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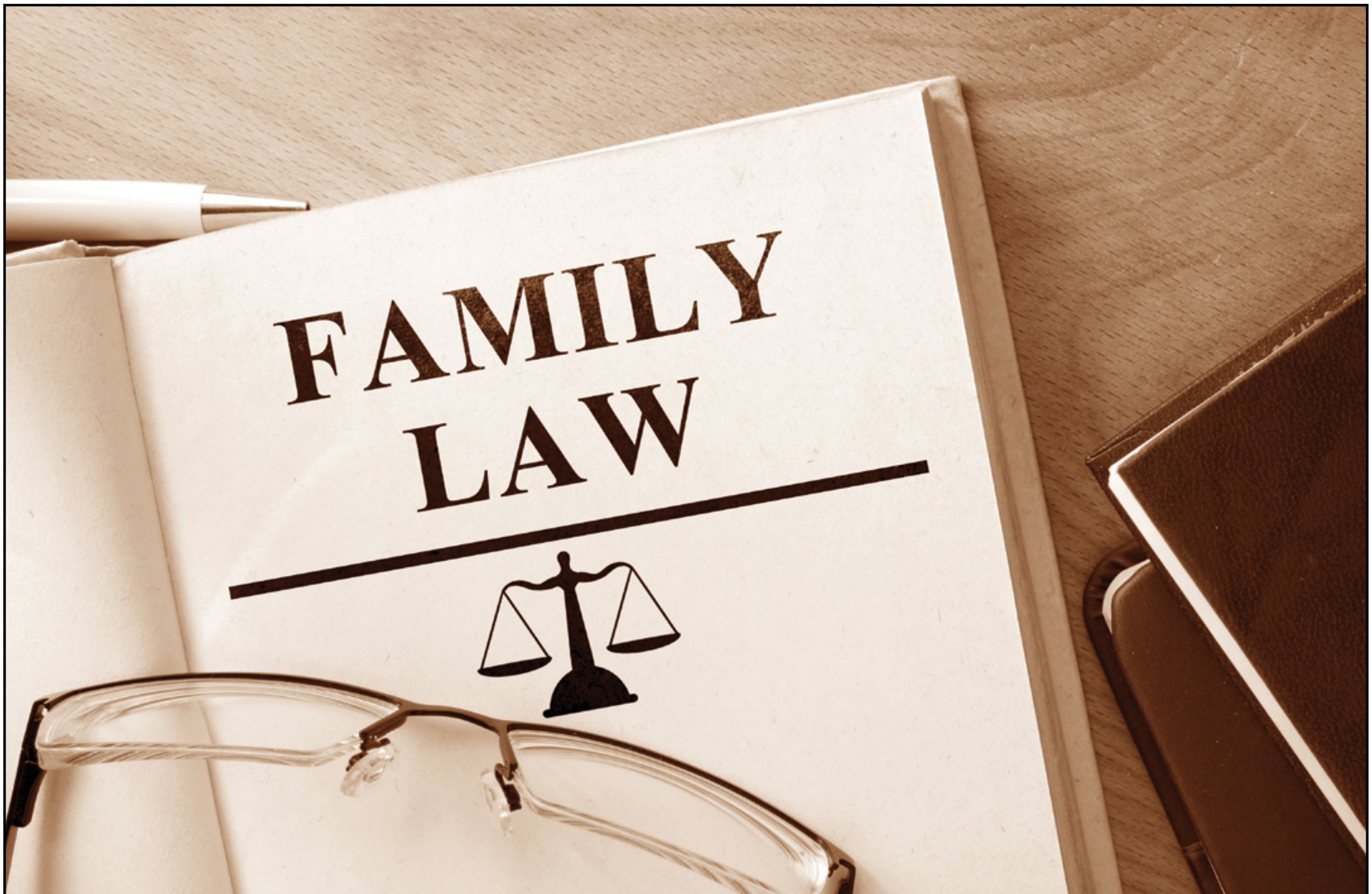

The End of the "Alimony" Deduction

By Lee Rosenberg, Editor-in-Chief

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The End of the "Alimony" Deduction Under the "Tax Cuts and Jobs Act of 2017": The Need to Deviate on Presumptive Spousal Support and the Unknown Future

By Lee Rosenberg, Editor-in-Chief

As those following the national news are aware, the "Tax Cuts and Jobs Act of 2017" is a major revision of United States tax law. What is lost on the general public, but as most practitioners know beginning in 2019, this legislation also eliminates the "alimony deduction"[1] which we all rely upon in calculating and negotiating spousal support.[2] The effect of same throws out decades of settled principle which interacts with child support as well as equitable distribution. By way of negotiation, the incentive of the deduction to the payor is gone—as is the ability to make the payment tax free in the course of those negotiations. Beyond this, New York's enactment of a presumptive spousal support award for both temporary and final support[3] continues to provide a formula to be followed which, like the Child Support Standards Act (CSSA), does not consider federal or state tax consequences in its determination of income to which the formula will apply. So, what now?

This article suggests that unless and until the New York State Legislature amends the statute to provide for the consideration of taxes in the income calculation, courts should not hesitate to deviate from the presumptive formula in light of the elimination of the alimony deduction.

The Tax Law

Under the previously existing United States Tax Code, "alimony" as was defined in Internal Revenue Code (IRC) Section 71 is deducted from the payor's income under IRC 215 and added to the recipient's income under IRC 71, as long as the requisite criteria are met. State divorce courts did have discretion to make awards non-deductible and tax free in certain cases.[4] A departure from the norms envisioned by those Internal Revenue Code provisions may otherwise have been considered to be error.[5] Practitioners also had to be aware of the dangers of "alimony recapture" to make sure that the agreed-upon spousal support did not lose its deductibility when front-loading spousal support in the first three "post-separation" years[6] of payment.[7]

Under the "Tax Cuts and Jobs Act of 2017," the repeal of the existing law relating to deductibility is set forth in Section 1309 in its elimination of IRC 71 and 215. The former IRC 71(b)(2) which defined the "Divorce or Separation Instrument" will be found in a new Section 121(d)(3)(C) as follows:

> DIVORCE OR SEPARATION INSTRUMENT.—For purposes of this paragraph, the term 'divorce or separation instrument' means—
>
> "(i) a decree of divorce or separate maintenance or a written instrument incident to such a decree, (ii) a written separation agreement, or (iii) a decree (not described in clause (i)) requiring a spouse to make payments for the support or maintenance of the other spouse."[8]

Related provisions of the prior law were then amended/stricken to correspond with the elimination of the alimony deduction and the following also added:

> SPECIAL RULES FOR SUPPORT.—
>
> "(A) IN GENERAL.—For purposes of this subsection—
>
> "(i) payments to a spouse of alimony or separate maintenance payments shall not be treated as a payment by the payor spouse for the support of any dependent, and (ii) in the case of the remarriage of a parent, support of a child received from the parent's spouse shall be treated as received from the parent.
>
> "(B) ALIMONY OR SEPARATE MAINTENANCE PAYMENT.—For purposes of subparagraph (A), the term 'alimony or separate maintenance payment' means any payment in cash if—

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> "(i) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument (as defined in section 121(d)(3)(C)), (ii) in the case of an individual legally separated from the individual's spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and (iii) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse."[9]

The law will be effective as to any divorce or separation instrument executed *after December 31, 2018 and* to any such instrument [as defined under the old law at 71(b)(2)][10] executed on or before December 31, 2018 and subsequently modified, if the modification *expressly* provides that the new law will apply to such modification.

Prior "Divorce or Separation Instruments"

So for purposes of protection on existing agreements and orders, as far as the IRS will be concerned will a Stipulation of Settlement pending a Judgment of Divorce be deemed a separation instrument or an agreement incident to the decree if the decree is signed after December 31, 2018? Are tax deductible pendente lite orders still good for the time being until the case is finalized or will there be an automatic *retroactive* adjustment? What about the time lag between a trial decision and entry of judgment—even if called a "decision and order" with decretal paragraphs? Navigating these issues without consulting with qualified tax professionals would seem to be a recipe for disaster in advising our clients. If, for example, transferring an IRA under a Stipulation of Settlement (to be incorporated into and to survive the final decree) in advance of the court's signing the judgment would result in a tax consequence, can we define with certainty how the IRS would treat the support deduction? Will the court "So Order" the stipulation of settlement? Can we still look to prior Tax Court decisions to guide us? This is all uncharted territory. In the June 1, 2017 decision in *Mudrich v. Commissioner of Internal Revenue*,[11] the United States Tax Court discussed the issue of the agreement:

> Section 71(b)(1)(A) requires that the payment be "received by (or on behalf of) a spouse under a divorce or separation instrument." Section 71(b)(2) defines a "divorce or separation instrument" as a decree of divorce or a written instrument incident to such a decree, a written separation agreement, or a decree requiring a spouse to make payments for support or maintenance of the other spouse. The record does not support a conclusion that the payment at issue was made pursuant to a divorce or separation instrument.
>
> The record *does not contain sufficient evidence* to indicate that the bonus agreement is a decree or a written instrument incident to a decree. There is no evidence in the record showing that the bonus agreement ever became an order in the divorce proceeding. Moreover, the bonus agreement is not a written separation agreement. *The term "written separation agreement" has been interpreted to require a clear, written statement memorializing the terms of support between the parties and entered into in contemplation of separation status*. (Endnote omitted). There is no question that Mr. Mudrich and Lauri entered into a bilateral written agreement; however, that agreement specifically provides for division of community property and not support. Thus, the bonus agreement is also not a written separation agreement.
>
> Because the bonus agreement was not a divorce or separation instrument, the payment to Lauri pursuant to the bonus agreement is not alimony. (Emphasis added).

Mudrich cites to *Jacklin v. Commissioner* from 1982,[12]

> *Neither section 71(a)(2) nor the regulations promulgated thereunder define what constitutes a "written separation agreement."* (Endnote omitted). The predecessor of section 71 was enacted to tax support payments to the recipient spouse and to relieve the payor spouse from the burden of being taxed on such payments by making them deductible by him. H. Rept. 2333, 77th Cong., 2d Sess. 46 (1942), 1942-2 C.B. 427; S. Rept. 1631, 77th Cong., 2d Sess. 83-87 (1942), 1942-2 C.B. 568. Initially, this benefit was available only in the case of divorce or a legal separation. Sec. 71(a)(1).9 Section 71(a)(2) extended this benefit to spouses who are not divorced or legally separated under a court decree but who are in fact separated and enter into a written separation agreement. H. Rept. 1337, 83d Cong., 2d Sess. 9 (1954); S. Rept. 1622, 83d Cong., 2d Sess. 10 (1954).
>
> ...Another somewhat analogous case lends support to our approach here. *Bo-*

gard v. Commissioner*, 59 T.C. 97 (1972). Like the present case, *Bogard* involved a written agreement between the spouses providing for the wife's support and maintenance. However, the agreement itself made no reference to the spouses' separation. Respondent argued that the agreement did not constitute a "written separation agreement" within the meaning of section 71(a)(2) because the document did not state that the parties had separated and were living apart. The Court declined to follow such a formalistic approach and held that the statute merely required an actual separation which could be established by extrinsic evidence. The husband was permitted to prove that he and his wife were in fact separated. The Court declined to hold that the agreement was insufficient as a matter of law.

Leventhal v. Commissioner,[13] which references *Jacklin*, is also cited by the *Mudrich* court:

> As no decree of divorce or separate maintenance was in effect during the years in issue, we must decide whether all or some of the payments were received by or on behalf of Hermine under a written separation agreement.
>
> The term "written separation agreement" is not defined in the Code, the applicable regulations, or in the legislative history. *Jacklin v. Commissioner* [Dec. 39,278], 79 T.C. 340, 346 (1982); *Keegan v. Commissioner* [Dec. 52,190(M)], T.C. Memo. 1997-359. A written separation agreement has been interpreted to require a clear statement in written form memorializing the terms of support between the parties. See *Jacklin v. Commissioner*, supra at 350; *Bogard v. Commissioner* [Dec. 31,570], 59 T.C. 97, 101 (1972). Letters which do not show a meeting of the minds between the parties cannot collectively constitute a written separation agreement. (Citations omitted) However, where one spouse assents in writing to a letter proposal of support by the other spouse, a valid written separation agreement has been held to exist. See Azenaro v. Commissioner [Dec. 45,684(M)], T.C. Memo. 1989-224. Furthermore, a written separation agreement will not fail simply because it does not enumerate a specific amount of required support, so long as there is some ascertainable standard with which to calculate support amounts. See *Jacklin v. Commissioner*, supra at 348-351.

