenance. Such provision states that a creditor of a beneficiary in that situation cannot compel a distribution, or otherwise reach, such beneficiary's beneficial interest in that situation unless such interest could otherwise have been reached in the absence of a beneficiary serving as trustee. The Comments of the Uniform Commissioners to this Section specifically provide that to the extent the assets of the trust estate would not be includible in the beneficiary/trustee's estate due to the distribution provisions being subject to an ascertainable standard, the creditors of the beneficiary cannot compel the trustee to make any distribution of the trust estate for the benefit of the creditor (unless such creditor fell within the exception under § 504(c), exceptions which were excluded in the KUTC).

Kansas under the KUTC had a similar concern as to the effect of the *Restatement (Third) of Trusts* position in such situation where a beneficiary was serving as a sole trustee of a trust having an external standard of distribution, because the KUTC in K.S.A. 58a-106 incorporated the provisions of § 106 of the UTC. In 2014, heeding such concerns, the Kansas legislature amended K.S.A. 58a-502 in a more comprehensive manner than did the UTC amendment, providing in relevant part:

> "(d) Except as provided in subsection (e), irrespective of whether the trust has a spendthrift provision, a creditor of a beneficiary may not compel a distribution to a beneficiary that is subject to the trustee's discretion, even if: (1) The standard of distribution is expressed in the form of a standard; and (2) the trustee has abused the trustee's discretion.
>
> (e) If a beneficiary is or was serving as sole trustee and the standard of distribution with respect to such beneficiary is not in the form of an ascertainable standard relating to such beneficiary's health, education, support or maintenance, a creditor shall have the right to: (1) Compel any distribution the beneficiary, while serving as sole trustee, either is

presently authorized to make to such beneficiary or was authorized to make to such beneficiary and did not make; and (2) attach such beneficiary's beneficial interest in the trust with respect to any present or future discretionary distributions to such beneficiary, in the absence of a spendthrift provision precluding such attachment."

Thus, there should be full creditor protection in Kansas against a creditor's attachment of a beneficiary's beneficial interest in the trust estate (except for claims under superseding federal law, e.g., a federal income tax liability of a beneficiary due to federal law superseding state law) if the trust is a "blended trust" or the trust has a spendthrift clause, with the latter being the more certain protective situation. Moreover, a creditor should not be able to do an "end around" a spendthrift clause and stand in the shoes of a beneficiary so as to be able to compel a distribution to a beneficiary who could otherwise have either compelled such distribution or made such distribution to such beneficiary while serving as sole trustee, if the trustee has discretion to make a distribution, even if the distribution is in the form of a standard, unless the beneficiary is, or was, serving as sole trustee and the distribution was not related to an ascertainable standard relating to such beneficiary's health, education, maintenance or support of such beneficiary. *See,* in this regard *In re Skubitz*, No. 12-11544-7, 2014 WL 222103, at *6 (Bankr. D. Kan. Jan. 21, 2014), stating that "like the model Uniform Trust Code, the Kansas UTC has adopted the view that so long as a trustee-beneficiary's power to make discretionary distributions to himself or herself is limited by an ascertainable standard (as defined for purposes of § 2041(b)(1)(A) and 2514(c)(1) of the Internal Revenue Code), the trustee-beneficiary's creditors cannot reach the trustee's beneficial interest in the trust, rejecting the contrary result proposed by the Restatement (Third) of Trusts § 60, Comment g, in that situation."

In short, beneficiaries should be able to serve as sole trustees of hybrid trusts in Kansas that have an ascertainable standard without compromising in any respect the asset protection that would otherwise have been afforded by having a third party serve in the same capacity. Moreover, the beneficiary as sole trustee would thereby have been given almost the same degree of control over the trust estate as would have been afforded by an outright distribution without having sacrificed such asset protection benefits from creditors or from spousal claims under the foregoing subsection. For example, such beneficiary/trustee can be given the authority to name or change successor trustees or name a co-trustee, make distributions for the health, education, maintenance and support of such trustee and such trustee's descendants, be given broad investment authority, and possess a limited power of appointment whereby the beneficiary may appoint the remaining trust estate to any persons or entities, usually excluding their estate or the creditors of their estate to ensure full creditor protection by removing any possibility, which does not appear to exist under current Kansas law, that such power might otherwise be exercised by a creditor of a beneficiary.

The foregoing discussion focuses on exposure of the trust estate to creditors of current beneficiaries. Before concluding such analysis, it is advisable to point out that exposure of remainder beneficiaries to creditor claims was always normally quite limited, even in the absence of a spendthrift clause. This is because such interests are often intertwined with other remainder beneficiaries (such as in a preceding sub-trust) so that they cannot be separately valued or are so remote or contingent that they cannot be sold at a price that is fair to both the creditor and beneficiary. In such situations, the courts have refused to permit such attachment. *Restatement (Second) of Trusts*, §§ 161, 162.

### 4. Spousal Claims

Third-party trusts can protect the beneficiary against the claim of a spouse in a marital dissolution proceeding and following death regarding forced inheritance rights. The absence of a general power of appointment or mandatory distribution right (such as a mandatory income distribution, which would be a property right vested in such beneficiary) would preclude any distribution of the trust estate other than for the beneficiary's health, education, maintenance and support needs, thereby precluding the trust estate from being available to satisfy a spousal claim in the event of a marital dissolution.

Such protection would be afforded because a court may not legally order the trustee of a third-party trust (i.e., a trust not created by the beneficiary) to make any distribution to a person that the trustee was legally prohibited from benefiting under the terms of the instrument. Moreover, following death the provisions of the Kansas Elective Share Act would normally preclude the claim of a decedent's surviving spouse to the trust estate, absent a general power of appointment in the trust estate being held by a decedent beneficiary. K.S.A. 59-6a205(a)(1).

However, this is not to say that in a marital dissolution proceeding a court may not consider the interest of a spouse in a trust estate in determining the division of the marital estate between the parties or the amount of alimony such beneficiary may be required to pay from such beneficiary's own assets or income.

## C. Considerations in Drafting Support (External Standard) Trusts

As is readily apparent from the foregoing discussion, the authors have little fondness for pure discretionary trusts in their broad sense in most circumstances. They provide insufficient indication of the settlor's intent, little if any protection for a beneficiary or remainder beneficiaries against the broad distribution whims of a trustee as to whether to make a distribution and can severely compromise asset protection goals. The resultant problems and consequences they present have been discussed above. Such deleterious consequences are for the most part the direct product of inattentive drafting with little aforethought

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## 1.Importance of Establishing Intent

It is thus advisable for the trust or testamentary trust instrument to specifically delineate the intent of the settlor in making trust distributions, as well as the circumstances meriting a distribution and the intended "needs" of the beneficiary to be satisfied by the trustee in making such distribution. Normally, the last factor relates to a beneficiary's health, education, maintenance, and support needs, often referenced as an "ascertainable standard" and more generally as constituting an "external standard" under the foregoing discussion. A trust having such distribution standards may also be collectively referred to as a "support trust."

