

BRAVE NEW WORLD...

(A) A Practical Approach to the Arizona Trust Code

(B) Other Arizona stuff

And other topics to fill out the time...

Craig Hunter Wisnom

Bogutz & Gordon, P.C.

3503 N. Campbell Avenue, Suite 101

Tucson, AZ 85719

cwisnom@bogutzandgordon.com

(520) 321-9700

Bogutzandgordon.com

Craig, a Tucson native, is an AV rated attorney at the law firm of Bogutz and Gordon, P.C., practicing in the areas of estate planning, probate, trust administration, estate and gift tax planning, and guardianship and conservatorships. He received his bachelor's degree from the University of Arizona summa cum laude; received his J.D. magna cum laude from the University of Arizona College of Law, and was admitted to the Arizona bar in 1995. He is a Certified Specialist in Estate and Trust Law, Arizona Board of Legal Specialization. He has been selected by his peers for inclusion in 2008's and 2009's Best Lawyers in America, in the specialty of Trusts and Estates. Craig is the winner of the State Bar of Arizona 2008 Continuing Legal Education Award.

Craig was the past chair of the Executive Council for Probate and Trust Section of the State Bar of Arizona, and past chair of the Estate and Trust Advisory Committee for the State Bar of Arizona which oversees the certification of specialists in Trust and Estate law. He is also on the Board of Directors for the Southern Arizona Estate Planning Council.

Craig appears regularly on Tucson's NBC affiliate, KVOA, on News at 4 as a legal contributor, presenting on legal issues, especially those related to estate planning. He is scheduled to present at the 2009 State Bar Convention on behalf of both the Probate and Trust Section, as well as ACTEC, the American College of Trust and Estate Counsel.

Craig is also worried that the portion of his biography where he mentions he is a Notary is becoming stale, in addition to having stolen the joke, so he will merely mention that he is obviously an extreme sports fanatic, if you consider roller skating with his children at an old fashioned roller rink extreme. Since Craig broke his leg there a few weeks ago, and has only fought back through the vigors of rehabilitation for the glory of presenting for the State Bar, he considers it as truly extreme.

THE UNIFORM ARIZONA TRUST CODE

A Practical Approach

After a long and winding road, the ~~Uniform~~ Arizona Trust Code became effective on January 1, 2009. In one of the more “interesting” paths to enactment, the vast majority of the Code (then referred to as the Uniform Trust Code, from whence it came) had been enacted a few years ago, but, after a twin-pronged attack regarding the Notice provisions from a populist perspective, and the modification provisions for irrevocable trust from estate tax practitioners, the Code was actually “temporarily” repealed by the legislature in emergency session shortly before it was going to become effective. A group worked hard to iron out the differences, add a few more improvements, and, lo and behold, it is now the law in Arizona.

This outline will attempt to highlight some of the big picture concepts for dealing with the law, and discussing some of the most important, interesting, and relevant details. Of course, this is a long enough piece of legislation that this examination is not exhaustive, and each practitioner is well suited to trying to read through the changes at least once.

I. ARIZONA TRUST CODE- THE THRESHOLDS!

A. Effective Date

In examining and working with the new law, up first is when the law is effective.

1. General Rule: The general rule is simple, it applies to all trusts, whenever they were drafted and/or became irrevocable, any proceedings commenced after 1/1/2009. Specifically, Section 18 of the Bill itself indicates:
 - a. This act applies to all trusts created before, on or after January 1, 2009.
 - b. This act applies to all judicial proceedings concerning trusts commenced on or after January 1, 2009.
 - c. This act applies to judicial proceedings concerning trusts commenced before January 1, 2009, unless the court finds that application of a particular provision of this act would substantially interfere with the effective conduct of the judicial proceedings or prejudice the rights of the parties, in which case the particular provision of this act does not apply and the superseded law applies.

- d. Any rule of construction or presumption provided in this act applies to trust instruments executed before January 1, 2009, unless there is a clear indication of a contrary intent in the terms of the trust.
2. Exceptions. **That** is the general rule, but peppered throughout the statutes are some particular provisions to which this effective date does not apply, but they are either understandable or relatively minor points:
- a. ***Most Important Exception***-The most frequently relevant exception to this, and the one that kept us from a headache during the first two months of this year, is that the requirements under 14-10813(B)(2)(3) to give notice within 60 days of a new Trustee taking over, or being Trustee of a new irrevocable trust, or a revocable trust which just became irrevocable, only apply to Trusts after 1/1/09. The rest of the ongoing notice requirements would still apply to these trusts, but everyone doesn't have to rush to get something done in the first 60 days of 2009.
 - b. 14-10110(B) adds a requirement (included at the request/insistence of the Attorney General) that for a "Charitable Trust" certain notice must be provided to the A.G., but this is explicitly limited to Trusts created on or after January 1, 2009.
 - c. 14-11014, which is the provision allowing for conversions to unitrusts, applies only to "Trusts in existence on October 1, 2008 or created after that date." Hmm, I'm trying to figure out what Trusts that would not apply to, and why that would be, uh, the same as the general effective date.
 - d. 14-10111(E) limits the application of the Non Judicial Settlement statute to trusts irrevocable after 1/1/2009.
 - e. A curious exception is the subsection of the Trust Protector statutes (14-10818(D)) which states that a Trust Protector is not a Trustee or liable as a fiduciary, and the exception is that this protection doesn't apply to a Trust irrevocable before 2009.
 - f. 14-11008 limits the effectiveness of an exculpatory term drafted or caused to be drafted by the trustee, but this doesn't apply to an irrevocable trust prior to 1/1/2009, or to a revocable trust drafted before 1/1/2009 that never gets amended.

B. **THE UNTOUCHABLES!**

These are the provisions of the Arizona Trust Code you cannot draft around. So when examining any issue as to whether a Trust drafts around any of the provisions (or, when you're drafting whether you want to rewrite any default provisions) the starting point is whether you can draft around it, and there are a few essential elements of the trust law which you cannot change, no matter what the document says (14-10105(B)). Many other phrases in the law say, "unless the trust says otherwise", which I hope is just redundant to 14-10105, as that's what I read it says unless it's one of the "untouchables."