Leventhal then cites back to a 1949 decision in *Jefferson v. Commissioner*[14] in which the court discusses whether or not a May 20, 1941 letter addressing support for the years 1942 and 1943 was a "written instrument" that was "incident to" a divorce decree initially entered on July 23, 1941:

> The doctrine is well settled that an instrument purporting to set forth the mutual obligations of the parties signed and performed by one of the parties and acquiesced in by the other, is to be regarded as a written contract. See 17 C. J. S., Contracts, p. 409, § 59. We agree with the contention of petitioner that the terms of the letter of May 20 with reference to the support and maintenance of Violet constituted a "written instrument" within the intendment of section 22 (k), supra.

Since, however, the new Tax Law will be untested and it will be unknown how new judicial appointees may view the deductibility issue, it would seem that *at the very least*, we must do the following: (1) Use separation language in our settlement agreements; (2) add language that it is intended for the agreement to be incident to the parties' divorce; (3) provide for adjustments in the agreement in the event the deductibility is lost; (4) consult with qualified tax experts; (5) make sure any agreements are specific on the issue regarding the client's consultation with tax experts, and carefully set forth all related exculpatory provisions; (6) be prepared to present evidence of the tax ramifications on the issue in motion practice and at trial; (7) don't forget to add all appropriate language to *prenuptial agreements*; (8) beware of merging 2018 agreements into the judgment of divorce as the agreement will no longer separately exist.

The Effect of the Tax Change on Presumptive Support Guidelines

After much discussion, controversy and debate, New York's current support statute on final maintenance went into effect as to those cases commenced on or after January 25, 2016. The temporary support statute [DRL§ 236B(5-a)] went into effect initially on October 12, 2010 and was then amended as to cases commenced on or after October 25, 2015. Under all, income to be used is governed by the definitions used in the determination of child support under the CSSA beginning with "Gross (total) income as should have been or should be reported in the most recent federal income tax return."[15] For child support purposes, the adjusted gross income in calculating that presumptive award will consider spousal maintenance which is paid.[16] Presumptive child support is then calculated after allowable deductions, including spousal support payments, based upon CSSA-defined adjusted gross income.

Under the long existing tax law, the "alimony" deduction is set forth on the IRS Form 1040 at line 31a, "Alimony paid" in the "Adjusted Gross Income" Section. Such payments, if qualifying under IRC §§ 71 and 215, reduce the taxpayer's income by 100% of the payment before determining the amount of tax which is due and adds the payment to the recipient's income. Under the CSSA, taxes, other than New York City or Yonkers taxes actually paid,[17] are *not* deductible from gross (total) income when calculating the presumptive basic child support obligation so that the child support payment is tax free to the recipient and the payor gets no financial tax benefit. While this is a "given" in calculating child support, the maintenance guidelines are presumptively established with the historic notion that the spousal support payment will be deductible by the payor and income to the payee. The change in the tax law now unfairly skews that presumption.

Deviation

Given that in the enactment of the maintenance formulas, such a drastic change in the tax law was not considered, the recipient receives a windfall by virtue of a tax-free payment that was not contemplated, and the payor loses a tax deduction which may very well have also been used in arriving at the temporary order and in a settlement agreement. This is simply "unfair and inequitable."

When the initial temporary spousal support law was passed, it was widely criticized for what the law did not consider. It was then left up to the courts to correct the inadequacies so as to provide fairness. It took the legislature some six intervening years to statutorily catch up and given that history, further amendment to adjust for the change in the tax law could very well be far off. Such a change is imperative and necessary. Our courts, however, sitting in equity and with the ability to deviate from the "presumptive" and now tax-free award, do not and should not have to wait for that to occur. The statute provides for deviation when the result would be unjust, based upon stated factors, specifically including the "tax consequences to each party" as is set forth in factor "j" of DRL §§ 236B(5-a)(h)(1) and 236B(6)(E)(1) and the catch-all "any other factor which the court shall expressly find to be just and proper."

When the initial temporary support law was passed, it was legislatively designed to "income shift."[18] But, as was referenced in *Khaira v. Khaira*,[19] the law did not contemplate or address the issue of "whether the statutory formulas are intended to include the portion of the carrying costs of their residence attributable to the non-monied spouse and the children." Accordingly, the court had to fashion an equitable remedy which is "reasonable and logical" by "view(ing) the formula adopted by the new maintenance provision as covering all the spouse's basic living expenses, including housing costs as well as the costs of food and clothing and other usual expenses." In considering the statutory factors, the court is within its discretion to find the presumptive award to be unjust or inappropriate.[20] In *Harlan v. Harlan*,[21] the court, considering statutory factors *vis-a-vis* the presumptive guidelines in the wife's claim for an *upward* deviation, noted "the statute's attempt to reserve to the court a *seemingly endless equitable power* to achieve a 'just and proper' temporary maintenance allocation. In prior cases, this court, among others, have used the broad scope of the (q) factor to evaluate temporary maintenance proposals." (Emphasis added). The court then, among many other factors cited, "calculate(d) the tax consequences" to the parties in trying to find that "just and proper" result.[22]

Such basis for deviation should now be used in light of the elimination of the alimony deduction.

The Rush to Resolution

As the last minute adjustments to the Tax Cuts and Jobs Act of 2017 provided an extension of time for its effectiveness until December 31, 2018, there is some time for the bench and bar to start examining the ramifications of the elimination of the alimony deduction. In the interim, there will be a push to get cases settled and tried to conclusion—with the entry of judgment—before the end of 2018. Given the overwhelming caseloads of our trial and appellate courts, however, the squeeze will be on. Whether the New York State Legislature will want to, or be able to, adjust the maintenance statutes after having previously undertaken the arduous path to enactment and amendment, remains to be seen. As is most often the case, it will be up to counsel to be creative and our matrimonial courts to provide equity, as new law will have to be made to address the "upside down"[23] created by the change in the tax law. Once more into the breach, dear friends.[24]

Endnotes

1. The United States Tax Code has continued to use the term, "alimony" while New York transitioned from "alimony" to maintenance" as part of the statutory changes made in 1980.
2. While the elimination of the alimony deduction went largely undiscussed in light of other controversial aspects of the legislation, the American Academy of Matrimonial Lawyers voiced its opposition to the provision by Resolution on November 15, 2017.
3. DRL §§ 236B(5-a) and 6.
4. Internal Revenue Code (26 USC) §71(b)(1)(B); *Bragar v. Bragar*, (1st Dep't 2000); *Kesten v. Kesten*, 234 A.D.2d 427 (2d Dep't 1996); *Lowe v. Lowe*, 211 A.D.2d 595 (1st Dep't 1995).
5. *Siskind v. Siskind*, 89 A.D.3d 832 (2d Dep't 2011); *Grumet v. Grumet*, 37 A.D.3d 534 (2d Dep't 2007).
6. IRC 71(f)(6) "Post-separation years. For purposes of this subsection, the term "1st post-separation years" means the 1st

calendar year in which the payor spouse paid to the payee spouse alimony or separate maintenance payments to which this section applies. The 2nd and 3rd post-separation years shall be the 1st and 2nd succeeding calendar years, respectively."

7. IRC 71(f)
8. The new language is essentially the same as in the prior definition which was, "The term "divorce or separation instrument" means (A) a decree of divorce or separate maintenance or a written instrument incident to such a decree, (B) a written separation agreement, or (C) a decree (not described in subparagraph (A)) requiring a spouse to make payments for the support or maintenance of the other spouse."
9. Section 152(d)(5)
10. *Supra*, note 6.
11. T.C. Memo 2017-14.
12. 79 T.C. 340 (1982).
13. 79 T.C. 1670 (2000).
14. 13 T.C. 1092 (1949). *See also Micek v. Commissioner*, T.C. Summary Opinion (2011-45) from April 6, 2011 involving a spousal support affidavit signed only by the husband qualifying as a "written separation instrument."
15. DRL § 240(1-b)(b)(5)(i).
16. See DRL § 240(1-b)(b)(5)(iii)(I); DRL § 240(1-b)(b)(5)(vii)(C); DRL §§ 236B(5-a)(c)(1)(f); and DRL §§ 236B(6)(c)(1)(g).
17. Also, the full amount of self-employment tax, which is in lieu of the Social Security/Medicare deductions. *See Myesha M. v. Omel McL.*, 61 A.D.3d 534 (1st Dep't 2009); *Haas v. Hass*, 265 A.D.2d 887 (4th Dep't 1999); *Carlin v. Carlin*, 217 A.D.2d 679 (2d Dep't 1995).
18. *Scott M. v. Ilona M.*, 31 Misc. 3d 353 (Sup. Ct., Kings Co. 2011).
19. 93 A.D.3d 194 (1st Dep't 2012).
20. *Osha v. Osha*, 101 A.D.3d 481 (1st Dep't 2012); *Goncalves v. Goncalves*, 105 A.D.3d 901 (2d Dep't 2013); *Su v. Su*, 128 A.D.3d 949 (2d Dep't 2015).
21. 46 Misc. 3d 1003 (Sup. Ct., Monroe Co. 2014). Notably, Harlan also provides an interesting discussion on the efficacy of the ongoing prohibition against the pendente lite sale of a marital residence under *Khan v. Khan*, 43 N.Y.2d 203 (1977).
22. The former "catch-all" factor "q" is now "m" under the temporary statute and "o" under the post-divorce support statute. Again, both the temporary and final maintenance statutes at factor "j" specifically reference "tax consequences to each party" for purposes of income over the statutory cap and deviation where the guideline amount is unjust or inappropriate.
23. Stranger Things, Netflix (2016).
24. W. Shakespeare, Henry V, Act III, Scene I.

What Every Matrimonial Attorney Should Know About the Latest Trusts and Estates Developments

By Sharon L. Klein

With the increasing overlap between the matrimonial and trusts and estates disciplines, family law attorneys can benefit from being apprised of the latest trust and estates developments that can potentially have a dramatic impact on their practice. From critical estate planning considerations in marital agreements, to documents that require review in light of a contemplated divorce, to powerful tools that can potentially change otherwise irrevocable trust terms and distributions in the divorce context, to the importance of credit solutions in divorce, to important considerations regarding the use of life insurance, there is much to be gained from having cross-disciplinary fluency.

I. Key Estate Related Considerations in Pre-Marital Planning

A. Portability of Federal Estate Tax Exemption Amount—A Valuable Asset to Consider

The federal estate tax, imposed at a top bracket of 40% in 2017, generally does not apply to transfers between U.S. spouses. In addition, each person has an exemption from federal estate tax, which, in 2017, was $5.49 million. That exemption amount, which is indexed for inflation, was estimated to increase to $5.6 million on January 1, 2018. At the time of this writing, the House and Senate versions of the "Tax Cuts and Jobs Act" and the conference committee report released on December 15, double estate and gift tax exemption amounts, starting in 2018, to $11.2 million per person, $22.4 million per married couple.

Before 2010, the federal exemption amount was a "use-it-or-lose-it" proposition. To give a simple example, assume a married couple both died in 2009 when the exemption amount was $3.5 million, and they each owned assets worth $3.5 million. If they each used their $3.5 million exemption amounts, with trust planning for example, zero federal estate tax would have been due on the death of the survivor. Assume, however, that the first spouse to die did not use her exemption amount and instead left everything to the survivor. If the survivor died with a $7 million estate, the exemption of the first spouse to die would have been wasted and federal estate taxes of $1.575 million would potentially have been payable.

Portability—a concept introduced in 2010, and made permanent since 2012—obviates the use-it-or-lose-it nature of the federal exemption amount. If one spouse does not use the entire exemption amount, it is possible to transfer or "port" the unused portion—called the Deceased Spouse's Unused Exclusion Amount, or "DSUE" Amount—to the surviving spouse.