Sometimes, such distribution purposes, as noted herein, are extended beyond an external standard to other purposes, such as for vacations and recreational and artistic activities. Often such expanded purposes are only applicable after a beneficiary reaches retirement age, and usually such authority is only exercisable by an independent trustee who is not a beneficiary so as to avoid such authority being considered a general power of appointment for both estate tax and creditor exposure purposes if held by a beneficiary as sole trustee.

The discussion below addresses the specificity required to adequately address such factors under an external standard.

## 2. Defining Distribution Standards

In reciting such standard, it is also quite helpful to include a definition of each standard under the definitional section of the trust instrument. This avoids issues in interpretation on the periphery of such standard. For example, does the term "education" include technical schools or private high schools? Is it to be construed as limited to only the cost of a public school education if the trustee determines a more expensive private school education carries with it a significant risk that insufficient assets many remain for later needs of the beneficiary or for educational or other needs of other beneficiaries in a blended trust? Do health needs encompass cosmetic surgery unrelated to an injury, disease or disfigurement? Can a beneficiary be a "professional student" so as to be able to "live off" a trust indefinitely without making meaningful progress toward a usable degree? Examples of such definitions addressing the foregoing questions and other issues presented in the absence of a definition are included in Appendix A. The reader will quickly note that the definitions of "maintenance" and "support" are identical, for under case law they are given virtually indistinguishable interpretations. *In re Brooks*, No. 314619, 2014 WL 5408695, at *4 (Mich. Ct. App. Oct. 23, 2014); *Estate of Nunn*, 10 Cal. 3d 799, 806, 518 P.2d 1151, 1155 (1974); *In re Wells' Will*, 165 Misc. 385, 388, 300 N.Y.S. 1075, 1078 (Sur. 1937).

Until adult beneficiaries reach a more mature age, say age 30, clients often desire that distributions for support and maintenance (as opposed to distributions for health and education) be conservatively construed, e.g., to provide only for the "barest necessities of life, irrespective of the standard of living to which such beneficiary may be accustomed, perhaps until thirty (30) years of age, or at another age when the beneficiary is eligible to serve as sole trustee. The goal thereof, which it is important to state in the trust terms is to establish the intent of the settlor, is normally to not adversely impact such beneficiary's maturational development, personal ambition and financial independence, or possibly lead to a premature exhaustion of the trust estate."

### 3. Providing Distribution Factors to be taken into Consideration

In addition, such authority to make distributions is often intended by clients to be exercisable only after considering all other resources available to the beneficiary for the purposes of maximizing asset protection of the trust estate due to most other outside resources of a beneficiary normally being exposed to such claims. For similar reasons as noted above, clients typically desire to provide for conservative distributions to younger beneficiaries both to reduce the risk of a premature exhaustion of the trust estate and avoid stifling a beneficiary's personal ambition, financial independence and personal esteem in generating their own resources.

Such outside resources include the beneficiary's outside income and investment assets, insurance, governmental resources such as SSI or Medicaid, any other trust having available resources to such beneficiary, the obligation of a spouse or parent to support such beneficiary, another trust providing a similar beneficial interest for the beneficiary, and the ability of an adult beneficiary who is not caring for a minor or disabled child or an adult in need of care in the home, to engage in gainful employment prior to attainment of a specified age (which can be off-handedly termed a "W-2, "get a job" or "anti-trust fund baby" clause). That age is often the age at which a beneficiary may serve as their own trustee. Such considerations also may be specifically deemed to be only precatory in nature when a beneficiary is serving as sole trustee of such trust. An additional provision that the beneficiary can be compelled to provide information as to other resources that could satisfy the distribution standard, such as income tax returns and any financial statements, is also desirable. In the absence of responding to such a request, the trustee should then be allowed to consider such distribution standard to have been satisfiable by such other resources and thereby decline to make a distribution.

### 4. Establishing Priority Beneficiaries

Further, a blended trust should include priority provisions that delineate which current beneficiaries have priority in the event there are multiple current beneficiaries and insufficient trust assets to satisfy the current and reasonably anticipated future needs of all such beneficiaries. For example, with respect to a spousal beneficiary, such spousal needs are typically given priority over all other beneficiaries such as children, whether they be of both spouses or perhaps only the children of the predeceased spouse in a blended marriage. With respect to distributions to beneficiaries, normally preference is given to the beneficiary having the closest relationship to the settlor (e.g., a beneficiary over a descendant of such beneficiary). In any event, such priority should be clearly delineated to avoid controversy and its associated potential for family disharmony.

Regarding discretionary beneficiaries within the same class (e.g., children or grandchildren), a minor beneficiary is normally given priority over an adult beneficiary and a disabled child over a child having no disability. Finally, the trust instrument normally should provide, if such is the normal situation, that current beneficiaries are to be given priority over leaving any residual amount to remainder beneficiaries and that within the foregoing guidelines, if such is also the case, there is no requirement that discretionary distributions among multiple current beneficiaries necessarily be equal in amount, whether currently or on a cumulative basis. Nonetheless, if it is the settlor's intent that any distributions to a current beneficiary who is also a remainder beneficiary are to be considered an advancement against the share such remainder beneficiary is to receive upon termination of the trust, the trust instrument should so specify.

In terms of structuring such provisions in the trust instrument, it can be quite desirable to place all of the foregoing provisions addressing drafting considerations in an "Administrative Trust Provisions" Section or Article separate and apart from the actual trust provisions themselves. In that manner, the basic trust provisions can remain simple in their scope to enhance their "user friendliness" for trustees, beneficiaries and settlors.

For example, the basic trust provisions might simply provide that the trustee, in the trustee's discretion, shall distribute income and principal for the benefit of the beneficiary and the beneficiary's descendants, usually advisable to be in the form of an ascertainable standard for all of the reasons discussed above. Additional provisions then define and refine such provisions as to the foregoing factors and considerations desired by the client to be taken into account by the trustee in exercising such discretion. The goals behind such standards should also be stated in the trust instrument. For example, if the goal of a beneficiary not succeeding as sole trustee of a generation-skipping or GST Trust until a later age, say sixty, is to ensure that the beneficiary will have sufficient assets for retirement, no matter what circumstances the beneficiary might occasion that could otherwise result in its depletion if the trust estate was otherwise held outright, the instrument should so state, guiding the trustee and ensuring a beneficiary could not compel a distribution that would be in derogation of such goal.