1. The requirements for creating a trust.
2. The duty of a trustee to act in good faith and in accordance with the purposes of the trust [**Hopefully not the most disconcerting technical requirement.-CHW**]
3. The requirement that a trust and its terms be for the benefit of its beneficiaries and that the trust have a purpose that is lawful, not contrary to public policy and possible to achieve. [**Again, darn, can't set up an illegal trust.**]
4. The power of the court to modify or terminate a trust under Sections 14-10410, 14-10411, 14-10412, 14-10413, 14-10414, 14-10415 and 14-10416.
5. The effect of a spendthrift provision and the rights of certain creditors and assignees to reach a trust as provided in Article 5 of this chapter.
6. The power of the court under Section 14-10702 to require, dispense with, modify or terminate a bond.
7. The power of the court under Section 14-10708, subsection b to adjust a trustee's compensation specified in the terms of the trust that is unreasonably low or high. [**I find this a helpful provision. Occasionally we have that EP client who doesn't quite understand the burdens of being a fiduciary, and wants to put something in the document where the person they name doesn't get paid, or gets paid a minimal amount. This gives some comfort that there is at least some possibility of solving that no matter what the document.**]
8. The duty to respond to the request of a qualified beneficiary of an irrevocable trust for trustee's reports and other information reasonably related to the administration of a trust. [**THIS IS THE ONE NOTICE REQUIREMENT THAT CAN'T BE DRAFTED AROUND. WHICH MEANS YOU CAN**

DRAFT AROUND ANY OF THE AFFIRMATIVE NOTICE REQUIREMENTS, BUT NOT A REQUEST!]

9. The effect of an exculpatory term under Section 14-11008.
10. The rights under Sections 14-11010 [**Limitation of liability of a Trustee**], 14-11011 [**Protection of a Trustee as a General Partner**], 14-11012 [**Protection of third-parties dealing in good faith with a Trustee**] and 14-11013 [**The Trust certification statute!**] of a person other than a trustee or beneficiary.
11. Periods of limitation for commencing a judicial proceeding.
12. The power of the court to take action and exercise jurisdiction as may be necessary in the interests of justice.
13. The subject matter jurisdiction of the court and venue for commencing a proceeding as provided in Sections 14-10203 and 14-10204.
14. The notice provisions of section 14-10110, subsection B [**The Attorney General’s rights to notice under a “charitable trust.”**]

SO, ANYTHING ELSE IN THE CODE YOU DON’T LIKE, FEEL FREE TO DRAFT AROUND IT IN YOUR DOCUMENTS!

II. WHAT SHOULD I CONSIDER DRAFTING AROUND OR SPECIFYING?

With a comprehensive set of laws newly fleshing out the Trust law, when at the planning stage, each drafts person will have to look if there are any provisions of the new law he or she wishes to avoid, rewrite, make an affirmative choice that is now available, or just clarify. Here’s some of the things to consider:

- A. **Notice? To Serve or Not To Serve?** Discussed in more detail below, the All Terrain Cycle provides some new, more specific requirements to when notice has to be given to which beneficiaries. Although it is much forgotten and neglected, Arizona had a notice statute previously, with no clear way to draft around it, but, under the ATC we now clearly have the option to draft away many of the particular notice requirements newly birthed, with the only one we can’t draft around being the Trustee’s obligation to respond to an affirmative request from a Qualified Beneficiary (again, we’ll talk about this later, but it’s basically the “main” beneficiaries, the current beneficiary and the most likely remainderpeople). Everything else, including affirmative duties to report, inform, and even from

requests from more remote beneficiaries, can be deleted. Query what you and your client will generally want to have happen, whether you want a Trustee subject to the extra duties, or you want to make things as secret as you can keep them. There's no right answer, but these are the options for you and each client. Consider, if you opt out of any of the requirements, whether you want to give the Trustee a permissive right to disclose the information he or she would have had to disclose before you write it out. When you consider what the definition of a Qualified Beneficiary is, and how it includes the next level of remainder beneficiaries, you really may wonder whether you'd want anyone else ever entitled to notice. I.e., in a Bypass/Family/Decedent's/Credit Shelter Trust, income and discretionary principal to wife, remainder to kids when she dies, the wife and all the kids are the Qualified Beneficiaries...do you really want the grandchildren or even more contingent beneficiaries to have any rights?

Example:

In specific exception of the default law of Arizona including the Arizona Trust Code, the Trustee shall not be required to provide any notice, report, accounting, or documentation (including all or a portion of this Trust Agreement) of any sort whatsoever, whether under Arizona law or otherwise required, to any trust beneficiary who is not a "Qualified Beneficiary" as defined under Arizona law.

- B. **Forced Place of Administration**-Subject to certain reasonableness, a trust instrument can designate where its place of administration is. Consider whether most of your Trusts should specify Arizona (and this is normally subject to change), just to avoid questions later on when an individual who lives out of state might become Trustee.
- C. **Non Judicial Settlements**-Do you wish to preclude non-judicial settlements under 14-10111.
- D. **Default Revocable Trust**-We would presume a trust would always indicate whether it is revocable or irrevocable. However, the default common law was that a trust was not revocable unless it said so, and 14-10602(A) changes this to default to revocable. Therefore, you need to be that much more careful and clearer that any irrevocable trust specifies such.

- E. **Methods of Revocation and Amendment**-14-10602 also provides default methods for amending or revoking a trust, and even where your instrument specifies the means, there are other methods unless the instrument specifically says the methods you list in the document are the exclusive means of amendment or revocation. So look at the other methods in the statute and decide if you want your document to say that the methods you list for amendment are to be the exclusive methods of amendment or revocation.
- F. **Trust Protector**-Only an issue when and if you include a Trust Protector or some sort of similar figure in your documents, but since 14-10818 sets up default rules and powers for the Trust protector, you may want to consider whether you wish to modify or limit any of the default powers.
- G. **Rule Against Perpetuities**-Given that, in addition to other exceptions existing under Arizona law previously, the new law clearly gives 500 years before a Trust could ever be deemed invalid or terminate under this law, you really should consider what the clauses in your documents say, as a standard old-school termination clause may simply be inappropriate at this time. While nothing may be necessary, some sort of reference to Arizona's law and exceptions may be appropriate to point out to someone reviewing the document and perhaps looking for a perpetuities clause to understand why it was not included.
- H. **Attorneys Fees**-The new statute of A.R.S. 14-11004(B) provides at least some mushy guidance for a court awarding fees from a trust, and, as I read it, at least arguably from a party that is not a Trustee, although it references back to (A), which is for a Trustee or nominated Trustee. Consider, to be safe, whether the Trust Agreement should indicate that no attorneys' fees for another, especially challenging, opposing, etc., party, be paid from the trust.
- I. **CAN POWERS OF APPOINTMENT KEEP EVEN QUALIFIED BENEFICIARIES OUT OF YOUR HAIR?**-As discussed in more detail below, in those situations where Settlers need and want an irrevocable trust, like a Trust B/Credit Shelter Trust, but really don't want to give the kids who are beneficiaries too much power, you can consider how you draft powers of appointment to affect their rights.