DSUE is a valuable asset to consider when drafting marital agreements, particularly so if the exemption amount doubles, as seems likely. Consider a prospective husband (H) and wife (W) who are negotiating their pre-marital agreement. H has assets totaling $11 million, while W has assets of only $1 million, which would pass to her heirs other than H, leaving $4.49 million of DSUE in 2017 based on the 2017 $5.49 million federal exemption amount. Generally, H would not ask for any financial considerations from W because of the imbalance in the assets tilted in his favor. However, if W predeceases H and her executor (who could be H) elects to use portability, her $4.49 million DSUE would pass to H. Assuming H dies in 2017, with a top 40 percent federal estate tax rate and a $5.49 million exemption, having W's additional exemption amount to shield estate taxes in his estate could save his heirs over $1.7 million in estate taxes! The potential savings can increase to millions of dollars if estate tax exemption amounts double, and each person can pass a DSUE that would shield the federal estate taxes on $11.2 million of assets. Accordingly, the wealthier spouse (H in this example) should view the DSUE as an important asset, and the less wealthy spouse (W in this example) should use the DSUE as a negotiating tool.

Federal Estate Tax Return Filing Required—Regardless of the size of the decedent's estate, DSUE can only be preserved by a timely filed federal estate tax return (Form 706), which is due nine months from the date of death, 15 months on extension.[1] This means that estates under the federal filing threshold ($5.49 million in 2017) must still incur the cost of filing a federal return, although the standards for Form 706 filing have been relaxed if the return is necessary only for a portability election. Since the return can be filed only by the executor (not the surviving spouse), the need to file the return should be negotiated in the prenuptial agreement to avoid a hostile executor spitefully refusing to file. Although it might be possible to bring a petition to request that a court grant someone other than the executor temporary executorial powers solely for the purpose of filing a return, and although there has been one reported case in which the court required the recalcitrant executor to file a return and elect portability, it is much better practice to plan ahead for this

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important matter. A case involving the recalcitrant executor—*Estate of Anne S. Vose v. Lee* [2]—was recently decided by the Oklahoma Supreme Court. The court required the personal representative (decedent's son from a prior marriage) to make the portability election requested by the surviving spouse, even though the surviving spouse waived all of his rights to the decedent's estate in a prenuptial agreement.

It is also important to consider the consequences if a return, not otherwise required to be filed, must be filed solely in order to protect the DSUE. Costs of filing the return, and costs associated with any audit proceedings, might logically be apportioned to the surviving spouse benefiting from the election. If a return must be filed because the estate is over the filing threshold in any event, consider whether the total cost should be borne by the estate.

B. The Delaware Advantage

1. Another Pre-Marital Agreement Option: Asset Protection Trusts

A Delaware Asset Protection Trust (DAPT) is an irrevocable trust created under Delaware law, with a Delaware trustee. In most jurisdictions, including New York, it is not possible for a person to create a trust for himself and protect the assets from his creditors. Under Delaware law, however, the DAPT generally limits the ability of an individual's creditors to reach the trust assets, while allowing the creator of the trust to remain a trust beneficiary. That includes the right to receive current income distributions, the right to receive a 5 percent annual unitrust payout and the ability to receive income or principal in the discretion of an independent trustee.

Delaware requires a creditor to bring an action against a DAPT in the Delaware Court of Chancery. For claims arising after an individual creates a DAPT, there is a four-year statute of limitations.[3] For claims arising before an individual creates a DAPT, a creditor must bring suit within four years after creation of the trust or, if later, within one year after the creditor discovered (or should have discovered) the trust.[4] For all claims, the creditor must prove by clear and convincing evidence that creation of the trust was a fraudulent transfer as to that creditor.[5] A very limited number of creditors can pursue claims against a DAPT. In the family context, a spouse, former spouse, or minor child who has a claim resulting from an agreement or court order for alimony, child support, or property division incident to a judicial proceeding with respect to a separation or divorce may reach the assets of a DAPT,[6] but a spouse whom the client marries *after* creating the trust may not take advantage of this exception. Accordingly, since future spouses cannot generally assert claims against a DAPT, a client's children can establish these trusts to protect assets from such claims, without providing the financial disclosure that ordinarily is required for enforceable prenuptial agreements.[7]

Giving an independent corporate trustee broad discretion to make distributions to a class of beneficiaries, instead of predicating distributions on an ascertainable standard, is also recommended since a court would be less likely to find such a discretionary interest reachable in divorce.[8] Some practitioners are also recommending inserting provisions in the documents that require a beneficiary's spouse to waive marital rights to trust assets each time the beneficiary is eligible to receive a principal distribution, before the distribution can be made.

2. Silent Trusts

Delaware permits the creation of so-called "Quiet" or "Silent" Trusts, so the trust creator can restrict beneficiary access to information under certain circumstances, even if that information would be required under the laws of other jurisdictions. This might be an effective tool to use in blended marriage situations, in order to minimize friction by restricting information access to children of a prior marriage while a trust is in existence for the life of a second spouse. This is particularly so if the family members know that the trustee administering the trust is a corporate, impartial trustee, with fiduciary obligations to treat beneficiaries fairly within the context of a specific trust agreement.

II. In the Event of Separation and/or Divorce, All Estate Planning Documents, Account Titles and Beneficiary Designations Need to Be Reviewed

All of the client's important planning documents, account titles, and beneficiary designations will need to be updated to be certain chosen heirs are still appropriate, as well as designees for health care and power of attorney documents. Documents to consider include:

- **Will and trusts**

These documents must be reviewed immediately. Consider that not all states provide for revocation on divorce of bequests in wills or other estate planning documents. Even if revocation on divorce does apply, the statute will be inapplicable during the pendency of the divorce, until the final divorce decree is entered.

In New York, Estates Powers and Trusts Law Section (EPTL) 5-1.4 addresses the revocatory effect of divorce on dispositions and fiduciary appointments (such as the appointment of an executor). Unless a will expressly states otherwise, divorce, judicial separation, or annulment of a marriage revokes all dispositions or appointments of property from the divorced spouse to the former spouse and all nominations of the former spouse as executor and trustee. However, because the statute does not cover events during the pendency of a divorce proceeding, it is important to update documents during this time. The following cases serve as reminders of why diligence in planning can be so important.

In *In re Leyton*,[9] the decedent's mother and sister sought to disqualify the decedent's former same-sex partner as executor and a beneficiary under the decedent's will. They argued that he was the equivalent of a former spouse, disqualified from inheriting pursuant to EPTL 5-1.4. The decedent and his former partner had entered into a commitment ceremony in New York in 2002, but were separated before the decedent died.

The Surrogate determined that it is for the legislature to decide matters regarding same-sex marriage, which New York did not recognize until 2011. Accordingly, the court could not retroactively apply the Marriage Equality Act to deem the commitment ceremony to have sanctified the marriage, so the parties could not be deemed divorced. The result was that the former partner, who had actually married another man before the decedent's death, was permitted to act as executor and inherit under the decedent's will. In affirming the decision, the appellate court also noted that, in order for EPTL 5-1.4's "former spouse" provision to apply, there must be a formal decree or judgment ending the marital relationship. No such decree was issued.

While EPTL 5-1.4 provides that divorce revokes dispositions to, and fiduciary nominations of, former spouses, the revocatory effect of the section does not extend to the relatives of an ex-spouse. In *In re Lewis*,[10] EPTL 5-1.4 disqualified the decedent's ex-husband from inheriting under her will or acting as executor. However, the ex-husband's father (the decedent's ex-father-in-law), was the successor beneficiary and executor and he was not disqualified under the terms of the statute. Presumably the ex-husband would inherit or obtain the property from his father, causing an end-run around the statute. While the court acknowledged this, it opined that the statute was clear and unambiguous in omitting the relatives of ex-spouses from disinheritance.

Under a proposal introduced in New York in both houses,[11] dispositions to divorced spouses would continue to be expressly revoked, and there would be a rebuttable presumption revoking dispositions to family members of the ex-spouse. The revocatory effect of divorce would be presumed to apply to a person in any relationship to the divorced individual that was based upon the marriage, including but not limited to step-children, step-grandchildren and parents-in-law, unless there is substantial evidence of the divorced individual's contrary intention. As is currently the case, spouses who are in the *process* of getting divorced, but are not yet divorced, will not be able to rely on any statutory presumption without a formal decree or judgment ending the marital relationship.

The most prudent course of action is *not* to rely on state default law at all. Divorced spouses, spouses in the process of getting a divorce, and unmarried couples who are separated, should give immediate attention to their planning documents, to ensure they reflect their intent (subject to elective share statutes and other legal restrictions).

Importantly, there is generally no revocation on divorce regarding an ex-spouse's interest in an irrevocable trust. Some practitioners use the concept of a "floating spouse," defined as the spouse to whom the trust creator or beneficiary is married from time to time. If an ex-spouse actually is named as a trust beneficiary, other techniques may have to be considered to restructure the trust, including decanting, discussed below.

- **Powers of attorney and health care directives**

It is obviously important to carefully review powers of attorney, which allow a designated person to conduct financial transactions, and health care directives, which allow a designated person to make important health care and potentially end-of-life decisions, to ensure that an estranged spouse is removed from those roles.

- **Retirement accounts and plans, other beneficiary designations, such as life insurance**

State laws that do provide for revocation on divorce may not apply to retirement plan beneficiary designations, which should be reviewed promptly. Spousal rights in retirement plans governed by ERISA are subject to special rules. It is also important to reconsider designated beneficiaries of life insurance policies, discussed further below.

- **Jointly named real estate and financial accounts**

These documents similarly need immediate attention.

- **Authorizations to access digital accounts, including financial accounts, email accounts, social media accounts, etc.**

Note that authorizations to access online financial accounts, social media accounts, and other sensitive information are generally not revoked on divorce and must be changed as soon as possible. In the context of an account owner dying, a uniform law [Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA)] has been adopted in almost every jurisdiction, including New York.[12] RUFADAA provides guidance regarding an executor's and trustee's access to electronic records after the death of the account owner. RUFADAA takes a three-tiered approach:[13]

1. Directions given via a provider's online tool that can be modified or deleted at all times (for example, Google's "Inactive Account Manager," or Facebook's "legacy contacts") prevail over any other direction in a will, trust, power of attorney or other record;

2. If the user has not utilized an online tool, or if the custodian has not provided one, a user's direction in a will, trust, power of attorney or other record prevails; and

3. In the absence of any direction, the generic terms of service agreement ("TOS") controls, which might provide that the account is terminated at death, and all data is deleted.

Accordingly, in order to avoid a provider's generic TOS Agreement from potentially controlling, it is important to use a provider's online tool, if one is provided, to keep that designation updated during lifetime. This is particularly crucial in the event of separation or divorce, and to address these issues in estate planning documents, which are also to be appropriately updated. Otherwise, even if an individual was divorced on death, the former spouse may be authorized to access all the decedent's digital accounts.

III. Trust Decanting Can Be a Powerful Tool: Revising an Otherwise Irrevocable Trust

There has been continued state-level activity regarding "decanting," which allows the trustee of an otherwise irrevocable trust to transfer the trust assets into a new trust with different terms. The rationale behind decanting is that, if a trustee has the ability to make discretionary distributions to or for the benefit of a beneficiary, the trustee should also be permitted to exercise that discretion to distribute trust assets into another trust for that beneficiary. Decanting can be a tremendous tool for dealing with changed circumstances, correcting mistakes, facilitating tax benefits or optimizing a trust's administration.

Uses of decanting include;

- Limiting a beneficiary's rights or eliminating a beneficiary;
- Trustee changes; and
- Changing investment limitations.

Ferri v. Powell-Ferri[14] is a recent example of the power of decanting in the divorce context. Trust assets were successfully moved out of reach of a divorcing wife, although they were considered for alimony purposes. Husband was the beneficiary of a trust (the "1983 Trust") created by his father under which he had the right to receive the trust assets at certain ages. The trust was valued between $69-$98 million. The trustees, who were concerned divorcing Wife would reach trust assets, transferred the assets to a new trust (the "2011 Trust") without the knowledge or consent of Husband. At the time of the creation of the 2011 Trust, Husband had a right to request outright 75 percent of the 1983 Trust assets, and during the course of the legal proceedings, his right matured to 100 percent. The new 2011 Trust extinguished Husband's power to request trust assets at stated ages, making distributions solely discretionary with the trustees. Wife had filed to dissolve the marriage in Connecticut. The trusts were settled in Massachusetts. The Connecticut Supreme Court asked the Supreme Judicial Court of Massachusetts to determine whether the trustees, one of whom was Husband's brother, validly exercised their powers under the 1983 Trust to distribute the trust property to the 2011 Trust. The Massachusetts court determined that since the father, who created the 1983 Trust, intended to convey to the trustees almost unlimited discretion to act, the decanting was authorized. The Massachusetts court did not rule on whether the trust assets must be considered in the divorce, including for alimony purposes.