By so doing such provisions also are multi-functional in applying to multiple trusts created under the trust instrument, thereby avoiding duplicative provisions under each separate trust created under the trust instrument. If there is to be any difference in their import as to separate trusts under the instrument, they can be so noted where appropriate.

It is important to keep in mind that the trustee is the settlor's surrogate. It is thus incumbent upon estate planning attorneys to inform clients that the trust provisions should be carefully crafted such that, as much as possible within the practical constraints of space and the English language, the trustee is not authorized to make any distributions that the settlor would not have made under the particular circumstances at hand, nor withhold any distribution that the settlor would have desired to be made in such situation. To aid clients in such determination, the authors frequently ask clients to assume they were still living, had more than sufficient resources, and a beneficiary, such as a child, was requesting funds for a particular purpose. The question then is under what circumstances would the parent comply and what questions would they ask in that regard. Examples can be given to clients in ferreting out such intent. The bottom line is that in the absence of clear, concise and comprehensive trust language evincing the settlor's intent in such situations, as above provided, there is a high risk that the trustee's decision would not mirror that of the settlor. Instead, when the beneficiary is not serving as trustee, the probability is that the settlor's intent will often not be fully carried out by the trustee, the beneficiary may not have an enforceable right with respect to ensuring such intent is effectuated, there may be significant disagreements between the trustee and beneficiary as to the settlor's intent, and the trust administration and legal expenses of the trustee and beneficiary may be dramatically increased as a consequence.

The parol evidence rule is likely to preclude divining such intent outside the confines of the instrument. In addition to the detriment of its additional administrative costs in its presentation, the parol evidence rule normally precludes the introduction of any extrinsic evidence as to the settlor's intent in the absence of an ambiguity in the trust instrument as to such intent. *McGinley v. Bank of America,* 279 Kan. 426, 440, 109 P.3d 1146 (2005); *Hemphill v. Shore*, 295 Kan. 1110, 1118, 289 P.3d 1173 (2012). This rule is one of judicial efficiency. Otherwise, almost every trust instrument would be prone to a judicial challenge as to the intent of the settlor by introducing extrinsic evidence as to such intent in a particular instance.

In essence, a court is unlikely to construe the intent of the settlor based upon evidence outside of the provisions of the trust instrument in the absence of an ambiguity as to such intent. *Id.* Moreover, having to glean such intent through parol evidence can be quite expensive. Similarly, in the absence of trust provisions that clearly state the trustee is to consider such factors, a court is unlikely to consider the priority of beneficiaries or assume a support and maintenance distribution standard is other than perhaps the standard of living to which the beneficiary was accustomed.

Nor would a trustee likely be required to consider outside resources, or perhaps even be able to, in making trust distributions in the absence of a trust provision addressing the issue. Such resources should be delineated with specificity, including other assets outside the trust which are available to the beneficiary to satisfy such distribution standard, such as income or other assets of the beneficiary, insurance, governmental benefits, support obligations of a spouse or parent to support such beneficiary, and the ability of an adult beneficiary to engage in gainful employment up to a certain age when not attending an educational institution full-time or attending to a minor child or disabled child or adult relative in need of care. Finally, it is also advisable to include a provision mandating a beneficiary provide relevant evidence of such outside resources, such as income tax returns, financial statements, or assets in other trusts in which such beneficiary is also a beneficiary, when requested by a trustee prior to the trustee being otherwise being required to make a discretionary distribution in consideration of such resources.

## 5. Refining Terminology as to Trustee Discretion

If the discretion of the trustee is to be subject to judicially imposed restrictions and requirements (so as to provide an enforceable right in a beneficiary to compel a distribution), the instrument should clearly so provide. Thus, if the distribution standard is intended to be "in the trustee's discretion" but is not intended to be plenary in nature, the trust instrument should thus indicate. Although most clients desire to give the trustee some discretion with regard to the circumstances that require a distribution, as well as the amount of a distribution, such authority is normally meant to be far from its unfettered nature under a pure discretionary trust.

Thus, in order to ensure that the administration of the trust conforms to the settlor's intent with the inclusion of such discretionary language, it might be desirable that the following provision, or a provision of similar import, be considered for inclusion in the trust instrument:

> Trustee's Discretionary Authority Regarding Trust Distributions. Under the provisions of this Trust Agreement, I have both authorized and provided for the Trustee to make trust distributions for the health, education, maintenance and support needs of trust beneficiaries. To the extent such distributions are made subject to additional qualifying language, such as "in the trustee's discretion" or in amounts the Trustee "determines to be necessary or advisable," unless a beneficiary who is then entitled to priority as to discretionary distributions is serving as a Trustee and such discretionary authority relates to such Trustee/beneficiary's descendants, or a beneficiary who is otherwise qualified to receive governmental benefits such as Medicaid and SSI is not serving as a Trustee and such interpretation (as provided herein) is necessary for such beneficiary to qualify for such governmental benefits, it is not my intent by the inclusion of such qualifying language to create a purely discretionary trust whereby the Trustee is unfettered by normally applicable fiduciary constraints and responsibilities regarding the Trustee's determination whether to make a distribution to a trust beneficiary pursuant to such distribution standard or the amount of such distribution, to be limited only in circumstances of dishonesty or bad faith.
>
> To the contrary, despite the inclusion of such qualifying language, the exercise of such Trustee authority shall be subject to reasonable fiduciary constraints and

principles. Nonetheless, it is not my intent that a court of competent jurisdiction shall be free to simply substitute its determination for that of the Trustee in the exercise of such authority. Rather, I intend by the inclusion of such qualifying language that the Trustee be afforded a reasonable degree of discretion regarding whether to exercise such authority, as well as the amounts to be distributed to a trust beneficiary in satisfaction of such distribution standard, such that a court of competent jurisdiction would not substitute its judgment for that of the Trustee unless the court has found that the admissible evidence demonstrates that there was an abuse of the exercise or non-exercise of such Trustee's discretionary authority such that the Trustee's action or inaction in that regard was clearly unreasonable (i.e., beyond the realm of reasonable debate) or arbitrary after applying the applicable distribution standard, the beneficiary's circumstances, and all other provisions of this Trust Agreement which are intended to impact such Trustee determination.

It is important that the foregoing provisions should normally limit the trustee's discretion by providing distributions solely for health, education, maintenance and support needs, although they might provide for more extended specific purposes, such as vacations or down payment on a residence when a third party is serving as trustee. It does so due to such standards being "ascertainable" both in an estate tax context and from a creditor protection standpoint should the beneficiary be serving as sole trustee. Such terms have defined "need based" judicial meanings and limitations (although the trust instrument can also further refine or expand them as the settlor may desire). Broader distribution standards such as "happiness" or "comfort" (the latter if not related in the trust instrument to a certain standard of living) have no such limitations and go beyond needs, typically allowing too much discretion in a trustee even when a third party is serving in such capacity.

