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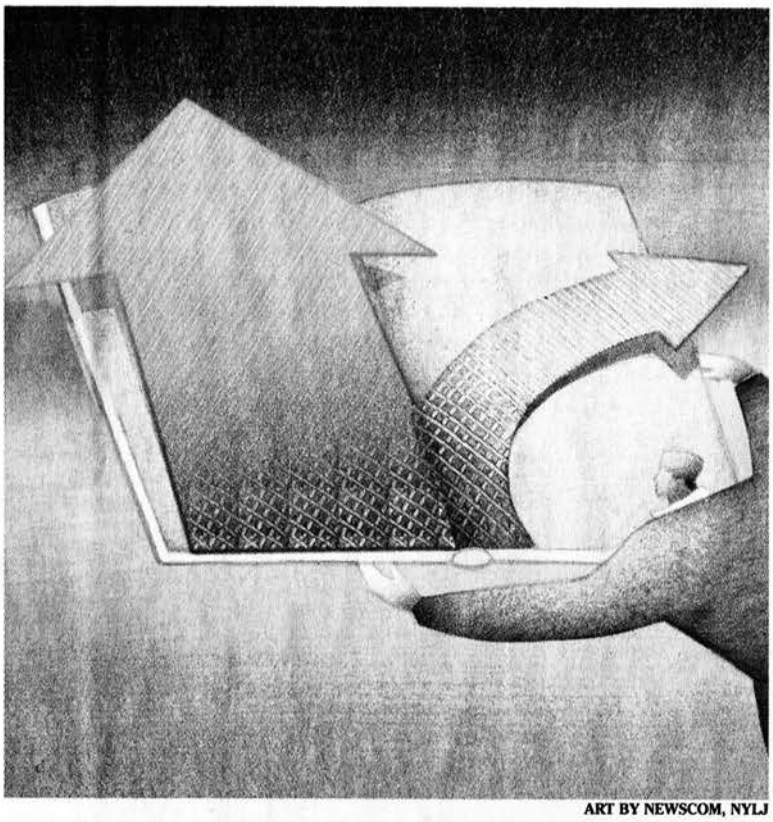

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Departing From Terms Of a Trust

Doctrine of equitable deviation comes into play.

BY BRUCE M. DICICCO

A CASE decided by the Surrogate's Court of Kings County and two cases decided together in a combined decision by the Surrogate of New York County have had occasion to bring to mind the "Doctrine of Equitable Deviation" applicable to the law of New York Trusts.

The Brooklyn case reaches a different result than the New York cases as to the permitted scope of the Doctrine of Equitable Deviation (hereinafter sometimes referred to as the Doctrine). The Doctrine is known by many lawyers as one that would allow a court of equity to permit a departure from the terms of a trust where there has been an unforeseen change in circumstances that threatens to defeat or substantially impair the purposes for which the trust was created. The purpose of this article is to examine the origins of the Doctrine and to comment upon the decisions of the Surrogate Courts only as they relate to it.

Bruce M. DiCicco, *an attorney with an LL.M. in federal taxation, practices in Manhattan.*

At the outset it should be noted that the doctrine of trust reformation (or reformation) is not the same doctrine as the Doctrine of Equitable Deviation being discussed in this article, notwithstanding the fact that many courts have probably applied their equitable power while describing the relief as reformation. Reformation of a trust has been permitted to correct errors in language, particularly when an estate tax issue has arisen due to an oversight of the draftsman. See, for example, *Estate of Hunt T. Dickenson*, NYLJ 8/4/99 (Surr. Ct., New York Co.) aff'd, 273 A.D.2d 89, 709 NYS2d 69 (1st Dept. 2000); reformation of a trust should not be granted if such would contradict a decedent's intention. NY Jur. 2d, Cancellation of Instruments, §80.

The cases discussed here indicate that the Doctrine of Equitable Distribution was one devised by courts of equity to supply an intent where that intent was lacking or the intent expressed prohibited an action that was needed to allow the protection of trust assets. One of the earlier introductions of the Doctrine into the law of New York State occurred in the case of *Toronto Gen. Trusts Co. v. Chicago B. & Q. R. Co.*, 64 HUN 1, 8, 18 NYS 593, 596. (Sup. Ct. 1st Dept., 1892). In that case, the decedent left stock in trust for his wife with power of sale after her death. The stock had lost 40 percent of its value from the date of death of the decedent to the time of its sale. The court went on to state that the trustees were correct in selling the stock because "reason and justice" required it. The court never used the words Doctrine of Equitable Deviation but the court stated:

> It frequently occurs, however, that courts, in the administration of justice, are obliged, not only to enlarge or vary the terms of a trust by implication, but even to imply an intention to create a trust where a trust has not been directly or expressly declared in terms. *Toronto Gen. Trusts Co. v. Chicago B. & Q. R. Co.*, supra, at 595.