III. REPORTING AND NOTICE

“To no more
Will I give place or notice...”

-W. Shakespeare, King Lear

The Trust Code provides a bevy of very specific requirements for notice, both in terms of general administration of a trust, but also for certain actions. The specifics should be considered when determining which of them you should draft around at the planning stage, and of course, you must be aware of them when representing a Trustee or serving as such, especially for those that there could conceivably be damages of some sort.

A. **Definitions** I think I have to finally get around to the definition of the Beneficiary and Qualified Beneficiary, since they have great impact in the Notice provisions.

“Beneficiary” Under 14-10103(2), the plain old “Beneficiary” has a broad definition, similar to that it previously had under 14-1201. (Wait, actually that it still has under 14-1201, as that statute hasn’t been overwritten.) It’s any beneficiary of a trust, vested or contingent, so, even if it’s the charity that only takes the Trust if all 37 family members named first get wiped out in a “King Ralph” situation (you can Wikipedia the premise for the movie, but you won’t thank me), they are a “Beneficiary” under the Trust Code. (Now, that’s the same as under the prior statutes, for instance, Notice required under 14-7303 applied to the broad “Beneficiary”, and there was no clear way to omit the more obscure beneficiaries.).

“Qualified Beneficiary.” Now, Qualified Beneficiary has a much more “reasonable” limitation. The technical definition is under 14-10103, but practically, it’s any present beneficiaries, whether for mandatory distributions or they are a permissible discretionary beneficiary, and the remainder beneficiaries who would take if all the present beneficiaries died, and/or the trust terminated. There’s also an inclusion for the Attorney General for charitable trusts, but, for your more typical trusts, this is what we are dealing with. So, for a typical Bypass/Credit Shelter Trust, spouse is lifetime beneficiary, kids are the remainder beneficiaries, the spouse and kids are all your Qualified Beneficiaries. The grandchildren, the charitable contingent beneficiary, etc., are not.

B. **“UNTOUCHABLE” Notice**. As indicated, no matter what the Trust says, the Trustee is required to respond to requests from a Qualified Beneficiary, specifically, to provide trustee's reports and other information reasonably related to the administration of a trust. The “Can’t-Draft-Around-Statute” simply says this, rather

than referring specific to provisions of the Notice statute, namely 14-10813. So, no matter what the Trust says, if a Qualified Beneficiary says, “Gee, can I see what the Trust is worth?” the Trustee is required to provide that.

C. **The Rest of the Notice–Default Requirements:**

1. **Affirmative General But Vague Duty.** A trustee shall keep the qualified beneficiaries of the trust “reasonably informed” about the administration of the trust and of the material facts necessary for them to protect their interests. Unless the trustee determines that it is unreasonable under the circumstances to do so, a trustee shall promptly respond to a **beneficiary**'s request for information related to the administration of the trust. (14-10813(A)). Keep in mind, our prior 14-7303 also included a “reasonably informed” requirement.
2. **Seeing the Trust** On request of a **beneficiary**, the Trustee has to “promptly” furnish to the beneficiary a copy of the portions of the trust instrument that are necessary to describe the beneficiary's interest. (14-10813(B)(1)).
3. **Duties at Inception/Acceptance:** Within sixty days after becoming Trustee (whether it's taking over from someone else as Trustee, a revocable Trust becoming irrevocable, or an irrevocable trust being created) that Trustee shall notify the **qualified beneficiaries** of the acceptance and of the trustee's name, address and telephone number, and/or the Trust's existence and the Settlor's, and the right to request. (14-10813(B)(2) and (3)). This only applies going forward, no need for existing Trustees of irrevocable trusts to do all this this year.
4. **Fees are going Up!** The Trustee has to notify the **qualified beneficiaries** at least thirty days in advance of any change in the method or rate of the trustee's compensation. (14-10813(B)(4)). This is a rather critical portion in my book, because in many of these notice requirements, violations may have no damages. Failure to give this Notice, could, however, give rise to an argument that the excess fees are forfeit, which, over a long period of time, could be significant. Now, there's no mention about giving notice at

inception/acceptance on what fees are...but again, you might be concerned with being as cautious/conservative as possible.

5. **Annual Reports**- The Trustee has to send to the *distributees or permissible distributees (i.e, not all the Qualified Beneficiaries, just the present ones)* of trust income or principal and *to other beneficiaries* [**NOT QUALIFIED BENEFICIARIES! That means those grandkids or contingent charities could be entitled to an accounting without drafting around it if they ask for it**] who request it, at least annually and at the termination of the trust, a report of the trust property, liabilities, receipts and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values. 14-10813(C).
6. **Quitting Time**. If there's on a vacancy in a trusteeship, unless a cotrustee remains in office, a report must be sent to the **qualified beneficiaries** by the former trustee. A personal representative, conservator or guardian may send the qualified beneficiaries a report on behalf of a deceased or incapacitated trustee. 14-10813(C). A Trustee is also required under 14-10705 to give 30 days written notice to the **qualified beneficiaries**, the Settlor (if living), and any Co-Trustees.
7. **Leaving Town**. 14-10108(D) provides that before exercising the right to change the trust's principal place of administration, the Trustee must give 60 days written notice to the **qualified beneficiaries**.
8. **Small Potatoes**. 14-10414 provides that a Trustee must give notice to **qualified beneficiaries** before terminating a too-small-to-be-economic trust. No time is specified for the notice.
9. **Safe Harbors for Distribution** Under 14-10817, the Trustee *may* send to the **beneficiaries** a proposal for distribution, and if it tells the **beneficiary** of his or her right to object, that beneficiary's right to object terminates if they don't notify the Trustee within 30 days of an objection. [**Hmm, does that include a right to object to any Trustee's actions or conduct prior to distribution/termination?**]

10. **Clumping and Cutting**- 14-10417 requires a Trustee to give notice to **qualified beneficiaries** (again, no time specified) before exercising the power to divide or combine trusts so long as the interests of the beneficiaries aren't affected. Some commentators have queried whether this is required before splitting an A-B Trust or dividing it up into the beneficiaries shares, but my reading is this would only be applied to the Trustee dividing a trust that the document references as a single unit, or vice versa, not following the specific requirements of the trust instrument.