Consequently, the integrity of the settlor's intent would be compromised in the vast majority of situations if the discretion of the trustee was not limited in terms to making distributions under an ascertainable standard, for not only could distributions be made to beneficiaries beyond what most settlors would desire, but depending upon the degree of discretion and purposes for which a distribution could be made, the beneficiary could arguably either be without any legal redress in a situation in which the settlor would have desired a distribution be made or be able to compel a distribution to satisfy such much broader standard which the settlor would not have desired. More importantly, it also could be fatal to asset protection if the beneficiary is serving as sole trustee, for such broad authority would likely constitute a general power of appointment exercisable by a creditor or trustee in bankruptcy. K.S.A. 58a-505(a)(1); 11 U.S.C. § 541. In any event, for such reasons and the fact that a health, education, maintenance and support standard in and of itself is normally sufficient to cover almost any conceivable living need that might present itself to a beneficiary, as a general rule distributions in trust instruments are normally limited to such standard, most particularly when a beneficiary is serving as sole trustee.

Obviously, in circumstances where a beneficiary is to serve as sole trustee (normally when the beneficiary has reached an expected age of maturity and self-sufficiency), the trust provisions, while still according asset protection benefits, do not protect the beneficiary from imprudent decision-making, including not giving proper deference to them in its administration. Nonetheless, it would be hoped that such trustee/beneficiary would adhere to them. As noted above, such circumstance is typically one in which the settlor's sole purpose is protecting the beneficiary from third party claims, not protecting the beneficiary from their own injudicious behavior. Such provisions would nonetheless have import in guiding the administrative parameters of any successor third-party trustee who might serve in the event of a disability of the trustee/beneficiary or following the death of such beneficiary with respect to distributions to other beneficiaries in a successor trust in receipt of the trust estate.

*Hypothetical Examples*

In light of the foregoing, the following hypotheticals examine some alternatives an attorney may want to consider in drafting trusts where potential creditor, Medicaid, or other competing interests may be present.

**Hypothetical #1 – Mary**

Mary, a widow, lives in Wichita and has two children. Both are adults in their thirties. Although having led an admirable life in all other respects, her first-born child, Jack, could be said to be "unlucky in love." His current marriage, his second, has been rocky, as was his first, which ended in divorce. Jack has one son, Jordan, age 16. Mary's other child, Susan, has severe health issues, has limited capacity, is in need of financial management, and, due to her physical health, is at risk of needing assistance from Medicaid or other government programs at some point. Susan is not married and has no children. Mary has been diagnosed with terminal cancer and likely does not have long to live.

Let's first consider Jack's situation. Because a divorce is pending, Mary is going to want to ensure that Jack's share will not be subject to division by the court. This means she will want to require Jack's share to be held in trust for his benefit and not distributed to him outright, for such purposes and also to protect him from creditors. Mary also may want to allow the trustee of Jack's trust share to make distributions for the benefit of her grandson, Jordan. Mary also knows that Jack may need to purchase a different home should his wife be awarded their current residence as part of any divorce proceeding. Provided such objectives can be met, Mary prefers Jack serve as his own trustee of his equal share of her trust estate following her death.

In order to provide both for protection of Jack's share from his soon to be ex-wife, to allow Jack to purchase a different home after the divorce is final, and to allow distributions to be made for the benefit of Jordan without any exposure to Jack's creditors or any spousal statutory or elective share right, Mary may want to consider the following language following her death concerning distributions from Jack's trust share:

> Trust Share for my son, Jack. The Trust share set apart for my son, Jack, shall be held for his lifetime by the Trustee for the following uses and purposes:
>
> "1. Discretionary Distributions During Trust Term. The Trustee shall expend so much of the income and principal of said share for the benefit of my son and my son's descendants, without regard to equalization, as the Trustee, in the Trustee's discretion, deems necessary or advisable for the health, education, support and maintenance of such beneficiaries. The primary purpose of such Trust created for my son Jack is to provide for him, and the Trustee is to satisfy the distribution standards with respect to Jack prior to making any discretionary distribution to his descendants. Discretion on the part of the Trustee to provide for the support and maintenance of Jack shall include authority to permit Jack to acquire, enlarge, improve, or refurbish any residence occupied or to be occupied by him and/or his family."

This distribution standard , accompanied by a spendthrift clause, ensures that distributions can be made for Jack and Jordan, and it protects the trust assets from division in the divorce proceeding as well as to protect the trust estate from any potential creditors of Jack or Jordan. As noted above, under provisions of the Kansas Uniform Trust Code discussed above, under such ascertainable distribution standard, Jack should be able to serve as his own trustee without jeopardizing the above-discussed asset protection benefits: provided, however, it would be desirable for the trust provisions to preclude Jack from otherwise serving as trustee at any time he might otherwise be eligible for Medicaid or any other government resource.

As noted in the prior text, it is usually more desirable to make the ancillary considerations in making a trust distribution global in nature in a "Trust Administration Provisions" Article applicable to all sub-trusts created under the instrument, rather than each specific trust . As also discussed above, such provision would specify such factors as the priority of beneficiaries with respect to distributions , the consideration of other resources with specificity to be taken into consideration prior to making trust distributions, the exactitude of the conservative nature of support and maintenance distributions to adult beneficiaries prior to their attainment of a certain age, the preference of current beneficiaries over remainder beneficiaries, whether distributions to the settlor's descendants might also be treated as advancements against their remainder shares, and the construction to be given to the discretionary language relating to the trustee, such as conservative construction for maintenance and support needs prior to the attainment of a certain age, such as possibly for Jordan.