In 1924 *Matter of Pressprich's Estate*, 124 Misc. Rep. 15, 207 NYS 412 (Surr. Ct. New York Co. 1924), was decid-

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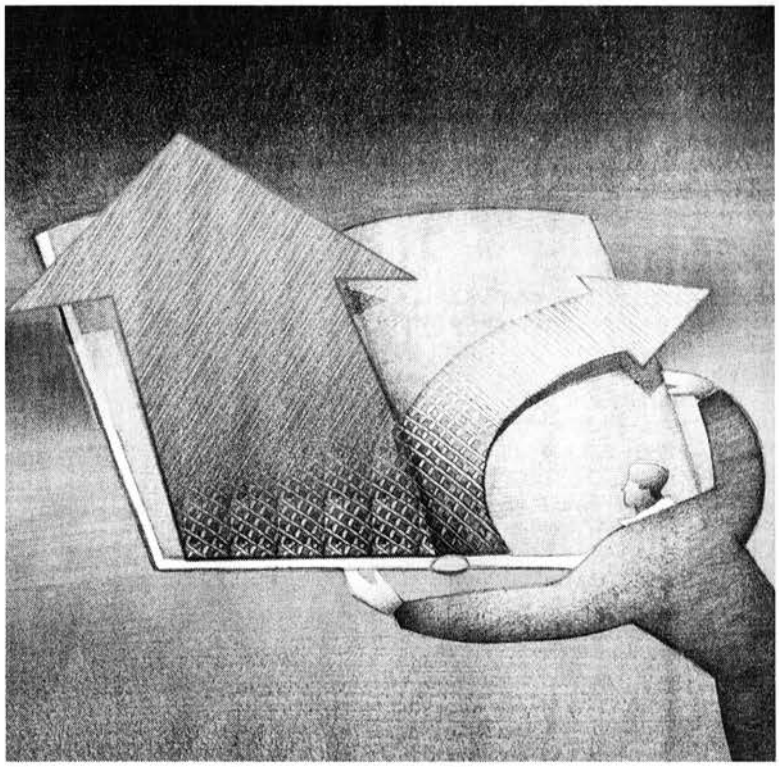
ed by the Surrogate of New York County. The will directed that there be no sale of assets until they became "non-income" producing. The court held, however, that an implied power of sale existed where the asset value was declining and such decline would eventually lead to there being no income produced by the investment. The decision states:

> While the exact point involved here does not appear to have been passed upon by the authorities in this state, it does appear that somewhat similar provisions contained in a will have been construed by the courts from the standpoint of the protection of trust funds rather than blind obedience to the language used by the testator. *Matter of Pressprich's Estate*, supra, at 415.

The court thus allowed the deviation from the express terms of the will when the precipitous decline in the value of the investments would surely lead to the failure of the company to pay dividends in the then foreseeable future.

Five years later, in *Matter of Quinby's Will,* 134 Misc. Rep. 296, 235 NYS 308 (Surr. Ct. Kings Co., Wingate, J., 1929), the court had before it a request by the trustee to authorize its power to sell stocks held in a trust upon the prospective transferee refusing the attempted sale on the grounds that the trustee had no such power. The court held that the trustees were empowered by the language in the will but expressly based the ruling in the case on a broader equitable ground. The court held that even if the will had not so empowered the trustees there was an implied power of sale. The court cited *Toronto Gen. Trusts Co. v. Chicago B. & Q. R. Co.*, supra, for the proposition that a power of sale always existed to prevent waste of trust assets.

The context of the rulings in the cases cited above all involved granting fiduciaries power to sell investments and it seems reasonable for one to argue that the Doctrine be limited to such grounds. It is, however, also reasonable to argue a broader application, and the cases certainly indicate that the issue being addressed by the courts in a general sense was the plight of trustees who were faced with dilemmas created by testators who not only failed to foresee events that imperiled their trusts, but left directives that would prevent the trustees from taking actions to move to safer ground when such perils were foreseeable.