11. **Unitrust Conversion**- 14-11014, which grants the Trustee powers to convert income trusts to unitrusts and vice versa, or change a unitrust percentage, has one of the most labyrinthine notice provisions, even though it's not terribly different in substance, including an exclusive reference to ignoring any powers of appointment, etc., but I won't go into it here, since you obviously have to be very intentional when you do this, and when it comes up, you can look at the specifics.

12. **Does Texting Count?** 14-10109 provides the means of giving required notice, requiring that it be "in a manner reasonably suitable under the circumstances and likely to result in receipt of the notice or document. Permissible methods of notice or for sending a document include first class mail, personal delivery, delivery to the person's last known place of residence or place of business or a properly directed electronic message." However, any judicially required notice is still subject to 14-1401.

There is a nice provision that no notice must be given to a person whose identity or location is unknown and cannot be reasonably determined.

IV. Victim of Changes

The Trust Code also codifies, clarifies, and adds to the classic common law justifications for some type of reformation or termination of a trust, despite its terms to the opposite. A few details in this section of the 2003 UTC were the most controversial other than the populist concern about notice, in terms of potential estate tax traps where a Settlor's ability to join in modification was available.

A. **Virtual Notice**-In these provisions keep in mind the new additions for “virtual” representation, that is, where not every last person has to be represented, and guardian ad litem aren’t needed for every minor or unborn person, and the result is generally the same as if it actually went to the real person being represented. This makes consent and notice much easier to accomplish. These are included in Sections 14- 1404 through 1408, and include the following:

1. The holder of a general power of appointment represents any permissible appointees, or the default beneficiaries.
2. A conservator may represent and bind the estate that the conservator controls.
3. A guardian may represent and bind the ward if a conservator of the ward's estate has not been appointed.
4. An agent who has authority to act with respect to the particular question or dispute may represent and bind the principal.
5. A trustee may represent and bind the beneficiaries of the trust.
6. A personal representative of a decedent's estate may represent and bind persons interested in the estate.
7. A parent may represent and bind the parent's minor or unborn child if a conservator or guardian for the child has not been appointed, except that the parent may not represent the child to consent to a modification or a termination of a trust if the parent is the settlor of the trust.
8. Unless otherwise represented, a minor, incapacitated person, unborn or unknown person may be represented a person who has a substantially identical interest with respect to the particular question or dispute, but only to the extent there is no material conflict of interest between the representative and the person represented with respect to the particular question or dispute. **[So, if there are 15 remainder beneficiaries of a Trust, with similar shares and who are affected the same way, and one of them can’t be located, you should still be good to go.]**

9. If the court determines that an interest is not represented under this article or representation might be inadequate, the court may appoint a representative to receive notice, give consent and otherwise represent, bind and act on behalf of a minor, incapacitated person, unborn child or person whose identity or location is unknown. The court may appoint a representative for several persons or interests.
- B. **Nonjudicial Settlement Agreements**-One of the prospective provisions, which only applies to Trusts that are irrevocable after Jan. 1, 2009, 14-10111 allows the folks with an interest in the trust to enter into a binding agreement. With a hint of 14-3951, this is an oddly limiting statute, and by my estimate might be more restrictive than what a lot of us thought we had before. This can only be done if it doesn't violate a material purpose, and includes what could properly be approved by the court. (So, you have to guess or interpolate what a court would have or could have approved). You can also have the court approve this, which, while it is different from the court making a determination, has probably the same practical requirements, and it seems, for anything you really want binding, this doesn't offer a lot of security.
- C. **Because We Said So.** 14-10411 allows the court to modify or terminate a trust to be based on the consent of all of the beneficiaries, *so long as it doesn't violate a material purpose of the Trust.*
- D. **Things have Changed!** 14-10412 allows the court to modify a trust, if, *because of circumstances not anticipated by the settlor*, modification or termination will further the purposes of the trust, and the modification must be made in accordance with the settlor's probable intention. Court may also modify if continuation as is would be impractical or wasteful. **[I don't know about you, but this is the legal equivalent of the perfect conditional tense, there's a lot of backward-forward guessing. You not only need to show the settlor hadn't originally anticipated what has happened, but how he would want things changed because of it.]**
- E. **Cy Pres**-14-10413 provides that where a particular charitable purpose has become impossible or impractical (Fund to provide relief for the veterans of the Civil War),

the court is generally charged with redirecting it to another charitable purpose in line with the Settlor's charitable purpose.

- F. **Small Potatoes.** 14-10414 mirrors common trust boilerplate, it allows termination of a small trust, without court approval, either one under \$100,000, or is uneconomic, but not by an interested trustee. The court can remove the trustee to allow this to happen.

- G. **Ooops!** 14-10415 allows the court to reform a trust, even if its language is clear, to what the settlor really wanted, by correcting any kind of mistake, either in the wording of the trust or some mistake that led to the way it was done. This must be proven by clear and convincing evidence. While it opens the door for a lot of litigation, it can alternately be very helpful to address the base rule of, "We don't care what he wanted, it clearly says this!"

- H. **Tax!** 14-10416 allows the court to reform a trust to achieve the Settlor's tax objectives, as long as it's not against the settlors probable intention

- I. **Cutting and Lumping.** After notice to the qualified beneficiaries, *without court order*, a trustee may combine two or more trusts into a single trust or divide a trust into two or more separate trusts, if the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trust.