With Susan's situation, Mary desires to ensure that the trust share created for her be held for her lifetime in a manner that does not disqualify her from receiving any future Medicaid or other government benefits such as SSI. But she also wants to make sure Susan has the opportunity to enjoy amenities that are not provided, or that she could not afford, using just such government benefits. Mary thus may want to consider the following language concerning distributions from Susan's trust share:

> <u>Trust Share for my daughter, Susan</u>. The Trust share so set apart for my daughter, Susan, shall be held in trust for her benefit and managed, distributed, and disposed of by the Trustee for the following uses and purposes:
>
> During and throughout the continuation of this Trust, the Trustee shall pay, in the Trustee's discretion, so much of the net income and principal thereof to or for the benefit of Susan, at such time or times, however frequently, or infrequently, as the Trustee, in the Trustee's discretion, shall deem advisable and for the best interest of Susan, or, in the discretion of the Trustee, all or any portion of the net income otherwise payable to or for the benefit of Susan may be withheld, retained, accumulated, and added to the principal of the Trust, hereby vesting Trustee with discretion to determine whether and when to make any such invasion and distribution. It is my intention to create a supplemental fund for the benefit of Susan and not to displace any assistance that might otherwise be available to her from any government or private agency source.
>
> In no event shall the Trustee make any distribution to or for the benefit of Susan if the effect of the distribution is to disqualify her from receiving federal, state or other governmental assistance or assistance from any private agency which has a legal obligation to provide services or other assistance to her. Distributions to or for the benefit of Susan shall be limited to providing for her special needs which are not otherwise satisfied by any governmental or private agency program, including but not limited to SSI and Medicaid. No distribution shall be made to provide basic food, clothing and shelter, or be available to Susan for conversion to such items, unless all government benefits for which she is eligible, if any, have been applied to those purposes and have been exhausted, or are not otherwise available.
>
> Such supplemental distributions may include, by way of description but not by way of limitation, spending money, differentials in cost between housing and shelter or shared and private rooms (and, in this connection, it is of paramount importance to me that my daughter be permitted to occupy a private room (in any facility in which she may be a resident) should she wish to do so and if the resources of her Trust are adequate in the judgment of the Trustee to pay for such private room), dental care,

supplemental nursing care and other health services not provided, sophisticated or experimental medical diagnostic work or treatment (including non-medically necessary procedures), programs of non-rehabilitative and private rehabilitative training where government assistance programs are not available or are insufficient, travel, vacations, outings and other recreation (including necessary or desirable companions), cultural and entertainment experiences (such as athletic activities, camping, contests, movies, plays, musicals, and symphonies); entertainment and communication equipment and services (such as computers, radios, mp3 players and the like, television sets, cable, satellite or streaming television or video services, DVRs, and mobile or landline telephones), and motor vehicles and other transportation devices, including those modified to accommodate any disability or condition of Susan.

I direct the Trustee to assist Susan in obtaining the full benefit of all governmental assistance programs, including any costs related thereto. I further direct the Trustee to collect, expend and account separately for all such governmental assistance benefits, but not commingle them with these trust funds.

No part of the Trust shall be used to supplant or replace benefits due from any insurance carrier under any insurance policy covering Susan.

If the Trustee decides that the mere existence of this trust jeopardizes Susan's eligibility for federal, state or other governmental assistance, the Trustee, without any court approval or court involvement, may amend this Trust in any way the Trustee deems appropriate in furthering my intent to avoid jeopardizing Susan's eligibility. It is my specific intent that this trust for Susan be supplemental to public assistance benefits available to Susan, including but not limited to benefits from Medicaid, medical assistance or benefits available under Title XIX of the social security act.

In exercising discretion under the provisions of this Trust, it is my desire that the Trustee attempt to help Susan become self-sufficient but, inasmuch as that may not be practical or efficacious, that the Trustee consider the long-term needs of Susan and the possibility that it may be essential to preserve the trust assets to provide long-terms security for Susan.

The foregoing distribution standard assumes Susan will not be serving as a trustee. It should ensure that Susan will continue to receive the government benefits to which she is entitled, but it also will allow her to enjoy comforts that would not otherwise be provided to her by such government benefits. It is important to note that the term "sole and absolute" discretion is not employed in such distribution standard. As discussed above, the applicable Kansas statutory law, K.S.A. 39-709(e)(3)(B), does not specifically require such language for such trust to be a "supplemental needs" trust. It only requires that distributions employ "discretionary language" in that regard and be supplemental to government resources.

The reason such broad discretionary language is not included is to not unnecessarily risk arbitrariness in the trustee's discretion. Inclusion of the above suggested boilerplate language relating to the degree of discretion to be accorded the trustee should provide the requisite tethering of such discretion. It also includes savings clauses that would broaden such discretion to a pure discretion should it be required to preclude the trust from being a resource for Medicaid or SSI benefits. This could occur should Kansas change its governing statute addressing such issue or should Mary reside in another state where such broader discretion is required for eligibility.

Finally, it should be noted that as any trust beneficiary may at some later time during the term of a trust (e.g., Jack's son during Jack's lifetime or if upon termination of the trust upon Jack's death the trust estate is left in a similar generation-skipping trust for his son) become disabled so as to otherwise qualify for governmental resource benefits absent the availability of assets left in trust for such beneficiary, it is advisable to place a standard boilerplate provision in the general trust administration provisions such as that included in the above discussion. Such provisions would provide that it is intended that distributions to be made "in the trustee's discretion" for a beneficiary are always to be supplemental to any governmental benefits, such as Medicaid or SSI. For family harmony reasons, Mary has decided upon naming a corporate successor trustee.

## Hypothetical #2 – Howard and Evelyn

Howard and Evelyn have been married for fourteen years. They are in their sixties. It's the second marriage for both. Howard's first wife died twenty years ago. He has adult children from his prior marriage and several grandchildren. Evelyn's first marriage ended in a divorce shortly before she and Howard married. Evelyn likewise has adult children from her prior marriage and many grandchildren. Although both have significant assets, Howard and Evelyn want to make sure the survivor of the two of them is able to continue to enjoy the same lifestyle they currently enjoy but realize that the survivor many not be able to sustain such standard of living for the remainder of their life strictly from their own resources. Thus, they desire to provide that their separate assets be left for the needs of the survivor, and only are to pass to their descendants upon the death of the survivor of them. They want to ensure that their assets not needed for the support needs of their surviving spouse pass to their children and grandchildren upon the death of their surviving spouse.

For purposes of this hypothetical, we will assume Howard's and Evelyn's estates are not subject to federal or state estate taxes and they have decided in favor of using revocable trusts. In order to give the trustee some direction regarding sometimes competing interests of the surviving spouse and the predeceased spouse's children and grandchildren, Howard and Evelyn may want to consider language such as the following in each of their respective revocable trusts:

> "Distributions to My Spouse and Issue. The Trustee shall pay to or for the benefit of my spouse so much of the income and principal of the Trust as the Trustee, in the Trustee's discretion, deems necessary or advisable to provide for the health, education, support, and maintenance of my spouse, taking into consideration any and all other resources available to my spouse for such purposes.[*Extensive itemization of such other resources to be considered would be listed in the trust administration provisions*] Although the primary purpose of this Trust is to provide for my spouse during my spouse's lifetime, provided my spouse's current needs are provided for and the Trustee deems there are sufficient remaining assets in the Trust to provide for the reasonably foreseeable future needs of my spouse, the Trustee may distribute so much of any remaining income of the Trust not so distributed to my spouse, to my children, on a per stirpes basis. As used herein, "support" and "maintenance" shall mean support and maintenance in reasonable comfort and in the accustomed manner of living with respect to my spouse."