The Connecticut Supreme Court issued two opinions in the *Ferri* matters, one related to the decanting, the other related to the divorce action.

The *Ferri* Action for Declaratory Judgment: Decanting Was Authorized[15]

The trustees sought a judgment declaring that they were authorized to decant assets to the new trust, and that Wife had no right or interest in those assets. The Connecticut Supreme Court adopted the opinion of the Massachusetts Supreme Judicial Court and held that the decanting was proper.

The Connecticut Supreme Court did affirm the determination of the Connecticut trial court that Wife had standing to challenge the trustees' actions because their actions regarding the original trust directly affected the dissolution court's ability to make equitable financial orders in the underlying dissolution action. Under Connecticut law, the 1983 Trust was a marital asset because Husband had an absolute right to withdraw up to 75 percent, and later 100 percent of the principal.

The *Ferri* Action for Dissolution of Marriage: 2011 Trust Not Marital Asset, but Could Be Considered in Alimony Determination[16]

The court noted that the Massachusetts Supreme Judicial Court determined that the decanting was appropriate: "Consequently, the assets from the 1983 Trust cannot be considered as part of the dissolution judgement..." With regard to the 2011 trust, because that was a so-called "spendthrift trust" (protected from creditors), it was not considered an asset of the marital estate that the court could divide under Connecticut law. Wife's status was that of a creditor and the court held that, although the court could divide the assets while they were held in the

1983 Trust, it could not reach them once they were moved into the 2011 Trust—the decanting was successful in removing the assets from division.

However, the court noted that, although the trial court could not consider the assets decanted to the 2011 trust for equitable distribution purposes, it could and did consider Husband's ability to earn additional income when creating its alimony orders. The trial court found that the trust funds had routinely supported Husband's investments. Notably, the trial court ordered Husband to pay Wife $300,000 in alimony annually, despite the fact that, when the action was commenced, he had been earning only $200,000 annually.

Some Further Thoughts About Decanting

Note that about half the states, including New York,[17] provide statutory authority to decant. Most states require that notice be given to beneficiaries. It was important in the *Ferri* case that the decanting occurred without Husband's permission, knowledge or consent. Query if the same result would follow if a beneficiary was given notice of the decanting, or whether notice alone would not detract from the Connecticut Supreme Court's holding that Husband took "no *active* role in planning, funding or creating the 2011 Trust" (emphasis added).

Including decanting provisions in trust instruments may maximize flexibility without resort to state default law. Indeed, in a recent New York case, *In re Hoppenstein*,[18] the trustees successfully relied on their powers under a trust document to distribute a life insurance policy on the settlor's life to a new trust that excluded an estranged daughter of the settlor and her issue. Dismissing an objection that the transfer did not satisfy the requirements of the New York decanting statute, court held that the New York decanting statute had no bearing on the case since the trustees relied on their powers under the document to effectuate the transfer.

IV. Other Potential Ways to Revise Trust Distributions: Power to Adjust and Unitrust Regimes

A trustee must invest assets pursuant to the so-called Prudent Investor Rule. Under that rule, a trustee is required to invest for "total return." That is, a trustee must invest in a way that benefits both income and principal beneficiaries. However, when beneficial interests clash, as they typically do in a divorce scenario, the source of return becomes critical, and the tension between investing for income and investing for growth can become more pronounced. More specifically, how does a trustee invest without considering whether return is produced from income or from capital appreciation when the income beneficiary (perhaps a second spouse) is pressuring the trustee for more income and the remainder persons (perhaps children from a prior marriage) are pressuring the trustee for more growth?

Fortunately, there are two regimes that provide trustees with the means to implement the mandate of total return investing—the power to adjust and unitrust regimes. Under a power to adjust regime,[19] the trustee is permitted to make adjustments between income and principal to be fair and reasonable to all beneficiaries. In other words, even if a principal distribution is not permitted under a trust document, or is permissible pursuant only to a very limited standard (like health or education), the trustee can "redefine" a portion of the principal as income, and pay that to the income beneficiary. Under the unitrust regime, the trustee can convert an income beneficiary's interest into a unitrust payout of a fixed percentage of the trust's principal. Most states allow a trustee to determine the appropriate unitrust payout within a band of 3-5 percent. In New York, the unitrust payment is fixed at 4 percent.[20]

These two regimes are intended to ease the tension between competing income and remainder beneficiaries and align interests, so that all beneficiaries benefit from the trust's growth, wherever that growth may emanate. Every state in the country has enacted one or both of these regimes, and every trustee or advisor should be aware of these powerful tools.

In particular, consider whether existing trust terms should be evaluated in the event of divorce to potentially adjust beneficial interests. Note that even if a divorce action is taking place in one state, a spouse may be a beneficiary of a trust governed by the laws of another jurisdiction, so familiarity with the operation of that other state's power to adjust or unitrust laws may be important. Typically, the state statutes provide a number of factors for a trustee to consider in determining whether or not to make an adjustment or opt into the unitrust regime.

See, for example, the use of the unitrust regime in *In re Jacob Heller*.[21] The trustees defended a challenge to their determination to opt into the unitrust regime. Jacob Heller created a trust under his will for the benefit of his second wife, who was to receive income for her life. Decedent's children from a prior marriage were named as remainder beneficiaries, and two of those stepchildren, the decedent's sons, became trustees.

When Mrs. Heller's two stepsons became trustees of the trust, Mrs. Heller's annual trust payment was $190,000—far above a 4 percent payout. In 2003, the co-trustees opted into the unitrust regime pursuant to New York law to reduce the payment to their stepmother to 4 percent *and* opted to make their election retroactive to January 1, 2002 (the date the unitrust regime became effective in New York). As a result of the unitrust election, Mrs. Heller's annual income from the trust was reduced from $190,000 to $70,000. As result of making the election retroactive, Mrs. Heller would have owed the trust $360,000 ($120,000 a year from the date of the 2005 decision, back to each of the three preceding years).

Mrs. Heller commenced a proceeding seeking to annul the unitrust election on the grounds that the co-trustees were also remainder beneficiaries of the trust and conflicted from making that decision, and a determination that the unitrust election could not be made retroactive to January 1, 2002.

The court reasoned that the co-trustees owed fiduciary duties to Mrs. Heller as an income beneficiary, but also to all remainder beneficiaries, including the trustees' siblings. The fact that the remainder beneficiaries' interests aligned with the interests of the co-trustees did not disqualify them from opting into the unitrust regime. As such, a question of fact remained as to whether the co-trustees were reasonable in their unitrust election, precluding summary judgment on that issue.

In addition, the Court of Appeals held that, since the New York statute allowed a trustee to specify the effective date of a unitrust election, the co-trustees' retroactive application of the unitrust election was proper. Note that in some jurisdictions the unitrust election can only be made prospectively. Since the decision in *Heller*, New York law was revised and a retroactive unitrust election is still possible, but only with court approval.[22]

V. Use of Leverage: Credit Solutions During Divorce

Leverage may be very useful in a divorce proceeding. There are many instances in which the marital estate being divided is comprised of assets that don't lend themselves to easy division and the remaining assets are not sufficient to make both spouses whole. This might occur in cases including:

- Closely held business interests;
- Partnership interests;
- Real Estate (personal and investment);
- Artwork and other collectibles;
- Private market interests with liquidity restraints;
- Aircrafts, watercraft.

In these circumstances, custom credit and leverage solutions can potentially provide the necessary liquidity to effectuate the asset division without major disruption to ownership of the underlying assets. Credit solutions can be tailored to the need, whether it is short-term borrowing with lines of credit or longer-term borrowing through defined term loans.

VI. Life Insurance—Using ILITs and Policy Reviews

Utilizing an Irrevocable Life Insurance Trust (ILIT) can be an advantageous way to purchase and maintain life insurance in divorce and other contexts. An ILIT is an irrevocable trust created to hold ownership of an insurance policy. The trust can hold existing policies (so long as the insured lives for three years following the transfer so the proceeds are removed from the insured's estate), newly issued policies, or both. To create an ILIT, an individual establishes a trust and transfers funds to the trust. The trustee then purchases a life insurance policy payable to the trust upon the insured's death. The primary benefit of using an ILIT is that, upon the death of the insured, policy proceeds pass to heirs free of estate taxes.

In many divorce proceedings, life insurance plays an integral role as part of the ultimate resolution/settlement, whether it is an asset to be allocated between the parties, or a requirement placed upon parties to maintain for some period of time. It is critical to review life insurance policies periodically to ensure they are performing as intended at the best cost, and that the premiums are being paid by the responsible party.

A policy review may uncover some or all of the following factors:

- The interest rate environment could have affected the policy performance, particularly if initial illustrations were run in a different interest rate environment.
- Market returns may have underachieved expectations.
- Policies issued prior to 2009 are based on 1980 mortality tables. Life expectancies have increased over time which may generate lower premium rates in newer policies.
- Newer policies have guaranteed and/or extended Death Benefit Guarantees that may not have been available with the original policy.

Insurance Policy Reviews Focus Attention on Important Details

Other important issues that may be uncovered by having a disciplined policy review procedure in place include:

- **Are premium notices being sent to the correct address and are premiums being paid on time?**

In *Orchin v. Great-West Life & Annuity Insurance Company*,[23] the insured's friend and fellow dentist, Orchin, served as trustee of a trust holding a life insurance policy. He did not miss a single premium payment from 1993 (when the policy was assigned to the trust) through January 2009. In April 2009, Orchin moved homes. Though he claimed to have told the post office his forwarding address, the insurance company was never notified of this change. It continued to send payment notifications to Orchin's old address, and as a result, Orchin never received them, nor the notices that the policy was in default or that it eventually lapsed.

On January 15, 2010, the insured died suddenly. At this point, Orchin realized he failed to pay the previous premium payments. Omitting to mention that the insured had died, Orchin convinced a supervisor to exercise her authority to make a one-time exception and reinstate the policy.

When Great-West discovered that the insured had died before the insurance was reinstated, they denied the claim. The insured's wife and Orchin brought suit against Great-West for improper termination of the policy and breach of contract, and the insured's wife also brought suit against Orchin for breach of fiduciary duty.

The court held that Great-West's decision to reinstate the coverage was unenforceable. Although "a close question," the court denied Orchin's summary judgment motion because issues of fact remained. Specifically, there were questions regarding whether it was reasonable for Orchin to expect the insurance notices to reach his new address and whether he exercised ordinary diligence.

As well as emphasizing the importance of having a reliable policy review mechanism in place to prevent a policy lapse, this case also highlights the issue that, when friends or family members are appointed as trustees, oftentimes they are simply unaware of the myriad duties to which they are subject. One important step a trustee can take to minimize fiduciary risk is to hire trusted professional advisors who are cognizant of the responsibilities imposed on fiduciaries, and have expertise in fulfilling those responsibilities.

- **Is the insurance fulfilling the originally planned intention?**

For example, to provide a source of funding for college education. If not, what changes are appropriate to consider?

- **Is the insurance contract the appropriate option for the trust based on the current insurance market?**

If market conditions have changed, what other options should be considered?

- **Are there any significant lifestyle or health changes and/or improvements?**

Are there any activities in which the insured no longer participates that were considered hazardous?

Has the insured's medical history changed?

- **Is the policy properly titled from an ownership perspective?**

Until recently in New York, absent fraud, strict privity was required to maintain a legal malpractice claim against an estate planning attorney. Since negligence in the estate planning context is usually not discovered until after a client's death, the strict privity requirement often resulted in the cause of action dying with the client.

In *Estate of Saul Schneider v. Finmann*,[24] the decedent's estate commenced a malpractice action against the decedent's estate planning attorney, alleging that the attorney negligently advised the decedent to transfer, or failed to advise decedent not to transfer, an insurance policy into his own name. The result was that the insurance proceeds were includable in the decedent's estate and subject to estate tax. With proper planning, the policy should not have been in the decedent's name, and the proceeds should have passed to heirs free of estate tax.