V. Spendthrift

Actually, pre-ATC law regarding the spendthrift protection of a trust was pretty well established by statute. However, the ATC does a nice job of filling a few of the gaps, as well as enhancing the protection in a couple of situations. As a practical point, this is a good opportunity to remind clients of the creditor protection offered by even a simple self-trusteed trust established for the beneficiary by someone else, and, in a world where the number of clients for whom estate tax planning is necessary, is helpful to remind them there are other benefits of trusts. Including protecting their kids from the kids' spouses the parents aren't too fond of.

- A. **Special Treatment for Special Needs Trusts.** There's a new definition in the Arizona Trust Code for a "Special Needs Trust" under 14-10103(16), as a "trust established for the benefit of one or more disabled persons if one of the purposes of the trust, expressed in the trust instrument or implied from the trust instrument, is to

allow the disabled person to qualify or continue to qualify for public, charitable or private benefits that might otherwise be available to the disabled person. The existence of one or more non disabled remainder beneficiaries of the trust shall not disqualify it as a special needs trust for purposes of this paragraph.” (“Disabled” is not defined in the ATC.) The reason I bring this up under the spendthrift section is it’s the only place that’s relevant, and there is an additional protection in that, unlike other trusts, a Special Needs Trust cannot be attached for child support or for protection of the beneficiary’s interest in the trust.

- B. **Basic Rules**-14-10501 says a court may authorize the creditor of a beneficiary to reach the assets of the trust **UNLESS** it’s a spendthrift trust (like almost any trust we draft should be) **OR** it’s a “discretionary trust”, then the court can’t attach it, and the Trustee isn’t liable for the distributions to that beneficiary.

14-10502 indicates you have a “spendthrift” trust if you restrain either voluntary or involuntary transfer, although a couple of other sections mention voluntary “and” involuntary transfer, which apparently should be corrected. Simply saying a trust is “spendthrift” is enough to invoke its protection.

Discretionary Trusts 14-10504(A) and (B) defines the “discretionary” trust, which is another way to get spendthrift protection, any time the Trustee has discretion, even if there’s a standard for distribution, and even if the Trustee has not respected the standards.

Life Insurance Proceeds 14-10504(D) is a fantastic provision, which clarifies that, wherever state law protects life insurance proceeds to an individual, they are equally protected if payable to a trust.

Self-Trusteed Trusts 14-10504(E) is another one of those clarification and enhancements that clarifies that even where a Trustee is the beneficiary, so long as the standard is discretionary, or, more commonly, an ascertainable standard, it is subject to protection. While this was my interpretation of the prior law, this is much better and clearer, and is what helps sell self-trusteed trusts to clients for their spouse’s or children with a bit more assurance.

- C. **Exceptions.**

1. **Child Support and Trust Work.** Under 14-10503, Spendthrift protection does not apply for child support (unless it's a Special Needs Trust), or for a creditor whose claim is related to services protecting the beneficiary's interest in a trust, nor does it apply where Federal or state law overrides, but, it limits that as much as possible by requiring a specific statute on point.
2. **Settlor-**Of course, the biggest exception from any spendthrift protection is from a self-settled trust. As always, you can't protect your own money from your own creditors very well. Obviously, with a revocable trust this doesn't require a second thought. (14-10505(A)(1)). But even with an Irrevocable Trust, the creditors can reach the maximum amount that could go to the Settlor, excepting payback for income tax liability in a grantor trust, or a special needs trust.

As previously, lapsed 5 x 5 rights do not make one a Settlor, nor does lapse of an annual exclusion amount, or even the lapse of the "one-time" right of withdrawal of a 2503(c) trust at age 21.

Additionally, another gap that Greg Gadarian had pointed out and has filled was that, when the donee spouse of an inter vivos QTIP dies, and "wipes clean" for tax purposes the original donor's interest, even where interests flow back to the original donor, now that donee's spouse death and estate tax inclusion also "wipes clean" that trust for these self-settled spendthrift protection as well.

3. **Late Stuff-**If a trust requires mandatory distributions, the creditors can reach them if the Trustee doesn't make them after a reasonable time when they are required under 14-10506.

VI. Powers to Appoint Around Troublesome QB's

As indicated above, while you can draft around any notice, involvement, or information to non-qualified beneficiaries, a concern Settlers may have when establishing any type of irrevocable trust is interference from the people they still want to be their beneficiaries. Consider, for instance, husband and wife, with four children whom they want to treat equally, but one of them can be a royal troublemaker, and they really would prefer that

beneficiary not poking into the trust information. They're worried that after the first death, they don't want to have to share a lot of information, especially with troublesome child.

One option is to leave that beneficiary out of the Trust, but, ensuring that the irrevocable Bypass/Family/Decedent's/Credit Shelter/Trust B in question has a power of appointment, which can be exercised by Will. Have the spouses' Wills contain an exercise of that power, putting that child back in, and therefore there's no danger something unexpected will happen and that troublesome child will remain disinherited. But, as far of the Trust is concerned, he **SHOULDN'T** be a Qualified Beneficiary, with the idea that the Will is not really effective to do anything, until the person dies and it is probate or otherwise proven subject to the requirements of the trust. Of course, reading the language of the Qualified Beneficiary definition, there could be some argument that, if the income beneficiary died today, that son would actually be the beneficiary, and while an independent Trustee might not know this, the Settlor as a Trustee would because it's his or her Will.

A second option, more flexible, and in some ways more straight forward, is to have the presumed beneficiaries, but give the spouse or lifetime beneficiary a power to appoint, and allow them to exercise it (a) with an intervivos instrument, which, if delivered to the Trustee, will effectively change the beneficiaries for notice purposes, or (b) a Will, which will take precedence over any previously exercised intervivos appointments. Then, if a child becomes too troublesome, expected or not, they can be written out under the intervivos exercise, put back in the Will, so the plan is preserved, but having to notice them isn't.