As noted in this second hypothetical. As in the first, it is usually desirable to make the ancillary considerations in making a trust distribution global in nature in a "Trust Administration Provisions" Article applicable to all sub-trusts created under the instrument. As also discussed above, such provision would specify such factors as the priority of beneficiaries with respect to distributions , the consideration of other resources with specificity to be taken into consideration prior to making trust distributions, the exactitude of the conservative nature of support and maintenance distributions to adult beneficiaries (other than the settlor's spouse) prior to their attainment of a certain age, the preference of current beneficiaries over remainder beneficiaries, whether distributions to the settlor's descendants might also be treated as advancements against their remainder shares, and the construction to be given to the discretionary language relating to the trustee, such as conservative construction for maintenance and support needs prior to the attainment of a certain age.

The foregoing distribution standard states Howard's and Evelyn's primary intent of making sure the surviving spouse is able to continue to live in his or her accustomed manner of living, but it also leaves room for the trustee to provide trust income for their children, too, during the surviving spouse's lifetime. For family harmony and other considerations in this second marriage scenario, normally it would be advisable that neither Evelyn nor any of Howard's children be named to serve as sole trustee, although Evelyn could be named as a co-trustee. As an additional consideration, it is appropriate to consider a bonded third party, such as a bank or trust company, be named as sole trustee or co-trustee with the spouse both to ensure the integrity of the plan and minimize family disharmony as well as possibly including an *in terrorem* clause.

As a further consideration, it may be desirable given the protection such trusteeship affords for the non-spousal current and remainder beneficiaries be "defined out" as "qualified beneficiaries" who would otherwise, in the absence of a waiver in the trust instrument, be entitled to accountings or a copy of the trust instrument in its administration under provisions of the KUTC, as well as a copy of the trust instrument. To not do so could raise a substantial risk of family disharmony, both between the spouse and such other beneficiaries, as well as among such other beneficiaries, regarding trust distributions during the surviving spouse's lifetime prior to the termination of the trust, with its attendant often high cost in terms of administrative costs and legal fees. For administrative flexibility, the surviving spouse also could be given the right to discharge such third-party trustee and name another independent trustee (typically limited to another bonded corporate fiduciary as co-trustee with the surviving spouse or sole trustee, as the case may be. Upon the death of the surviving spouse, the remaining trust estate would be distributed to the predeceased spouse's descendants, either outright or in protective generation-skipping trusts.

In the event such foregoing strategy is adopted, it would additionally be desirable that the settlor include in the testamentary instrument, rather than strictly in a personal letter to be delivered to his children by the estate planning attorney or third party trustee following his death, noting, inter alia, the considerations that went into the estate plan, particularly family harmony being of paramount interest, as well as in a very broad non-specific, "broad brush "fashion the tenor of its provisions, e.g., protecting trust assets from the claims of creditors of the beneficiaries and ensuring the integrity of the estate plan. The letter to children could note there would not be any accountings to remainder beneficiaries due to the desire of such beneficiaries of same being more than offset by the increased risk of family disharmony in doing so, the integrity of the plan being protected by having an independent corporate co-trustee throughout the entirety of its administration.

## *Conclusion*

For the reasons discussed herein, and as appreciated by a substantial number of estate planning attorneys, mandatory distribution trusts should almost always be eschewed in achieving a client's estate planning goals. Similarly, pure discretionary trusts should also be avoided due to their typical lack of specificity as to intent and the overly expansive authority they tend to repose in the trustee, even in the wake of the *Roene* decision.

Consequently, the clear trend over the past several decades has been toward hybrid trusts. However, although drafting such trusts is unquestionably hazardous, practitioners are often not sufficiently appreciative of their complexities and risks. Without refinement in the degree of discretion to be accorded the trustee, the beneficiary may have little to no recourse as to capricious decisions of a trustee in the exercise of such discretion. Further, without substantial specification in the distribution standard and the considerations for the trust to cogitate in making trust distributions, not only will it be highly likely that the distributions a third party trustee chooses to make to a beneficiary will mirror those the settlor intended, but adequate asset protection benefits will likewise be absent, most particularly in the ability of a beneficiary to qualify for governmental resource benefits.

Without question, the words chosen for a distribution standard in a trust document have lasting impact. Other than possibly having a competent and responsible trustee conducive to family harmony, what could be more important in drafting a trust instrument than ensuring that the trust assets are distributed in a manner that comports with the intent of the settlor? Yet, often without sufficient aforethought as to the consequences, estate planning attorneys tend not only to use imprecise, overly broad and simplistic language with respect to the discretionary authority reposed in a trustee in satisfying a particular distribution standard, but also with respect to the standard of distribution and related factors to be considered by the trustee in making such distribution. Such factors include the priority of multiple beneficiaries in a single trust, the consideration to be given specific outside resources of a beneficiary in making trust distribution, and the interpretation to be given such distribution terms as support and maintenance based on age and situationally dependent circumstances.

Unfortunately, far too many trust instruments provide relatively untrammeled trustee discretion in making trust distributions, albeit often inadvertently, as well as a less than definitive distribution standard when applied to a beneficiary's particular situation, including priority of multiple beneficiaries, age considerations and the availability of other resources that could satisfy such distribution standard, not the least of which overlooked resource is the ability of a beneficiary to engage in gainful employment. Much of this lack of specificity is in the pursuit of the ostensibly laudable, but normally misdirected, goal of providing administrative flexibility.

Ironically, due to such drafting proclivity, in a high frequency of circumstances when the trustee is called upon to exercise discretion in making distributions, the settlor's intent is likely to be frequently thwarted by lack of definition. With little restriction on the exercise or non-exercise of the trustee's discretion and insufficient distribution guidelines, unless the subjective goals and values of the trustee coincidentally mirror those of the settlor in every important respect and the factors the trustee would consider in deciding to make a distribution and the amount thereof, it would be mere happenstance if the trustee's decision in any particular instance closely matched the decision the settlor would have made. Thus, practically speaking in a trust administration context, there may be only an ephemeral distinction that can be made between purely discretionary authority and arbitrary authority.

Concomitant with the decisions of the trustee regarding trust distributions frequently being inapposite with the desires of the settlor due to overly broad discretion in applying a distribution standard lacking in definition, is a resultant virtually unenforceable right of a beneficiary to compel a distribution that the settlor would have intended to be made. Typically, contentious disagreements arise in this context between the beneficiary or beneficiaries and the trustee, as well as among the beneficiaries themselves, as to the settlor's intent in any given circumstance accompanied by a cacophonous discord of significant administrative costs and attorneys' fees.