The New York Court of Appeals held that sufficient privity existed between the personal representative of the estate and the estate planning attorney for the personal representative to maintain a malpractice claim against the attorney on the estate's behalf. According to the Court, the strict privity rule leaves the estate with no recourse against an attorney who planned the estate negligently, and the estate essentially "stands in the shoes of a decedent," giving the estate capacity to maintain the malpractice action.

Most importantly, in order to avoid adverse tax consequences, ownership of insurance policies must be carefully considered.

- **Does the policy have the correct beneficiary designation and are taxes apportioned as intended?**

A case recently decided in Georgia underscores the importance of having both the correct beneficiary designation and the tax apportionment result that was intended. In *Smoot v. Smoot*,[25] decedent's ex-wife, Dianne Smoot, was the named beneficiary of life insurance and retirement assets that were included in the taxable estate. The decedent and Dianne had divorced in 2006, but the decedent had not changed any of his beneficiary designations. Having lost a previous action in which the decedent's son from a prior marriage claimed that Dianne was not entitled to the decedent's retirement benefits, the son argued in this action that Dianne was responsible for paying her pro-rata share of the federal estate taxes. The tax apportionment clause in the decedent's will provided for taxes to be pro-rated against those who received property included in his taxable estate.

The court held that federal law governed the tax apportionment concerning the life insurance proceeds. However, with regard to the retirement benefits, the court noted that, under Georgia law "[a]ll provisions of a will made prior to a testator's final divorce…in which no provision is made in contemplation of such event shall take effect as if the former spouse had predeceased the testator...." According to the court, because the will made no provision in contemplation of divorce, the tax apportionment clause had to be construed as if Dianne had predeceased the decedent. Accordingly, the tax apportionment clause did not apply to her, with the harsh result that not only did the ex-wife receive the retirement benefits, but she received them tax-free.

Although states may have default laws that would have prevented this result (because designations are revoked in the event of divorce or because of default pro-rata tax apportionment provisions), this case is a stark reminder not to rely on state law but to carefully update beneficiary designations.

VII. The Bottom Line: Collaboration Is Key

Clients will benefit when matrimonial, trusts and estates, and investment professionals partner to integrate considerations that cross disciplines. Advisors will be well-served in taking a collaborative approach to ensure they consider the many nuanced factors in this arena, and effectively represent clients.

Endnotes

1. Note that, with the exception of Hawaii (and Maryland in 2019), portability is generally not available for state level estate tax exemption amounts. Although Delaware also allowed portability, the repeal of the Delaware state estate tax in 2018 will render state level portability moot.
2. 390 P.3d 238, 2017 OK 3, 2017 WL 167587 (Okla. 2017).
3. 12 Del. C. § 3572.
4. *Id*.
5. *Id*.
6. 12 Del. C. § 3573(1).
7. There is a risk that a court in the state where the divorce is proceeding might decide that its law, not Delaware law, applies. However, at the least, a properly designed DAPT will raise formidable obstacles for creditors.
8. *Pfannenstiehl v. Pfannenstiehl* (Massachusetts Supreme Judicial Court) 475 Mass 105, 55 N.E. 3d 933.
9. *In Matter of Leyton*, 135 A.D.3d 418 (1st Dep't 2016).
10. *In re Estate of Lewis*, 25 NY3d 456 (2015).
11. New York A.6229/S.6503 (2017).
12. EPTL Article 13-A.
13. In New York, for example, see EPTL 13-A -2.2.
14. *Ferri v. Powell-Ferri*, 476 Mass. 651 (2017).
15. *Ferri v. Powell-Ferri*, SC19432, SC19433.
16. *Powell-Ferri v. Ferri*, SC19434.
17. EPTL 10-6.6.
18. *In re Hoppenstein*, 2015-2918/ANYLJ 1202784244139 (Sur. Ct. N.Y. Co, March 31, 2017); 2017 N.Y. Slip Op. 30940(U).
19. New York's power to adjust regime is found in EPTL 11-2.3.
20. EPTL 11-2.4.
21. *In re Jacob Heller*, 23 A.D.3d 61 (2d Dep't 2005), *aff'd*, 6 N.Y.3d 649 (2006).
22. See, for example, *In re Will of Kruszewski*, 116 A.D.3d 1288 (3d Dep't 2014).
23. *Orchin v. Great-West Life & Annuity Insurance Company*, 2015 WL 5726334, 133 F. Supp. 3d 138 (2015).
24. *Estate of Saul Schneider v. Finmann*, 15 NY3d 306 (2010).
25. *Smoot v. Smoot*, 2015 TNT 69-13, No. 2:13-cv00040 (U.S.D.C. S.D. Ga. March 31, 2015).

Recent Decisions and Trends in Matrimonial Law

By Wendy B. Samuelson

Recent Legislation

22 N.Y.C.R.R. 1500.22(a), amended, effective January 1, 2018

The CLE Board issued two updates to the CLE program rules pursuant to 22 N.Y.C.R.R. 1500.22(a), including the addition of a new category of CLE credit.

In addition to ethics and professionalism, skills, law practice management, and areas of professional practice, a new category was added for diversity, inclusion and elimination of bias courses. This category of credit is effective January 1, 2018, and attorneys must complete one hour of such credit within a two-year reporting cycle.

These courses must include, among other things, implicit and explicit bias, equal access to justice, serving a diverse population, diversity and inclusion initiatives in the legal profession, and sensitivity to cultural and other differences when interacting with members of the public, judges, jurors, litigants, attorneys and court personnel.

In an effort to assist attorneys with compliance with the new rules, the NYSBA is offering free CLE programs for NYSBA members, including live webcasts, on diversity, inclusion and elimination of bias topics.

Tax Cuts and Jobs Act

In one of the most sweeping overhauls since 1986, the President has signed the $1.5 trillion tax reform law. Among the 500 pages of the law, it repeals the ability to deduct alimony (maintenance) payments made to a spouse and, conversely, does not require the addition to income of these payments received for any divorce decrees granted after 2018.

In New York, this will cause havoc to the maintenance and child support statutes. Maintenance is currently considered as income to the payee spouse, and is included as income for purposes of determining child support. New York may need to revise its definition of income for purposes of child support and maintenance.

Recent Cases

Agreements

Modification of Child Support Based on Payment of Maintenance

***Toscano v. Toscano*, 153 A.D.3d 1440 (2d Dep't 2017)**

The parties' separation agreement, which was incorporated but not merged into their judgment of divorce, provided that the mother would pay the father $4,000/month as spousal support for three years and thereafter $2,083/month for two years. The father, who had no income, would pay $25/month child support, unless there was an adjustment circumstance, which included "(i) December 31st of any year in which the Father's earned income exceeds $25,000; (ii) December 31st of any year in which the Father's gross income from all sources exceeds $45,000; (iii) The date on which each child becomes emancipated." The parties also did not opt out of the child support modification statute.

A year later, the mother brought a motion seeking a modification in the father's child support obligation, claiming that since she paid the father $45,000 in maintenance in a calendar year, the father's gross income from all sources exceeded $45,000, thereby triggering a mandatory adjustment. The father opposed, contending that there was no indication in the agreement that the spousal support paid to him was intended to be included in the calculation of his child support obligation and that it was illogical that he would accept spousal support from the mother, only to immediately pay her back with her own money.

The court below denied the mother's motion, concluding that the parties' agreement did not intend for the spousal support to be included as income to the father. The Second Department reversed and remanded for further determination. The parties' agreement clearly distinguished between "earned income" and "income from all sources," and spousal support is included as income from all sources.

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Contempt

Spouse Not in Violation of TRO by Not Paying for Whole Life Insurance Policy Where Other Term Life Insurance Existed and Whole Policy Considered Investment

***Savel v. Savel*, 153 A.D.3d 172 (2d Dep't 2017)**

The husband commenced the divorce action by summons with notice, accompanied by the automatic restraining order of DRL § 236(B)(2)(b), which requires, *inter alia*, that the parties maintain their existing life insurance policies in full force and effect. Thereafter, the husband moved to hold the wife in civil and criminal contempt for failure to pay the premiums on his whole life insurance policy. The wife conceded that she stopped paying for the policy, but claimed that the husband was not prejudiced because the parties maintained $12 million in term life insurance for their children in addition to their $7.6 million whole life insurance policies. She argued that the whole life insurance policies were intended as savings vehicles that should not be subject to the automatic orders, and she should not have to contribute her post-commencement earnings to a savings vehicle for the husband.

For civil contempt, the movant must establish that (1) a lawful order of the court, clearly expressing an unequivocal mandate, was in effect, (2) the order was disobeyed and the party had knowledge of its terms, and (3) the movant was prejudiced by the offending conduct. See, Judiciary Law § 753[A][3]. Prejudice is shown where a party's actions were calculated to or actually did defeat, impair, impede, or prejudice the rights or remedies of a party. In criminal contempt, the movant must prove willful disobedience, but no prejudice needs to be shown, as the purpose of criminal contempt is to vindicate the authority of the court.

The court below properly denied the husband's motion for contempt, finding that the whole life insurance policy was a savings vehicle and not life insurance subject to the automatic restraining order, particularly where the parties had $12 million in term life insurance and an additional $7.6 in whole life insurance, and the husband admitted that the whole life policy was used as a savings plan.

Child Support

Child Support Reduced by Extraordinary Travel Expenses for Visitation

***Decillis v. Decillis*, 152 A.D.3d 512 (2d Dep't 2017)**

The mother filed a petition for child support of the parties' child. The Support Magistrate determined that the father's basic child support obligation would be $572 biweekly, and imputed $43,000 of income to the mother when determining this sum. The father was granted a credit against his child support obligation of $168 biweekly for the "extraordinary expenses" associated with his visitation, including $67 for travel expenses and additional deductions for the cost of meals and entertainment during those visits. The mother appealed, claiming that these deductions were improper.

The Second Department determined that the Support Magistrate properly imputed $43,000 of income to the mother based upon her prior income, her choice to engage in only part-time employment, and her current living arrangement, in which she did not pay rent or related housing expenses.

> *"Prejudice is shown where a party's actions were calculated to or actually did defeat, impair, impede, or prejudice the rights or remedies of a party."*

With respect to the father's credits for travel and entertainment expenses, the appellate court reduced the credit to $33 biweekly for travel expenses only and not for meals and entertainment. The court must direct the noncustodial parent to pay his or her *pro rata* share of the child support obligation, unless it finds that the *pro rata* share is "unjust or inappropriate" (Family Ct. Act § 413[1][f]), upon considering factors such as the "extraordinary expenses incurred by the non-custodial parent in exercising visitation." (Family Ct. Act § 413[1][f][9]. At bar, the appellate court determined that there was no basis for the trial court to conclude that the father's *pro rata* share was so "unjust or inappropriate" as to warrant a credit against his child support obligation to cover meals and entertainment during visits with the child. Extensive travel expenses, however, are a different matter and can be counted as a credit.

The lower court properly rejected the mother's petition for paternal support for private school tuition and expenses. According to the record, the couple never agreed to share the child's education costs, and the child had no specialized, scholastic need to justify such high-cost schooling.

The lower court properly denied the mother's request for the father to contribute a *pro rata* share of the child's extracurricular activities.

Imputation of Income

***Volkerick v. Volkerick*, 153 A.D.3d 885 (2d Dep't 2017)**

The parties were married 18 years and have two children. The decision fails to state the ages of the parties. The parties submitted the issues of maintenance and child support to the trial court on affidavits, affirmation and financial exhibits. The wife was a high school graduate, and earned approximately $10,000-$15,000 year as a cashier. The husband was a college graduate with many years of experience working as an estimator for various construction companies. From 2005 until 2009, the husband's annual salary was approximately $130,000. In 2010, the year that determined the husband's income under the CSSA, the husband was unemployed for part of the year, and earned only $47,000, which was supplemented by unemployment compensation and withdrawals from retirement accounts, and therefore his total income was $186,582. The husband worked for most of 2011 and had an annual income of $130,000 from a combination of earnings and unemployment compensation.

The trial court awarded the wife $1,500/month maintenance for four years and $248.41/week in child support based on the husband's imputed income of $130,000/year. The husband appealed, and the appellate division affirmed, since the trial court did not abuse its discretion in considering the husband's earning history.