Here's some language for that, although I admit I drafted this before the current Code and you may wish to make some of the references more specific:

Except as otherwise specifically provided for hereunder, any power of appointment granted under this instrument may be exercised (a) by Will, or (b) by a separate written instrument making specific reference to this power of appointment, signed by the person holding the power ("Holder") and notarized, and delivered to the Trustee during the Holder's lifetime. If the Holder exercises the Power of Appointment by the separate written instrument, upon the Trustee's receipt of that instrument, for all purposes that exercise shall be deemed to be immediately effective, and although it may only change disposition after the Holder's death, the beneficiaries provided for under that exercise shall be deemed to be the beneficiaries of

the trust for purposes of determining remainder and contingent beneficiaries for all purposes, including determination of which parties are entitled to notice, accountings, representation in any judicial or non-judicial settlement agreement, and other similar purposes under Arizona law. It is the Settlers' intent that such exercise by separate written instrument effecting the disposition of any trust hereunder shall have the same effect as an intervivos trust amendment would normally have for these purposes. The Holder shall continue to have the right to execute subsequent exercises, and the most recently executed shall control for purposes of this paragraph and for disposition, provided that the Holder's last Will shall have precedence over all other exercises at his or her death in determining ultimate distribution.

If this seems an unfair or gimmicky workaround...keep in mind it's in situations where the spouse is intended to actually have the power to write that person out, for real, if necessary, and if they can do that, why not allow them to write them out temporarily and put them back in, and the only real result of the gimmick is to make sure there's no gap where the person could unexpectedly die before putting them back, if that's what they want.

The simplest method of all for all but the most dense beneficiaries in these situations where the survivor/beneficiary has a power to appoint the revocable trust, but also complete flexibility over their own Survivor's Trust or Will, is to tell the child to leave you alone, or, they will get their required notice, but they may not end up as a beneficiary at all.

VII. Provisions Which Give Me Joy

A. **Best...Statute...Ever**- You may or may not wish to frame a print-out of this statute, it's up to you. An add on to the Trust Code, it attempts to protect attorneys from the nebulous and nettlesome confluence of *Shano*, *Fickett*, and *Fogelman* (more to the latter, in my opinion of relevance):

1. Part A of the statute says:

Absent an express agreement to the contrary, the performance by an attorney of legal services for a fiduciary, settlor or testator does not by itself establish a duty in contract or tort or otherwise to any third party. For the purposes

of this subsection, third party does not apply to the personal representative, settlor or testator.

2. Part B addresses a reasonable compromise very directed at Fogelman, essentially acknowledging some issue with the overlap in representation in an estate, but solving it not through disqualification but through reasonable disclosure:

An attorney who acts as a personal representative or trustee shall disclose to all adult persons who have an interest in the estate or trust the names of any person who has an interest in that estate or trust to whom the attorney is currently rendering or has in the past rendered legal services. The attorney must make this disclosure in writing within a reasonable time after learning that a client or former client has an interest in the estate or trust. The representation of an interested person by that attorney is not grounds for removing the attorney as the personal representative or trustee unless the attorney is unable to perform the fiduciary duties as personal representative or trustee without violating the attorney's ethical responsibilities to the client or former client.

B. Savings Clauses

1. Whether you look at it as protecting clients from the sins of their attorneys which they would not understand, or protecting us from those slips of a keyboard when we draft documents for clients, 14-10814(B) is a wonderful buffer for where a trust drafter accidentally creates a general power of appointment. The statute automatically limits a non-settlor-trustee-and-beneficiary from distributions to themselves to the ascertainable standards of health, education, maintenance. It also eliminates the IRS's illusory *Upjohn* argument about property being included because a person could satisfy support obligations with their discretionary powers. This doesn't address a problem in an actual power of appointment, where it is drafted unintentionally broadly to allow appointment to self, estate, or creditors.

VIII. Miscellanica

- A. **Trust Protector**-14-10818 sheds some additional statutory light on a Trust Protector, but only where a document in some sense has named one. Probably the most important provision of this is that it clarifies the Trust Protector is not a fiduciary and not-fiduciarly liable, although this as it is written is prospective only. (P.S., I've contacted both DC and Marvel comics, I think "Trust Protector" would make fantastic superhero.)
- B. **Conversion to Non-Charitable Unitrust**-14-11014 sets forth the process and option of a Trustee converting an income trust to a unitrust. I won't rehash the very specific steps set forth in the statute, but all drafters should be aware of the benefits of this arrangement. Any time we have a trust directing mandatory income distribution, then except in a QTIP or QSST arena where there is a tax mandate that all income be distributed, the general goal is an automatic distribution of a likely sustainable amount that the beneficiary can rely on, but which is limited. A unitrust replaces the net income concept with a payout based on a percentage of the trust value. The idea is to address the same goals with (a) a somewhat more reliable amount, i.e., not subject to the fluctuation of income along with inflation, (b) not dependent on the nature of investments (at least, the remainder and lifetime beneficiary have no conflict as to how assets are invested).
- C. **Trust Certification**- 14-11013 specifically sanctions a Trustee's ability to certify the relevant administrative provisions of the trust, which third parties are generally bound to accept, as a means of maintaining privacy and somewhat simplifying what document is regularly presented to institutions when funding or administering a trust.

OTHER UPDATES IN ARIZONA

(Most of these updates prepared by Bruce W. Martin, also at Bogutz & Gordon, P.C., member of the Executive Councils for both the Probate and Trust Section and Elder Law and Mental Health Section)

I. LEGISLATIVE UPDATE

A. House Bill 2836

House Bill 2836 took effect on 9/26/2008, 90 days after adjournment sine die of the Second Regular Session of the Forty-eighth Legislature. The bill makes two small changes to A.R.S. Sections 14-5314 and 14-5414. A copy of the bill follows this outline.

The Non-Uniform Laws Legislative Subcommittee of the Arizona State Bar Section on Probate and Trust Law proposed changes to A.R.S. Sections 14-5314 and 14-5414 several years ago. The changes were drafted and approved by the committee and forwarded to the Executive Council of the Probate and Trust Section. The Executive Council made minor changes and forwarded the proposal to the Board of Governors (of the State Bar). The Board of Governors approved the proposal and worked with the Bar's lobbyist to get a bill before the legislature last year. It was passed by the House on May 21, 2008, and was signed in to law on May 27, 2008.

The bill addresses two fairly narrow issues that sometimes come up in guardianship and conservatorship matters: The first is: "Who pays the fees and costs associated with a guardianship or conservatorship petition, especially when no guardian or conservator is ultimately appointed?" The second is: "What powers does a conservator (of the estate) have over the ward's property after the ward's death?"