In short, the greater the discretion accorded a trustee and the broader the standard of distribution, not only is the intent of the settlor less likely to be realized, but also the greater degree of acrimony there is likely to be between the trustee and beneficiary, as well as the incurrence of attorney fees and administrative costs related thereto. See Appendix B illustrative of such inverse correlations.

To avoid such adverse dispositive consequences, the practice of inattentive or default drafting and the rather routine incorporation of generic and simplistic boilerplate distribution standards should be avoided. There is no substitute for estate planning attorneys devoting sufficient time with their clients to understand their philosophies, values and desires as they impact trust distribution standards. The trust instrument must then be drafted in a manner that best ensures that the client's intent is likely to be achieved in its operational phases.

At its essence, the trustee is the settlor's surrogate or proxy in the administration of the trust. Consequently, the phraseology in the support standard should be accompanied by, and made subject to, other trust provisions specific to the settlor outlining the considerations to be taken into account by the trustee in making a trust distribution (such as outside resources), the liberal or conservative nature of the support standard applicable to the beneficiaries usually attendant prior to attaining a specified age, the priority of distributions among multiple current beneficiaries, and whether any types of distributions to current beneficiaries should be considered as an advancement against their remainder share. Then, and only then, is the trustee likely to make trust distributions in the same manner the settlor would have made had the settlor instead been then serving as trustee.

Just as importantly as outlining in detail the standards and factors to be considered in making a trust distribution is determining the degree of discretion to be accorded the trustee in making such determinations under the provisions of the trust instrument. This normally means eschewing such words as "sole" or "absolute" relating to the trustee's discretionary authority in making distributions for the health, education, maintenance and support needs of a beneficiary. Moreover, the incorporation of terminology such as "the trustee is authorized to make" or "the trustee may," as opposed to "shall," should likewise be shunned, absent more refined language as to intent. Such language normally serves only to make the settlor's intent obtuse.

Nonetheless, the usage of the term "in the trustee's discretion" in a support trust is often desirable to overtly indicate, as well as acknowledge, the degree of flexibility and judgment to be accorded the trustee in making distributions which would otherwise left only as implicit as to the timing, amount, manner and degree under the standard. It also serves as protection for the trustee against overly demanding beneficiaries who frequently view their access to the trust estate as relatively unbridled entitlement as opposed to arising strictly out of the settlor's beneficence in defined circumstances. However, when such limited discretionary language is included with compulsory language, such a "shall," so as to make the trust a hybrid trust, it is important that the degree of such discretion be appropriately defined in the instrument such as with the inclusion of the above discussed provision. Otherwise, its interpretation would be left to the whim of the trustee, and if challenged, to a current Kansas judicial climate which is likely to continue to favor a broad degree of fiduciary discretion in construing such provisions in a hybrid trust, extending probably well beyond what most clients would have contemplated or intended.

In sum, infusing the aforementioned considerations into the estate planning process will avoid a trust being interpreted, in a hybrid trust context, as a pure discretionary trust in making of a distribution in the clear majority of circumstances where the settlor likely did not intend such result. It also provides a desired degree of substantive legal redress to current and remainder beneficiaries, which along with much more definitive guidelines regarding trust distributions, go a long way to ensure the trustee's administration of the trust will be consistent with the settlor's intent. It should also reduce legal fees in discerning the settlor's intent under inherently ambiguous, ill-defined or non-comprehensive distribution provisions, and avoid unnecessary discord between trustees and trust beneficiaries and related administrative costs that can arise in such circumstances

Perhaps just as gratifying to estate planning attorneys, thoroughness in discerning the client's dispositive intent and its incorporation in the trust provisions is also likely to give clients a much greater satisfaction with both the attorney's expertise and comprehensiveness of the plan, as well as an appreciation of the substantial value-added component it brings to the integrity of their estate plans.

As a final note, the discussion herein is not intended to diminish the possible role of Special Trustees and Trust Protectors in effectuating the settlor's intent through a trust amendment when necessary. To the contrary, outlining the purposes of the trust assists such appointed parties in making the proper amendment in furtherance thereof. However, it is important that such parties be described as acting as fiduciaries in that regard. Otherwise, their authority may be deemed to be in the nature of holders of powers of appointment, removed from judicial constraints. Concerns as to their personal liability in doing so can be mollified through waivers of liability for good faith decisions. Expanding enunciation of such trust purposes also would confirm actions taken by them for such delineated purposes were made in good faith.

## APPENDIX A

**Health.** With respect to discretionary payments for "health," such term shall mean all expenditures the Trustee deems to be reasonably necessary to promote the soundness of the body and mind and ensure freedom from pain and sickness of the beneficiary, including but not limited to: psychological and psychiatric tests, treatment and counseling; medical costs related to operations and surgical procedures; physician office visits; prescription drugs; prescribed treatments for ailments, maladies and injuries; radiological, laboratory or other diagnostic procedures or tests; dental, orthodontic, and optical examinations and procedures, prescribed devices and prosthetics or cosmetic interventions of any kind when necessary due to disfigurement by disease, injury or congenital defects.

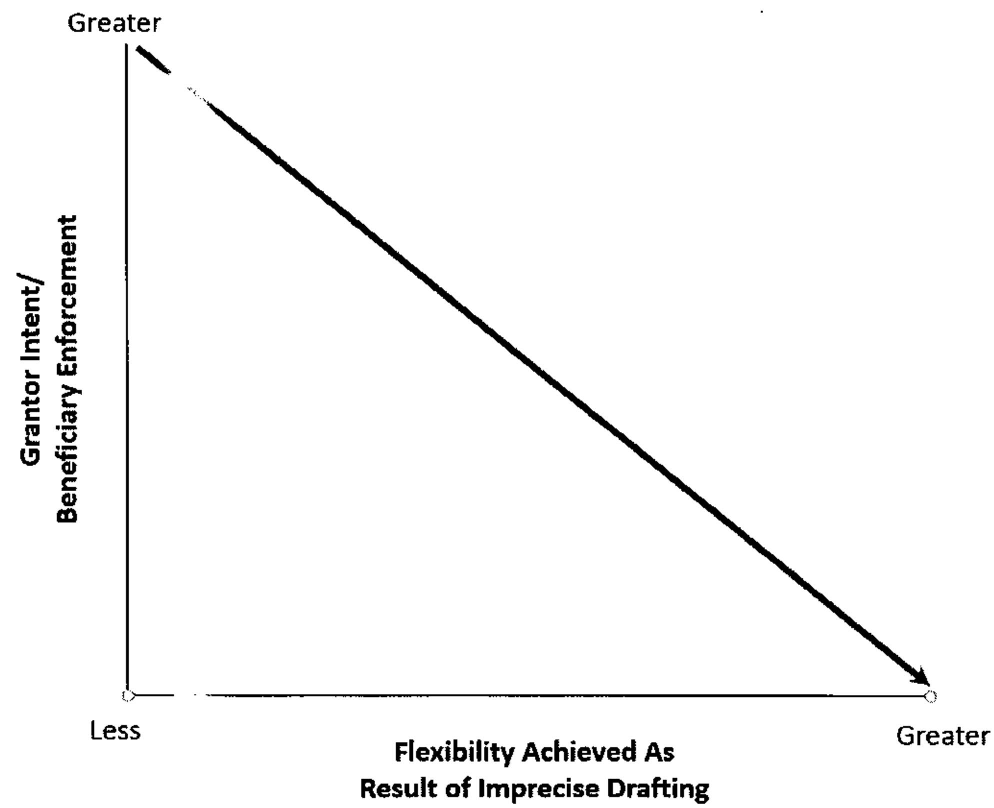
**Education.** The term "education" shall mean expenses related to attendance at any educational institution, including private grammar schools, private preparatory schools, colleges, universities, trade schools, graduate schools or professional schools, and shall include vocational apprenticeships, internships, and residencies, as well as all reasonable costs relating thereto, including tuition, fees, reasonable living expenses, reasonable travel expenses and the costs of books and equipment required by such educational institution. It is not my intent that the term "education" be interpreted to enable any beneficiary to be a "professional student," nor to allow a beneficiary to enroll in dubious internet, correspondence or other courses that are not in furtherance of an undergraduate or graduate degree or that would have no significant value in qualifying the beneficiary for a vocation.