Equitable Distribution

Appreciation of Separate Property Whole Life Insurance Policies as a Result of Premiums Paid During the Marriage Deemed Marital Property

***Seale v. Seale*, 149 A.D.3d 1164 (3d Dep't 2017)**

The parties were married approximately 12 years, and had two children. The husband owned motels, car washes and other real property

During the marriage, the husband exchanged one of his car wash businesses and lot that he owned prior to the marriage for another car wash business, and did not use any additional funds for the purchase. The trial court properly found that the new car wash business and lot was the husband's separate property despite that he negotiated the exchange during the marriage. Negotiation, on its own, does not equate to active management of the business, and there was no evidence that the husband made unusual efforts to negotiate the transaction. In addition, the wife failed to establish that the original car wash business appreciated in value from the date of the marriage to the date of the exchange, as the court discounted the wife's expert's report.

In a battle of the experts, the trial court credited the husband's expert's testimony that three of his car wash businesses did not appreciate in value during the marriage.

In addition, the trial court also determined that the wife failed to establish an appreciation in the husband's separate property shopping mall and resort. The appellate court held that even if the wife could have established an appreciation, she failed to show that the appreciation was due to active management as opposed to market forces. Her expert testified that she could not form an opinion as to the degree that the properties appreciated in value due to active management as opposed to market forces because the properties consisted of actively run businesses and real estate.

The trial court erred in concluding that all of the insurance policies purchased by the husband were entirely his separate property due to the fact that he took out the polices prior to the marriage or, for policies taken out after the marriage, in exchange for his separate property. The husband owned the policies prior to marriage, but rolled them over into another policy during the marriage and paid the premiums with income earned during the marriage. The appellate court determined that the insurance policy increased in value by approximately $57,000 as a result of the premium payments made during the marriage, and awarded the entire amount to the wife. By doing so, the wife was awarded 45 percent of the entire marital assets and the husband was awarded 55 percent.

The trial court properly imputed $50,000 of gross annual income to the wife despite her being a substitute teacher, particularly where she had a Master's degree in reading and had taught at various times prior to and during the marriage, and in 2000, she earned between $45,000 and $50,000 as a teacher.

75% of Marital Assets Awarded to Wife Where Husband Incarcerated for White Collar Crimes

***Linda G. v. James G.*, 64 N.Y.S3d 17 (1st Dep't 2017)**

The parties were married for more than two decades and have two children. In 1991, the husband worked at one of Wall Street's major financial services companies, made partner by 1996, and by 2007 was earning $1.25 million a year. The wife worked at a prominent Wall Street bank, with annual earnings of $700,000, a job she quit in 2000 to care for their children.

In October 2007, the Securities and Exchange Commission began investigating the husband's financial dealings, and in 2010 he was indicted on charges of conspiracy and insider trading. At the criminal trial, the husband maintained his innocence, blaming his mistress for using his phone without his knowledge to conduct illegal activity. The SEC investigation and criminal trial sapped the married couple's assets. The husband was found guilty and served over a year in federal prison. The parties were unemployed from 2007-2010. The wife began divorce proceedings in January 2010, four months before his prison time began. After the husband was released from prison, he was only earning $226,000/year. The children suffered emotionally, both were suicidal and had other behavioral issues, and were expelled from their schools.

The parties' co-op on Park Avenue was valued at more than $4 million. The Supreme Court allotted 75 percent of the marital home to the wife and 25 percent to the husband, ruling the lopsided apportionment justified due to the damage caused by the husband's "behaviors and activities." In addition, the wife was credited with 50 percent of the legal fees expended in the criminal action.

The First Department affirmed. The husband's insider trading, and ensuing criminal trial, conviction and incarceration caused the family to undergo financial losses and a substantial decrease in the standard of living. During the three-year period from the investigation to the trial, the couple was forced to spend down their assets since the husband was forced to resign from his employment, and the husband refused to take a plea bargain and instead blamed his girlfriend for his insider trading. These events also significantly disrupted the family's stability and well-being. Therefore, the appellate court found that pursuant to DRL § 236(B)(5)(d)(14), (any other factor the court finds just and proper), it was proper to consider the husband's criminal activity and an award of an unequal division of the home.

Nonetheless, the appellate court reduced the 75 percent/25 percent split to 60 percent/40 percent since it was improper to consider the husband's extramarital affair, which was not considered so egregious or shocking to warrant considering marital fault.

Custody

Nonbiological and Non-Adoptive Father of Child Born of Surrogacy Has Standing as Parent to Vacate Adoption by Another Man

***In re Maria-Irene D.*, 153 A.D.3d 1203 (1st Dep't 2017)**

Two gay men entered into a legal marriage in the UK. Intent on becoming parents, they executed an egg donor and surrogacy agreement, with both appellant and respondent contributing sperm. Ultimately, a baby girl was born with the appellant's sperm.

The couple was intent on co-parenting the baby; the fathers named the baby after their mothers, and they lived together as a family in Florida. Nonetheless, the Missouri court awarded the appellant "sole and exclusive custody," as only the appellant had a genetic link to the child.

Thereafter, the appellant began a relationship with a new partner, and two years later, the respondent left to return to England. After the respondent left the country, the appellant moved to New York with his new partner and his new partner commenced a petition in New York to adopt the baby. The respondent's role in the surrogacy was not disclosed to the Family Court nor that a divorce action was commenced by the respondent in Florida in which the respondent sought joint custody of the child.

Lacking this critical information, the Family Court granted the adoption petition in May 2016. When the respondent learned of the adoption, he moved to vacate it on the ground that relevant facts had not been disclosed to the court and that he was entitled to notice of the adoption and an opportunity to be heard. Family Court granted his motion and vacated the adoption in accordance with DRL § 114(3), concluding that appellants' failure to disclose the respondent's role in the surrogacy or the respondent's motion for joint custody amounted to material misrepresentations.

The First Department affirmed, as the appellant and respondent were legally married at the time of the surrogacy process, making the baby a child "born in wedlock." That distinction means the respondent was entitled to notice of the adoption proceeding. See DRL § 111[1][b] and the Court of Appeals' most recent decision concerning parental standing, *Brooke S.B. v. Elizabeth A.C.C.*, 28 N.Y.3d 1 (2016).

In addition, a second ground to vacate the adoption was that the adoption petition required petitioner to give a sworn statement that the child was not the subject of any other proceeding affecting her custody or status. The petitioner falsely alleged that there was no other proceeding pending.

Appellate Court Remanded Custody Determination Where the Family's Circumstances Changed After the Divorce, Rendering Record Outdated

***Bruzzese v. Bruzzese*, 152 A.D.3d 563 (2d Dep't 2017)**

The husband filed for divorce and ancillary relief, and the wife counterclaimed for a divorce. Before trial, the parties agreed to a divorce on the ground of an irretrievable breakdown of the marital relationship pursuant to DRL § 170(7), leaving other issues such as custody, equitable distribution, and child support to be resolved at trial. The trial court awarded a divorce to the wife but did so on the ground of cruel and inhuman treatment by the husband. The court also made an equitable distribution of the couple's assets, granted custody of the couple's minor children to the wife, and ordered the husband to pay child support and 75 percent of the children's future medical expenses, and directed the husband to pay the wife's attorney's fees.

The appellate court overturned virtually every aspect of the Supreme Court's ruling, chief among them the lower court's discarding of the couple's agreed-upon grounds for divorce. "Parties by their stipulations may in many ways make the law for any legal proceeding to which they are parties, which not only binds them, but which the courts are bound to enforce" (*In re New York, Lackawanna & W. R.R. Co.*, 98 N.Y. 447, 453). "[S]tipulations of settlement are judicially favored and are not lightly cast aside absent cause sufficient to invalidate a contract" (*Lewis v. Lewis*, 183 A.D.2d 875, 876). Therefore, the court below erred by not granting a judgment of divorce based on irretrievable breakdown of the marriage.

The lower court erred in calculating the husband's share of the children's future unreimbursed healthcare expenses. Domestic Relations Law § 240(1-b)(c)(5)(v) establishes that children's health care expenses not covered by insurance is to be paid by both parents in proportion to their pro rata share of the combined parental income. Here, the husband's income was 65.4 percent of the combined parental income, and therefore his share of medical expenses should be 65.4 percent, not 75 percent.

The lower court awarded the wife custody of both minor children. However, the attorneys for the children advised the appellate court that the family's circumstances changed significantly since the judgment of divorce was entered, as the parties' son moved into the father's residence and refused to communicate with the mother. The appellate court found that the lower court's custody ruling was outdated and required reevaluation (*In re Michael B.*, 80 N.Y.2d 299, 318; *Bosque v. Blazejewski-D'Amato*, 123 A.D.3d 704, 705). Therefore, it remanded the custody matter back to the trial court for further determination and issued a temporary custody arrangement with the couple's son living with the husband and their daughter living with the wife. (It is unusual that the appellate court would require a re-hearing on custody, rather than requiring the parents to make a motion for a modification of the custody order.)

The lower court did not abuse its discretion in awarding the wife $84,038 in attorney's fees, as a result of the disparity of incomes of the parties and the husband's conduct that delayed the proceedings.

Highlight: Decision of Interest

In an apparent "case of first impression," Justice Jeffrey S. Sunshine in *Dayan v. Dayan*, 2017 N.Y. Slip Op. 27399 (Sup. Ct., Kings Co., Nov. 30, 2017), analyzes the rights of outgoing counsel to a pendente lite charging and/or retaining lien. The discussion also involves establishing an "interim charging lien" and the posting of security relative to the retaining lien after hearing to establish the amount to which the attorney is entitled.

Dayan v. Dayan

2017 N.Y. Slip Op. 27399

Decided on November 30, 2017

Supreme Court, Kings County

Sunshine, J.

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Maurice S. Dayan, Defendant.

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Jeffrey S. Sunshine, J.

Introduction

In New York State an attorney has the right at common law to secure a retaining lien on a file to secure payment pending a hearing to establish a security interest if available for counsel to secure a fee or determination of a charging lien pursuant to Judiciary Law § 475. In a matrimonial action it now appears that the right to a charging lien must be held in abeyance in order to satisfy the dictates *of Charnow v. Charnow* (134 AD3d 875, 876, 22 N.Y.S.3d 126 [2d Dept., 2015]).

In *Charnow* the Appellate Division, Second Department held that:

> "a charging lien is a security interest in the favorable result of litigation, giving the attorney equitable ownership interest in the client's cause of action and ensuring that the attorney can collect his fee from the fund he has created for that purpose on behalf of the client (*Chadbourne & Parke, LLP v. AB Recur Finans*, 18 AD3d 222, 223, 794 N.Y.S.2d 349 [citation omitted]); see Judiciary Law § 475). In a matrimonial action, a charging lien will be available 'to the extent that an equitable distribution award reflects the creation of a new fund by an attorney greater than the value of the interests already held by the client' (*Moody v. Sorokina*, 50 AD3d 1522, 1523, 856 N.Y.S.2d 755 [internal quotation marks omitted]). However, '[w]here the attorney's services do not create any proceeds, but consist solely of defending a title or interest already held by the client, there is no lien on that title or interest' *(Theroux v. Theroux*, 145 AD2d 625, 627—628, [2d Dept., 1988])."

Charnow creates the situation where plaintiff cannot secure her file and properly prosecute her matrimonial action because the issue of a charging lien is not ripe for adjudication *pendente lite* since the case has not yet been tried and determined. Thus this Court herein as a matter of first impression must establish that outgoing counsel has a right to a hearing on the issue of a retaining lien and that the court may set a security interest and an "interim charging lien." That lien would then be subject to a further hearing at the conclusion of the trial and after decision to determine the amount of a "final charging lien" that would attach to proceeds that is limited "to the extent that an equitable distribution award reflects the creation of a new fund by an attorney greater than the value of the interests already held by the client" (*Charnow* supra at 876). To hold otherwise would leave a party without recourse to obtain their file and in effect deprive a party of the ability to prosecute or defend an action for divorce.