Under previous law the petitioner's attorney, the court-appointed attorney, and the attorney representing the proposed guardian and/or conservator could all be paid from the ward's estate after appointment of a fiduciary. The fees of the court-appointed investigator could also be paid from the ward's assets. When a petition is not ultimately granted, however, there was no authority for paying any of

those individuals – perhaps on the theory that the petition was denied because it had no merit.

The new law closes the gap in the previous statute and more clearly lays out where the fees get paid from in the event the petition is withdrawn or otherwise not granted. In addition it allows the court to consider the facts of each individual case and to order fees and costs paid from the appropriate party.

The second change allows a conservatorship to be closed without a formal accounting upon submission of simple affidavit submitted with waivers from those entitled to receive the ward's estate. Previous law allowed a conservator to endorse his or her letters to in essence probate a deceased ward's estate within the conservatorship proceeding.

B. Revisions to A.R.S. Section 46-456

A second proposal to come out of the Non-Uniform Laws Legislative Subcommittee of the Arizona State Bar Section on Probate and Trust Law has proved to be quite a bit more controversial than the above-mentioned changes to A.R.S. Sections 14-5314 and 14-5414. The members of the committee and members of the Bar at large had perceived that the current §46-456 was being used as a "club" to cow other parties in Title 14 litigation. Members of the committee and the Executive Council felt that too often persons were being threatened with triple damages and forfeiture for supposedly minor violations of a trustee's duties. A.R.S. § 46-456(A) provides that: "A person who is in a position of trust and confidence to an incapacitated or vulnerable adult shall act for the benefit of that person to the same extent as a trustee pursuant to title 14, chapter 7." Prior to the effective date of the Arizona Trust Code Title 14, Chapter 7 was the section dealing with trust administration.

However, the proposed changes were fairly controversial at both the committee and the Executive Council levels. In addition, over the last several years the proposal met with both support and opposition when it has been discussed at various meetings of attorney who practice in this area. While many agreed with the proposition that the current statute was too often used a club others said that the current statute lacks teeth.

Nonetheless, the proposal was eventually approved by the Executive Council and the Board of Governors. The plan was for a bill to be submitted to the legislature last year. Unfortunately, the bill ran into opposition and ultimately was not introduced. After discussions between the Executive Council of the Probate and Trust Section and representatives of the Attorney General's office a compromise bill was crafted that has been submitted to the legislature this term. The bill should prove satisfactory to the Executive Council as well as to the Attorney General's office. A copy of the bill follows this outline.

The new law would subject the exploiter to liability for actual damages as well as give the court discretion to impose additional damages for an amount up to two times the amount of the actual damages. This is a change from the exiting law's mandatory triple damages.

The bill also makes forfeiture of the estate for the exploiter discretionary with the court. Current A.R.S. § 46-456(d) contains a mandatory forfeiture clause.

II. ETHICS UPDATES

A. File Retention

Ethics Opinion 07-02 ("Maintaining Client Files; Client's Papers and Documents; Electronic Storage") answers the question of whether an attorney can maintain a paperless law office. The opinion draws on two prior of opinions of the Bar: 98-07 ("Client Files") and 05-04 ("Electronic Storage; Confidentiality").

In Ethics Opinion 05-04 the Bar determined that—despite ERs 1.6 and 1.1—it is not unethical to store client information and confidences as electronic information on computer systems whether or not those same systems are connected to the internet. However, the firm is obligated to take competent and reasonable steps to assure that client's confidences are not disclosed to third parties through theft or inadvertence. In addition, the firm is obligated to take reasonable and competent steps to assure that the client's electronic information is not lost or destroyed.

Ethics Opinion 98-07 discussed an attorney's responsibilities for a client's file after termination of representation. At issue was how long how long client files in the

practice areas of criminal (felony and misdemeanor), divorce, corporate representation, securities representation and commercial litigation should be retained. The Bar determined that "Indefinite file retention for probate or estate matters, homicide cases, life sentence cases and lifetime probation cases is appropriate" and that "file retention of five years for most other matters is appropriate."

In Ethics Opinion 07-02 the bar ruled that in some cases, an attorney may keep current and closed client files as electronic images in an attempt to maintain a paperless law practice or to more economically store files. However, after scanning paper documents, an attorney may not, without client consent, destroy original paper documents that belong to or were obtained from the client. An attorney may after scanning destroy copies of paper documents that were obtained from the client unless the attorney has reason to know that the client wants the attorney to retain them. An attorney has the discretion to decide whether to maintain the balance of the file solely as electronic images and destroy the paper documents.

Ethics Opinion 08-02 ("Client Files; Confidentiality of Information; Safekeeping Property; Duty as to Client Property") deals with attorneys' ethical obligations in maintaining closed client files. The opinion provided that clients are entitled to most of the contents of a closed file. It provides that attorneys should establish a file-retention policy and communicate that policy to the client, in writing, at the commencement of the attorney/client relationship. If an attorney does not adopt a file-retention policy, the attorney will have to fulfill additional ethical obligations prior to the destruction of any closed client file.

B. **Acceptance of Credit Cards**

Ethics Opinion 08-01 ("Fees; Trust Accounts; Credit Cards"), issued in September 2008, the Bar opined that an attorney may accept credit-card payments only for earned fees, earned-upon-receipt retainers, or reimbursement for advanced costs. However, the credit-card payments may not be deposited into the attorney's trust account. The Bar's primary concern with depositing credit-card payments into the attorney's trust account was that banks typically require designation of a single account for receipt of credit-card funds and retain the right to access that account in order to debit an amount equivalent to any deposit that the cardholder disputes within a designated period of time. If the account that the attorney designates for the receipt

of credit-card funds is his or her trust account, the banks' right of access renders designation of the lawyer's trust account ethically impermissible. Additionally, the opinion provided that an attorney may not accept payment in advance by credit card for unearned fees or costs not yet advanced.