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Protecting the Trust

The trilogy of the above cited cases, among others including numerous foreign jurisdictions cited in these cases, were then later relied upon in the case of *In Re Pulitzer's Will*, 139 Misc. Rep. 575, 249 NYS 87 (Surr. Ct. New York Co.), decided in 1931. There, Joseph Pulitzer left a will and codicil admitted to Probate wherein he established a trust funded by his stock ownership in Press Publishing Company and the Pulitzer Publishing Company but expressly prohibiting the sale of the Press stock. The court held that an implied power of sale exists in cases where sales are necessary to protect the trust from loss. The court stated:

> Courts of equity in other jurisdictions have found power to relieve against the provisions of the instrument by granting the authority to dispose of perishable property or wasting assets, despite the express command or wishes contained in the will. *In Re Pulitzer's Will*, supra, at 95.

The *Pulitzer* court also cited in support of its rule, various out-of-state cases and *Matter of O'Donnell*, 221 NY 197 (1917), involving instead, the application of the then effective §105 of the Real Property Law (now repealed); *Bigelow v. Tilden*, 52 App. Div. 390, 65 NYS 140 (1900), involving the application of the then effective §105 of the Real Property Law; *Matter of Varet's Estate*, 181 App. Div. 446; 168 NYS 896, (1st Dept. 1918), aff'd in *Matter of Feitner*, 224 NY 573 (1918), construing the words "as soon as may be" to include the word "reasonable" so that the clause was read to mean "as soon as may be reasonable after my demise"; and *Matter of Wotton*, 59 App. Div. 584. 69 NYS 753

(App. Div. 1st Dept. 1901), speaking to the issue of whether or not the executor had a power to obtain non-statutory investments. These cases did not involve situations where the court acted "despite the express command or wishes contained in the Will" and are more largely based on the interpretation and the intent of language rather than on equitable actions of the court.

Toronto Gen. Trusts Co. v. Chicago B. & Q. R. Co., supra, *Matter of Pressprich's Estate*, supra, and *Matter of Quinby's Will*, supra, are, however, still available candidates for the genesis of the doctrine in New York State. By April 27, 1942, the Surrogate of Ontario County was of the view, as stated in *In Re Young's Will*, 178 Misc. 378, 34 NYS 2d 468 (1942), that

> The courts of this state have uniformly permitted a deviation from the terms of a trust whenever its provisions have become impracticable or impossible of fulfillment. *In Re Young's Will*, supra, at 471.

The Surrogate found it unnecessary to cite any authority to support the view that deviation was "uniformly" permitted when he allowed re-investment of trust assets in contravention of an express requirement to only permit re-investment in first mortgages secured by real property having a value of at least twice the mortgage. Such investment vehicles were not available, and thus, the court was acting to again protect trust assets by allowing investments contrary to the express terms of a trust. So by 1943, just 12 years after *Matter of Pulitzer*, supra, the Doctrine was invoked without citation.

Indeed, *Matter of Pulitzer*, supra, was cited as controlling authority in *In Re Roche's Will*, 233 AD 236, 251 NYS 347 (App. Div. 4th Dept. 1931), holding that the prohibition against sale of assets prior to conclusion of estate administration could be ignored when retention would result in loss of value, and in *In Re Proctor's Will*, 157 Misc. 706, 284 NYS 675 (Surr. Ct. Westchester Co. 1935), where decedent died in 1929 funding his trust with a $4 million mortgage, holding that the trustee could extend the term and allow unusual protections to sub-lessees without any foreclosure action in order to allow the mortgagor suffering from the economic downturn of the Great Depression to continue to attempt payment.

Recent Cases

This brings me to *Matter of Ciraolo*, NYLJ, p. 31, 2/9/01, (Surr. Ct., Kings Co., Feinberg, J.), and the companion cases of *Matter of Sylvia U. Rubin* and *Matter of Katharine H. Mortimer*, NYLJ p. 24, Col. 5, 6/15/04 (Surr. Ct., New York Co. Preminger, J.), all involving trusts created prior to the landmark decision in *Matter of Escher*, 94 Misc.2d 952, 407 NYS2d 106 (Surr. Ct. Bronx, Co., Gelfand, J. 1978), aff'd sub nom 438 NYS2d 293 (1981), and the enactment in 1993 of EPTL §7-1.12 that established the supplemental needs trust (SNT) for Medicaid applicants.