Plaintiff's incoming counsel moves by order to show cause (motion seq. #15), dated August 31, 2017, for the following relief: 1) Directing Butterman & Kahn, LLP to deliver the file with respect to this action to plaintiff's new attorney; or in the alternative 2) Directing [*2]Butterman & Kahn, LLP to deliver a copy of the file with respect to this action to Plaintiff's new attorney; and 3) For such additional and different relief as to this court seems equitable just and fair. Plaintiff's former counsel submitted an affirmation in opposition on September 15, 2017. Defendant did not respond or take a position regarding this order to show cause.

Plaintiff's Contentions

Plaintiff contends that she retained the law firm of Butterman & Kahn, LLP "on or about August 2015" in connection with the above captioned matrimonial action. She avers that pursuant to this Court's March 6, 2017 decision and order, the Court directed defendant to pay "directly to Butterman & Kahn, LLP *pendente lite* counsel fees in the sum of $100,000.00 within 45 days of service of notice of entry." She asserts that the payment "was due by May 9, 2017" and "to date, defendant has not paid any portion of the *pendente lite* counsel award." At oral argument plaintiff's outgoing counsel asserted he has already secured a judgment against defendant directly for $100,000.00.

Plaintiff avers that "in or about July 2017" she received an invoice from Butterman & Kahn, LLP "reflecting a balance due in the approximate sum of $288,000.00." She contends that "as of the date of that invoice, I had already paid the firm a total sum of $95,000.00." She contends that her attorney "requested that I pay the balance due on his invoice or seek other representation."[FN1] She states that on July 28, 2017 she "substituted the law firm of Coffinas & Lusthaus, P.C." as the attorney of record on consent (annexed as exhibit A to the order to show cause).

Plaintiff asserts that incoming counsel, Meredith Lusthaus, Esq., sent a letter to outgoing counsel, Jay Butterman, Esq., on August 1, 2017 (annexed as exhibit B to the order to show cause) requesting the plaintiff's file in the above-captioned matrimonial matter. She avers that by letter dated August 3, 2017 (annexed as exhibit C to the order to show cause), Mr. Butterman "declined to turn over the file and asserted both a retaining lien and a charging lien." She then states that Ms. Lusthaus sent a letter to Mr. Butterman dated August 11, 2017 (annexed as exhibit D to the order to show cause) requesting "at least" a copy of the file, to which Mr. Butterman responded by letter dated August 14, 2017 (annexed as exhibit E to the order to show cause) in which he declined to provide a copy of the file to incoming counsel.

Plaintiff contends that "there has been extensive litigation in this case" and that the file "consists of numerous documents that cannot be reproduced from the Court file, such as documents and other evidence that I provided to Mr. Butterman, documents provided in response to numerous subpoena demands and discovery documents obtained from non-parties and out of state proceedings." She avers that "there will be a significant delay of the matrimonial proceedings if the file is held until resolution of the fee dispute" and that "without the file, or at least a copy of the file, my attorney will not be able to adequately represent my interests in the [*3]matrimonial action and in turn, I will be severely prejudiced."

Plaintiff contends that "the case law with respect to the assertion of a retaining lien does not support a former attorney's refusal to deliver a copy of the file." She also argued during oral argument on September 18, 2017 that "there are documents that were made part of the file that belong to the plaintiff directly that weren't necessarily work product. So, I would argue that at least those documents be made available, not only documents but other types of evidence which again was supplied directly by plaintiff and I would ask that those at least be made available to her pending a hearing."

Plaintiff's Former Counsel's Contentions

Mr. Butterman contends that "the file which plaintiff seeks turnover consists of 15 boxes, including massive amounts of work product, and numerous boxes of discovery material." He affirms that "the parties have heavily litigated custody, including emergency motions and proceedings, time consuming negotiations on the custody issues with opposing counsel and the children's attorney Susan Smith, numerous drafts of parenting plans, and addressing a myriad of requirements of both parties with regard to the children."[FN2] He argues that "the financial case required even greater effort [...] involving substantial assets."

Plaintiff's former counsel avers that he has "been completely transparent to the Court and plaintiff as to the amount of my fees throughout this litigation, and the difficulty of my firm was facing in the absence of payment." He argues that "I fully appreciate the difficult position plaintiff is placed in, but [...] I am unable to place my firm in a position of financial distress solely for the benefit of one case which required an enormous amount of effort and which produces no revenue." Plaintiff's former counsel contends that "plaintiff not only did not object to these efforts, but was either personally present for much of the work or in constant contact with me or my office by phone, text or email." He avers that "plaintiff consistently demanded specific work be done on her behalf, often in response to requests from me for payment" and "plaintiff made no objection when I referenced the sums due in Court and in papers."

Mr. Butterman contends that "as of my statement which runs through the end of June (exhibit A in counsel's opposition), the last bill sent before I was discharged, the total outstanding fees and disbursements due and owing amount to $278,591.12. Additional time and disbursements since June but prior to discharge amount to

$288,841.25 (exhibit B in counsel's opposition)." Counsel then states he sent a "notice to charging lien in the amount of $288,792.65 (exhibit C in counsel's opposition)." Counsel acknowledges that "since July of 2015, when my firm was retained by [plaintiff], we have been paid a total of $95,250.00" (exhibit D in counsel's opposition) and "the last payment of fees was made on January 4, 2017."

Former counsel argues that "to turn over the file to plaintiff's new counsel until the issue of my retaining and charging liens are addressed by the Court would be to abandon many of the rights I retain with regard to payment of the fees due to my firm." He acknowledges that "there is an exception to this rule in cases of exigent circumstances" but contends that "plaintiff does not [*4] claim any exigent circumstances recognized under the law."[FN3] Counsel contends that "the entire point of a retaining lien is to exchange an object of value in litigation, i.e., the case file, for payment or security." Counsel avers that the "plaintiff, while certainly placed in financial difficulties by her husband, cannot be deemed "indigent" for the purposes of extinguishing the retaining lien." He contends that "plaintiff does have the ability to pay at least a substantial portion of the fees due [...] plaintiff had previously promised to pay over to my firm the proceeds of a ring in her possession which is separate property." Counsel states that "to my knowledge she never sold the ring" and that "plaintiff's net worth statement lists numerous items of jewelry, both marital and pre-marital" that counsel believes could be sold with the Court's permission. While counsel does acknowledge that he is "extremely reluctant to demand that plaintiff sell her jewelry" he asserts that he "cannot ignore the obligations due and owing my firm." During oral argument on September 18, 2017, Mr. Butterman argued "there is one piece of separate property which had been pledged to me, which she rather promised that it would be utilized and it wasn't. I gather it still exists. It can be utilized to pay down those fees."

Counsel requests the Court to direct a hearing to set the counsel fees due his firm and that he only be directed to turn over the file "in exchange for payment of that fee or the posting of adequate security for that amount, following said hearing."

Discussion

Discharged Attorney's Right to Fees

"A client has an absolute right to discharge an attorney at any time. If the discharge is without cause before the completion of services, then the amount of the attorney's compensation must be determined on a quantum meruit basis" (*Theroux v. Theroux*, 145 AD2d 625, 536 N.Y.S.2d 151 [2d Dept., 1988]). "An attorney who is discharged without cause has three remedies to recover the value of his or her legal services: the retaining lien, the charging lien, and the plenary action in quantum meruit." (*Butler, Fitzgerald & Potter v. Gelmin*, 235 AD2d 218, 218—19, 651 N.Y.S.2d 525 [1st Dept., 1997). "These remedies are not exclusive, but cumulative." (*Schneider, Kleinick, Weitz, Damashek & Shoot v. City of New York*, 302 AD2d 183, 186, 754 N.Y.S.2d 220, 223 [1st Dept., 2002]). The Court also notes that in New York, fee disputes up to $50,000.00 are subject to arbitration. (See Part 137.1 of the Rules of the Chief Administrator).

Retaining Lien

It is well established according to the common law that "[i]f a client discharges an attorney without cause, the attorney possesses a common-law retaining lien on the client's file in his or her possession and is entitled to recover compensation from the client measured by the fair and reasonable value of the services rendered, regardless of whether that amount is more or less than the amount provided in the contract or retainer agreement" (*Sterling Corporate Tax Credit Fund XXV, L.P. v. Youngblood Senior Hous. Assoc., LLC*, 115 AD3d 932, 932, 982 N.Y.S.2d 392 [2d Dept., 2014]; see also *Cohen v. Cohen*, 183 AD2d 802, 803, 584 N.Y.S.2d 116 [2d Dept., 1992]). "Such lien arises upon the rendition of services by the attorney, regardless of whether the attorney has commenced any action on his client's behalf; and such lien arises and exists independently of the rights created by statute (Judiciary Law, § 475)" (*Lerner v. Seigel*, 22 AD2d 816, 816, 254 N.Y.S.2d 802, 804 [2d Dept., 1964])). Thus the common-law retaining lien [*5]is founded and determined by possession of the file and operates outside of Judiciary Law §475 which governs charging liens.

The retaining lien "is extinguished only when the court, which controls the functioning of the lien, orders turnover of the file in exchange for payment of the lawyer's fee or the posting of an adequate security therefor [sic] following a hearing" (*Cohen v. Cohen*, supra at 803). "Absent exigent circumstances, the attorney may generally not be compelled to surrender the papers and files until an expedited hearing has been held to ascertain the amount of the fees or reimbursement to which he or she may be entitled" (*Mosiello v. Velenzuela*, 84 AD3d 1188, 1189, 924 N.Y.S.2d 480 [2d Dept., 2011]). However, "Judiciary Law §475 cannot be an umbrella under which an attorney may seek shelter from the demands of a client for the return of excessive fees paid [...] It has long been recognized that courts have the traditional authority to supervise the charging of fees for professional services under the court's inherent and statutory power to regulate the practice of law" (*Hom v. Hom*, 210 AD2d 296, 622 N.Y.S.2d 282 [2d Dept. 1994]).

Furthermore, "an attorney's retaining lien attaches to all property, papers, books, documents, or securities of the client that come to the attorney professionally or in the course of his or her professional employment" (1B Carmody-Wait 2d § 3:551; (See *Leviten v. Sandbank*, 291 NY 352, 52 N.E.2d 898 (1943)). "The lien encompasses not only documents and property given by the client to his attorney, but also the work product of the attorney: his mental creations, his interviews with witnesses, and all documents secured or prepared by him in connection with the litigation at hand" (Attorney's Retaining Lien over Former Client's Papers, 65 Colum. L. Rev. 296, 299 (1965); (cf *In re Rapid Road Transit Co.*, [1909] 1 Ch. 96 (1908), and *Matter of Knapp*, 85 NY 284 (1881), with *Hughes v. Hughes*, [1958] P. 224 (C.A.), and *Sorin v. Shahmoon Indus*., Inc., 20 Misc 2d 149, 191 N.Y.S.2d 14 (Sup. Ct. 1959)). Thus, plaintiff's request at oral argument for those documents that she alleges were provided by her to plaintiff's former counsel and should not be considered "work product" are hereby subject to the retaining lien.

It is clear to the Court at first instance that this matter has been extensively litigated by both sides and that further court intervention is necessary to decide this issue.[FN4] This matrimonial action is quickly approaching its third year of litigation and as the plaintiff finds herself in the midst of a fee dispute with Mr. Butterman, the defendant continues to defy this Court's order of pendente lite counsel fees to Mr. Butterman's firm in its March 6, 2017 decision. At the same time defendant admits that his attorney has been paid $100,000.00 as of this Court's March 6, 2017 decision and in excess of $200,000.00 according to plaintiff's former counsel, which defendant claims are payments made from family members. The plaintiff is in a difficult position financially as a result of this litigation but the Court notes that she has retained new counsel, although it is unclear in the papers submitted how much she has paid her new attorney. While the Court does not reach the issue as to the value or necessity to sell plaintiff's jewelry or alleged separate property at this time, the Court does find that any claim of indigency is sufficiently controverted by Mr. Butterman (and conceded by the plaintiff) as to require a hearing before a [*6] retaining lien can be extinguished and the Court can fix the required security pending completion of the case.