Unfortunately, as a result of that opinion, some members of the public who rely on credit cards to retain lawyers were cut off from access to legal services, and sole practitioners and those lawyers engaged in family law practices in particular had to turn away clients who could only pay advance fees with credit cards

The Board of Governors of the State Bar responded by filing a petition to the Supreme Court asking for emergency rule changes that would allow lawyers to take credit cards for advance fees and costs. The Court responded on December 9, and ordered, on an emergency and experimental basis, amendments to Ethical Rule 1.15 and Rule 43. The emergency rule amendment solves the problems identified in the ethics opinion so that lawyers may now accept credit-card payments for advance fees and costs as well as for earned fees, earned-upon-receipt fees, and advanced costs. The changes took effect on January 1, 2009. A copy of the Petition to Amend Supreme Court Rules 42 and 43 is attached to this outline.

Although the Court has adopted the rule changes on an emergency and experimental basis, the State Bar's petition will go through the Court's normal procedure for the amendment and adoption of rules. Comments on the petition are due on or before May 20, 2009.

The amended Rules 42 and 43 contain specific directions which—if followed—allow attorneys to accept credit-card payments for advance fees and costs. The amended rule allows the attorney to deposit his or her own funds in the trust account to pay any fees or charges related to credit card transactions or to offset debits for credit card chargebacks. Previously the rules only allowed the attorney to keep his or her funds in the account to pay a bank service charge.

III. CASELAW UPDATE

- A. Newman v. Newman, 1 CA-CV 07-0373, considers claims by a personal representative/child of decedent against another child of the decedent, for violation of A.R.S. Section 14-3709(D), breach of fiduciary duty and A.R.S. Section 46-456.

The defendant had withdrawn funds from the decedent's IRA and placed them into a joint account of which he was the joint owner and had used funds from the decedent to purchase real property in joint tenancy with himself. The decedent had left a will and trust. The court found that A.R.S. Section 14-3709(D), providing for double damages if an order of disclosure is issued, will apply only if an action is successful under subsection (A) of the same statute in obtaining a predicate order from the court for the recovery of property where a defendant has wrongfully concealed, embezzled, conveyed or disposed of that property. The court also ruled that forfeiture under A.R.S. Section 46-456 applies to benefits received from a trust as the result of the forfeiture of a devise under a will and is not limited to forfeiture merely of benefits received directly from the estate. The court stated that: "...it would be inappropriate for Max to recover trust benefits that he would only have received because of a bequest under the probate Estate which has been forfeited as a result of A.R.S. §46-456(D)."

The court also clarified and reiterated the general proposition that there is no right to a jury trial in a probate or breach of fiduciary duty matter, absent the granting of such a right by statute. Without statutory authority, there is only a right to a jury trial if there is a constitutional right to a jury trial, meaning there was a common law right to such a jury trial in such a matter prior to the adoption of the Arizona constitution, or the court in its discretion calls a jury to decide an issue of fact (in which case the jury verdict is advisory only). The court found that probate matters and claims for breach of fiduciary duty were equitable actions at the time of adoption of Arizona's constitution and are not entitled to trial by jury absent specific statutory authority. The court also found that A.R.S. §46-456 does not contain authority for a jury trial.

- B. **Mathews v. Life Care Centers**, 1 CA-CV 07-0228. The court ruled that a binding arbitration agreement voluntarily entered into by an agent under a general power of attorney for an incapacitated person was valid. The agreement for admission to the care facility stated: "The execution of this Arbitration Agreement is voluntary and is not a pre-condition to receiving medical treatment at or for admission to the Facility." The agent later filed a complaint against the facility alleging negligence and violation of A.R.S. §46-455. The defendant filed a motion to compel arbitration. The trial court had denied the defendant's motion to compel arbitration, and the court of appeals reversed. The court of appeals did not agree with appellee's argument that §46-455(O), providing that civil remedies of the statute are supplemental and

remedial, precluded binding arbitration, since an arbitrator in applying substantive law would have the power to apply APSA in resolving the case. The court ruled that the language of subsection (O) is intended only to avoid having other statutory provisions limit the application of APSA. The court of appeals agreed with the trial court that A.R.S. §12-1503 allows for substitution of another arbitrator where a AAA arbitration panel, called for in the arbitration agreement, is unavailable in the case.

- C. **Parker v. Dometri Investments**, LLC, 1 CA-CV 07-0072, confirmed that a purchaser of property from a claimant, who had acquired the real property under an affidavit executed and filed according to A.R.S. §14-3971(E), relying on that affidavit, takes title to the real estate under A.R.S. §14-3972(C) in the same manner as a purchaser acquiring property from a personal representative under A.R.S. §14-3910, free of the rights of any person interested in the estate, regardless of the propriety of the sale or the actual rights of the person acquiring the property by affidavit. Those interested in the estate must pursue the affiant. This was true even though the affiant had disclaimed any interest in the property years earlier and was not entitled to the property upon the death of the decedent. Instead, the property was to pass by pourover will to the separate property trust of the decedent and then to his children by a former marriage. However, affiant acquired the real property by affidavit, and then subsequently conveyed the property to Dometri Investments, LLC, for value. The LLC was therefore entitled to rely on the affidavit and had no duty to inquire into the affiant's actual legal entitlement to the property.

- D. **Stephenson v. AHCCCS**, 1 CA-CV 06-0785. The court of appeals held that a secured creditor could foreclose on its security interest by trustee's sale without first seeking permission from the personal representative, with was the Arizona Health Care Cost Containment System (AHCCCS), or from the probate court. AHCCCS had recorded a Notice of Medical Assistance Lien against the real property in June 2004, AHCCCS filed a petition for appointment as PR in July 2004 and was appointed in December 2004, and the trustee under the deed of trust recorded a notice of trustee's sale in October 2004. The trustee's sale was conducted on January 18, 2005. The court ruled that secured creditors do not have to use probate proceedings to enforce any security even after the appointment of a personal representative.

- E. **In re Friedman Family Trust**, 1 CA-CV 06-0723. The court of appeals applied a standard of "malice" in determining whether the costs of a special administrator

appointed to investigate an APSA claim under A.R.S. §46-456 should be borne by the beneficiaries of the trust or estate that are bringing the claim. The court cited the provisions of APSA giving immunity from civil liability to those bringing an APSA claim in good faith, and absent malice, in finding that the costs of a special administrator appointed to investigate such claims should be borne by parties bringing that claim only if the parties acted maliciously, meaning with a primary purpose other than safeguarding a vulnerable adult from abuse or exploitation.