The court in *Matter of Rubin* and in *Matter of Mortimer*, supra, states that the Brooklyn Surrogate in *Matter of Ciraolo*, supra, applied the Doctrine of Equitable Deviation in reaching the result in the case. The decision in *Matter of Ciraolo* states, however, that the trust is being "reformed." In the *Ciraolo* case there was no mistake in the instrument. The testator simply drafted a will in which a testamentary trust existed for certain beneficiaries vesting upon attaining age 21. One of those beneficiaries was disabled, so the petitioner requested an SNT be created by order of the court into which the residue due that beneficiary would flow. The creation of the SNT would thus permit the beneficiary to receive Medicaid. The court allowed the "reformation" stating:

> It is divorced from the realities of life to presume that if the testator were aware of the facts as they now exist, he would desire to pay the immense cost for his child's care in preference to having society share his burden. (Citing *Matter of Escher*, supra.)

(The New York Surrogate obviously recognized the Doctrine of Equitable Deviation when she saw it and which had been ably pointed out by the guardian ad litem in the New York case.)

The petitioner in *Matter of Rubin*, supra, sought to establish the distribution to an entirely new trust created by the father of the Medicaid applicant with limited amounts payable to the applicant and remainder passing free of creditors to other beneficiaries. In *Matter of Mortimer*, supra, three trusts were terminating providing for a distribution of principal of approximately $900,000 to a disabled child who was already receiving Medicaid, and petitioners sought the creation of a new trust that would qualify as an SNT. The remainder of the new trust would also pass free of creditors (read Medicaid).

The court denied the applications for reformation stating that there was no mistake which required reforming, and reformation may not be used to change the terms of a trust to effectuate what the settlor would have done had the settlor foreseen the change of circumstances that has occurred. The decision then addressed the Doctrine of Equitable Deviation but rejected its application stating that a prerequisite for allowing deviation from the trust terms was lacking. The petitioners had not shown that the presumed intent of the settlor was incapable of fulfillment under the trust as drafted in that the beneficiaries were still being provided for from the trust, albeit with a shorter term, than if Medicaid were paying the bills.

Is failed intent a requirement of the Doctrine? Arguably the case history indicates that the Doctrine applied not where the intent was impossible to be achieved, but rather where the intent was the antithesis of that which was needed to protect the trust assets. It is more likely that the reference to intent meant that the beneficiaries were not at risk in that the trust was intact and would be providing for the beneficiaries. This interpretation of the intent language would at least ease the reconciliation of the case law set forth in this article.

Would the creation of the SNT protect the trust assets in the situations encountered in the two recent Surrogate Court cases? Clearly yes, but was there an emergency? The genesis of the Doctrine shows that peril was always in play when equity was called off the legal shelf to save the day/money. Perhaps the size of the Brooklyn trust was such that an emergency was more immediate? Does the astronomical cost of nursing home care create an "emergency," since to absorb such costs is sure to rapidly deplete alarmingly sizeable amounts of capital? In *Matter of Pressprich's Estate*, supra, though, the funds were not yet in the situation in which it was no longer producing income, so was the danger imminent in that case? Is it a matter of degree? These seem open questions as applied to SNTs and the usefulness of the Doctrine.

The New York Surrogate also distinguished the Brooklyn case by calling attention to the following specific language used in that decision:

> Since the revision does not alter the testamentary scheme of the testatrix and each beneficiary retains the same interest accorded him by the will, the application is granted....*Matter of Ciraolo*, supra.

The New York case, in contrast, states that the beneficiaries were affected if the court were to allow the deviation in that the creditors would not recover from the third-party SNTs:

> The reformation as requested would increase the shares of the siblings of the disabled beneficiaries at the expense of credi-

tors, particularly the state and federal governments that supply the medical benefits petitioners want to preserve.

It seems, however, that the Brooklyn SNT would also escape the reach of creditors but the Brooklyn decision did not so note the effect on creditors, and as mentioned, the Brooklyn Surrogate specifically stated that there was no effect on the beneficiaries.

Perhaps, however, the Brooklyn Surrogate simply did not consider the rights of creditors as constituting a change of beneficiary shares. The New York court thus enunciates another criteria for the application of the Doctrine, namely that there be no effect on the rights of beneficiaries (including creditors). But did not *In Re Proctor's Will*, supra, summarized herein above, affect the rights of the beneficiaries when it applied the Doctrine? In that case, you will recall, the term of the mortgage was extended and rights were granted sublessees that did not exist prior to the application of the Doctrine.

The parameters of the Doctrine of Equitable Deviation may be influenced by the recent decisions but it is nonetheless grounded deep in New York trust law and should be pled when trust assets are in jeopardy and substantial roadblocks appear to exist in governing instrument language that explicitly prevents corrective action. Doing so at the expense of Medicaid, however, seems to be unavailing—at least in New York County.