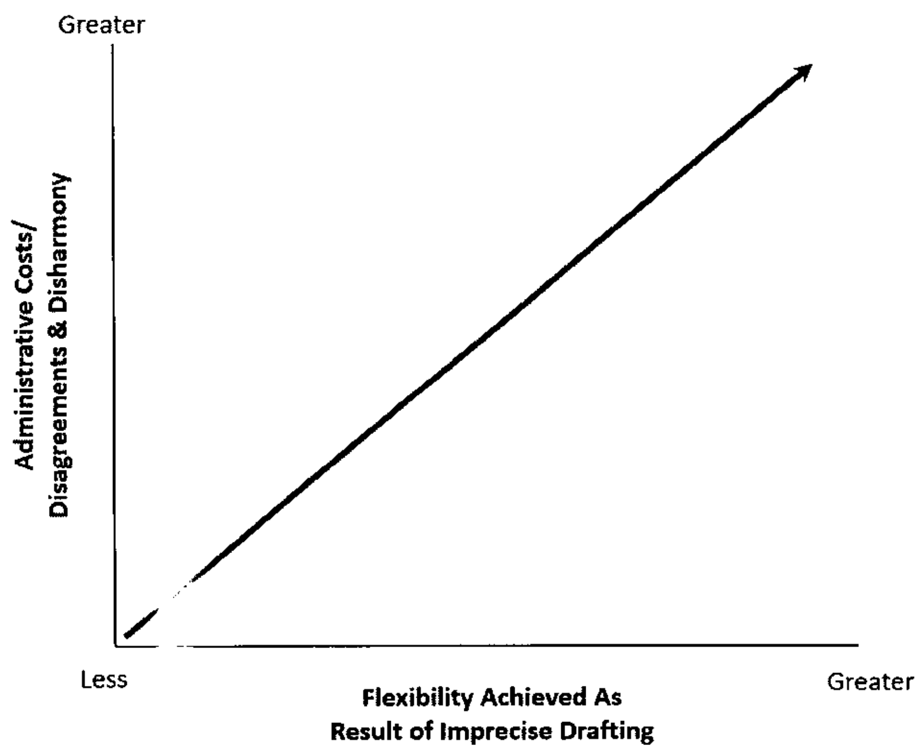
The Trustee may set limits on the payment to ensure the trust assets will provide each beneficiary of the same priority with a similar opportunity in attaining an education as defined above. For example, the Trustee may determine to make payments that match one dollar for each dollar the beneficiary contributes to such beneficiary's own education. For further example, the Trustee may determine to make payments to the same extent and in the same amounts as the Trustee would have made if such beneficiary were attending a university within the Kansas state regents system or a state university in any other state in which the beneficiary may be domiciled, based on in-state tuition, even though the beneficiary may choose to attend a private university, whether within the State of Kansas or a state university in any other state the beneficiary may be domiciled and entitled to in-state tuition, and require that the beneficiary bear the additional costs resulting from such beneficiary's attendance at such private university or college or out-of-state university from such beneficiary's own efforts and/or resources and that such additional costs not be reimbursed or paid by Trustee from the income or principal of this trust. Each beneficiary shall provide the Trustee with advance notice of the beneficiary's intent to enroll at any school or university to enable the Trustee to determine whether and to what extent payments will be made for such purpose, and to set the conditions or procedures for such payments, such as, for example, paying expenses directly to the provider. Notwithstanding the foregoing, the Trustee may refuse to pay or reimburse any beneficiary for small costs or expenditures, including without limitation, parking passes, stationery, notebooks, pens, pencils, etc., and may require the beneficiary to submit all requests for payments on or before certain periodic dates to reduce the administrative burdens on the Trustee.

**Maintenance**. The term "maintenance" shall mean those expenses reasonably necessary for subsistence and means of living, including, but not necessarily limited to: housing; household expenses, including utilities, insurance and taxes; food, hydration and other sustenance of the body; cosmetics, toiletry, and other items for personal hygiene and appearance; clothing; transportation and automobile expenses; cleaning items; and suitable burial at death. Depending upon the age of the person, the purposes of the trust, and my normal desire for the same definition of "maintenance" (absent the context indicating otherwise) applying to persons of the same relationship to me, such definition need not necessarily be the same as the standard of living to which a person may be accustomed.

**Support.** The term "support" shall mean those expenses reasonably necessary for subsistence and means of living, including, but not necessarily limited to: housing; household expenses, including utilities, insurance and taxes; food, hydration and other sustenance of the body; cosmetics, toiletry, and other items for personal hygiene and appearance; clothing; transportation and automobile expenses; cleaning items; and suitable burial at death. Depending upon the age of the person, the purposes of the trust, and my normal desire for the same definition of "support" (absent the context indicating otherwise) applying to persons of the same relationship to me, such definition need not necessarily be the same as the standard of living to which a person may be accustomed.

**APPENDIX B**


Greater
Grantor Intent/
Beneficiary Enforcement
Less
Greater
Flexibility Achieved As
Result of Imprecise Drafting


Greater
Administrative Costs/
Disagreements & Disharmony
Less
Greater
Flexibility Achieved As
Result of Imprecise Drafting