As such, the Court must refer this matter to a hearing to determine plaintiff's counsels appropriate fee and the posting of adequate security to satisfy the retaining lien (see, *Pileggi v. Pileggi*, 127 AD2d 751, [2d Dept. 1987]; *Artim v. Artim*, 109 AD2d 811, [2d Dept., 1985]; *Rosen v. Rosen*, 97 AD2d 837, [2d Dept., 1983]; *Petrillo v. Petrillo*, 87 AD2d 607, [2d Dept., 1982]; *Gamble v. Gamble*, 78 AD2d 673, [2d Dept., 1980]). However, the Court notes that while counsel is entitled to a summary determination of the value of the services in connection with the assertion of a lien, the outgoing attorney is not entitled to an order directing the entry of a money judgment against their former clients, either before or after they relinquished the file (cf., *Matter of Rosenblum*, 121 AD2d 546, 547, [2d Dept., 1986]; Ryan v. Ryan, 75 AD2d 1000, [4d Dept., 2000], lv. dismissed 51 NY2d 709, 435 N.Y.S.2d 1025, 416 N.E.2d 1058). Obviously, the *pendente lite* award is subject to entry of a judgment which has been effectuated, however "A law firm is not entitled to a money judgment against a former client pursuant to Judiciary Law § 475, absent the commencement of a plenary action" (*Wasserman v. Wasserman*, 119 AD3d 932, 934, 990 N.Y.S.2d 571 [2d Dept., 2014]).

Charging Lien

Along with a common-law retaining lien, an attorney of record who is discharged without cause possesses a charging lien pursuant to Judiciary Law §475. The New York Court of Appeals held in *LMWT Realty Corp. v. Davis Agency Inc.*, (85 NY2d 462, 467—68, 649 N.E.2d 1183, 1186 (1995)) that "with the signing of a retainer agreement that expressly assigns a portion of the proceeds of a cause of action to the attorney, the attorney 'acquires * * * a vested property interest which cannot subsequently be disturbed by the client or anyone claiming through or against the client.' Manifestly, then, an attorney's charging lien is something more than a mere claim against either property or proceeds; an attorney's charging lien 'is a vested property right created by law and not a priority of payment." The Appellate Division, Second Department held in *Wasserman v. Wasserman* (119 AD3d 932, 933, 990 932 [2d Dept., 2014])"Judiciary Law §475 provides that, from the commencement of an action in any court, the attorney who appears for a party has a lien upon his client's cause of action, claim, or counterclaim, which attaches to a verdict, report, determination, decision, judgment, or final order in his client's favor, and the proceeds thereof." Moreover, pursuant to 22 NYCRR § 1400.5:

(a) An attorney may obtain a confession of judgment or promissory note, take a lien on real property, or otherwise obtain a security interest to secure his or her fee only where:

(1) the retainer agreement provides that a security interest may be sought;

(2) notice of an application for a security interest has been given to the other spouse; and

(3) the court grants approval for the security interest after an application for counsel fees.

(b) Notwithstanding the provisions of subdivision (a) of this section, an attorney shall not foreclose on a mortgage placed on the marital residence while the spouse who consents to the mortgage remains the titleholder and the residence remains the spouse's primary residence.

The Court is mindful that, generally, "[w]hen challenged, counsel fees must be proved in [*7]an adversarial atmosphere where, upon presentation of testimony, the opposing parties may assert the right to cross-examine" (*Weinberg v Weinberg*, 95 AD2d 828, 829 [2d Dept., 1983]). "A hearing on attorney's fees is particularly warranted where the record before the Court is patently deficient to allow for a proper fee determination" (*see Singer v Singer*, 106 AD2d 623, 624 [2d Dept., 1984]). "A hearing is not only required in cases where an opposing party seeks to challenge the award of attorney's fees sought by his or her adversary, but also may be necessary to determine the appropriate amount of legal fees due to counsel from his or her own client" (*see Silver v Silver*, 45 AD3d 759, 759 [2d Dept., 2007]).

Pursuant to existing case law, in a matrimonial action a charging lien will be available "'to the extent that an equitable distribution award reflects the creation of a new fund by an attorney greater than the value of the interest already held by the client' *Moody v. Sorokina*, 50 AD3d 1522, 1523, 856 N.Y.S.2d 755, quoting *Zelman v. Zelman*, 15 Misc 3d 372, 375, 833 N.Y.S.2d 375 [Sup. Ct., New York County]; cf. *J.K.C. v. T.W. C.*, 39 Misc 3d 899, 908, 966 N.Y.S.2d 812 [Sup. Ct., Monroe County]" (*Wasserman v. Wasserman*, *supra* at 933).

"It is well settled that as a matter of public policy a charging lien does not attach to an award of alimony or maintenance" (Turner v. Woolworth, 221 NY 425, 117 N.E. 814 (1917); Theroux v. Theroux, 145 AD2d 625, 627, [2d Dept., 1988]). Additionally, the New York courts have held that as a matter of public policy "an attorney's charging lien cannot attach to an award of child support (CPLR 5205 [d] [3])" (Haser v. Haser, 271 AD2d 253, 254, [1st Dept., 2000]).[FN5]

Thus matrimonial attorneys are left to consider the equitable distribution of marital assets when asserting a charging lien and it is well settled that a charging lien will be available to attach to an award of equitable distribution "'to the extent that an equitable distribution award reflects the creation of a new fund by an attorney greater than the value of the interests already held by the client' (*Moody v. Sorokina*, 50 AD3d 1522, 1523, 856 N.Y.S.2d 755 [internal quotation marks omitted]). However, '[w]here the attorney's services do not create any proceeds, but consist solely of defending a title or interest already held by the client, there is no lien on that title or interest' (*Theroux v. Theroux*, 145 AD2d 625, 627— 628, 536 N.Y.S.2d 151)" (*Charnow v. Charnow* 134 AD3d 875, 876, 22 N.Y.S.3d 126, 127—28 [2 Dept. 2015]).

In *Charnow*, pursuant to the parties' stipulation of settlement the defendant was to pay to plaintiff's counsel $150,000.00. When the defendant failed to pay those fees, plaintiff's counsel moved to enforce a charging lien for the amount owed. The Supreme Court denied plaintiff's counsel's motion; the Appellate Division, Second Department held "the plaintiff and the defendant already owned the marital residence jointly as tenants by the entirety. Thus, the parties' settlement agreement merely permitted the plaintiff to retain her existing interest in the marital residence. "Although the nature of the property was converted from realty into dollars, her [*8]interest remained the same. Thus, no equitable distribution fund to which a charging lien can attach was created by the efforts of the [plaintiff's] attorney."

The question of what "recovery" the charging lien may attach to in a matrimonial proceeding has been the subject of recent commentary.

Dolores Gebhardt, Esq., in her August 23, 2017 New York Law Journal Article, *Charging Liens in Matrimonial Actions: A Vanishing Right* writes:

> "A charging lien may not attach to the client's share of an IRA, which had been funded through a rollover of the share of the other spouse's IRA, because the rollover did not create "proceeds" for the client. J.K.C. v. T.W.C., supra.
>
> The most valuable asset that many divorcing couples have is their home the "marital residence." However, several courts have held that a client's share of the proceeds of sale of the marital residence is not a "new fund" because the client already owned an interest in the marital residence with his or her spouse as tenants by the entirety. Charnow v. Charnow, 134 AD3d 875, 22 N.Y.S.3d 126 (2d Dept. 2015); Moody v. Sorokina, 50 AD3d 1522, 856 N.Y.S.2d 755 (4th Dept. 2008); Zelman v. Zelman, 15 Misc 3d 372, 833 N.Y.S.2d 375 (Supreme Ct., New York Co. 2007). [...]
>
> "In light of the elimination of maintenance and child support awards, and now awards of an equitable share of the enhanced earnings generated by a license or degree obtained during the marriage, I submit that there is not much left to which a charging lien may attach in many matrimonial cases [...] The attorney's sole recourse is to commence a plenary action against the client, or, if the unpaid fees are less than $50,000.00, seek fee arbitration if the client consents."[FN6]

Here, in light of the fact that the instant divorce action is still pending, and as such, no final decision on equitable distribution has been determined, there is no "recovery" for the charging lien to attach to. The Court will deem Mr. Butterman's application as one for a final charging lien and as such that branch of Mr. Butterman's application is denied without prejudice as premature under existing Appellate Division, Second Department case law (See *Charnow v. Charnow supra*). The case law now in effect prevents the attorney, *pendente lite*, from attaching a final charging lien to any fund prior to a determination as to whether a "new fund" has been created by the attorney's efforts as this matter has not yet proceeded to trial and no judgments have been issued. Thus any establishment of a charging lien must be delineated as an interim charging lien subject to a hearing on a final charging lien once the matter is concluded consistent with *Charnow.*

Conclusion

Plaintiff has been placed in a position by the defendant while at the same time his own counsel has been paid in excess of $200,000.00 according to plaintiff's former counsel, ostensibly by defendant's father, which has not been disputed by defendant. Thus, the plaintiff, who was benefitting from the parties' prior lifestyle, the less-monied spouse, is left with very few remedies based upon her husband's actions and the inability to obtain her case file and transfer it to her [*9]newly retained counsel. Defendant steadfastly maintains that the plaintiff owns her own successful clothing business and is secreting her income.

As such, the Court must refer this issue of fixing the security interest and interim charging lien to a hearing to a Referee to hear and report pursuant to CPLR §4212, or to hear and determine on consent of the parties pursuant to CPLR §4317, before Referee Carolyn Genovesi, Part 5CG, subject to compliance with 22 NYCRR part 1400 (*Hovanec v. Hovanec*, 79 AD3d 816, 817, 912 N.Y.S.2d 442 [2d Dept., 2010]). Counsel shall contact Referee Genovesi by conference call to schedule the hearing on Tuesday December 5, 2017. The annexed referral form must be completed and returned to the Court by Friday December 8, 2017.

If any lien is established by the Court, plaintiff's former attorney will then be ordered by the Court to turn over the file for posting adequate security under the present statutory and case law requirements or outgoing counsel may be granted an "interim charging lien." The interim charging lien would serve to prevent this matter from further delay and give counsel adequate security to extinguish the retaining lien. However, that security interest and the "interim charging lien" would be subject to further adjustment once the case has been properly adjudicated and then a further hearing can be held to determine what role Mr. Butterman or his firm had in obtaining the result achieved in equitable distribution consistent with the dictates of *Charnow*. Then and only then would a final charging lien attach.

This shall constitute the decision and order of the Court.

ENTER:

Hon. Jeffrey S. Sunshine

J. S. C.

Footnotes

Footnote 1: It should be noted that Mr. Butterman did not move before the Court to be relieved. Had he done so, the Court would have had to consider that non-payment of the fee alone may not have been a basis to be relieved (*Weiss v. Spitzer*, 46 AD3d 675, 848 N.Y.S.2d 237 (2d Dep't., 2007); *George v. George*, 217 AD2d 913, 629 N.Y.S.2d 602 (4th Dep't 1995). (cf. Where the clients were in substantial arrears in the payment of legal fees and failed to cooperate in their representation, the motion for leave to withdraw as counsel should have been granted. *Aragona v. Shaibani*, 138 AD3d 649, 29 N.Y.S.3d 68 (2d Dep't., 2016).). It is unclear at this time if the plaintiff was aware of this standard.

Footnote 2: Ms. Smith takes no position on the instant application.

Footnote 3: It is unclear from the record herein how much plaintiff has paid her new attorney at this time.

Footnote 4: The Court notes that it has issued a separate decision on this matter dated November 30, 2017 relating to motions sequences # 13 and 14, to renew and reargue this Court's March 6, 2017 *pendente lite* decision and order that delves into further detail regarding the contentious nature of this matrimonial action.

Footnote 5: The Appellate Division, Fourth Department held in *Mura v. Mura* (128 AD3d 1344, 1347, 7 N.Y.S.3d 766 (4d Dept., 2014), leave to appeal dismissed, 26 NY3d 951, 38 N.E.3d 812 [4d Dept., 2015]) that a charging lien could attach to a child support award because "plaintiff did not seek to enforce the 16-year-old support obligation until the parties' children, who were the intended beneficiaries of the support, were either emancipated or nearly emancipated. This is therefore not a situation in which the enforcement of a lien pursuant to Judiciary Law § 475 will result in the depletion of monies necessary for the ongoing support of a minor child or children" and thus the funds to which the charging lien attached were not considered "child support" in violation of the case law and statute.

Footnote 6: Dolores Gebhardt, *Charging Liens in Matrimonial Actions: A Vanishing Right*, NYLJ, August 24, 2017 at 8, col 1-3).

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