

Memorandum 92-25

Subject: Study L-640.10 - Living Trust Industry

In March, Kathryn Ballsun of the State Bar Probate Section addressed the Commission on irresponsible promotion of living trusts in California. These trusts are mass-produced and aggressively marketed by non-lawyer financial or estate planners without being carefully tailored to the needs of the individual consumer. The Commission asked the staff to look into the matter and to consider whether a warning statement in trusts sold or distributed in California would be useful.

Possible approaches to the problem include:

(1) Require a warning statement in form trusts advising the consumer that there are significant risks in using a form document that has not been carefully tailored to the needs of the individual consumer.

(2) Facilitate malpractice claims on mass-produced trusts, such as by requiring the name and address of the responsible attorney to be included in the instrument.

(3) Regulate unauthorized practice of law through ethics opinions and attorney discipline.

Warning Statement

There is ample precedent for warning statements or notices in written instruments. E.g., Civ. Code §§ 2450, 2500 (durable powers of attorney), 1803.2 (retail installment contracts), 1812.85 (health studio services), 1812.209 (seller-assisted marketing plans), 1812.302-1812.304 (membership camping contracts), 1812.511 (employment counseling services), 1812.516 (job listing services). But will consumers read and understand a warning statement in an instrument that is already lengthy and complex? If a warning statement were required in "form" trusts, would that include standard form trusts in law office word processors?

Our consultant, Professor Edward Halbach, thinks a warning statement in form trusts would not be useful. The promoters of form trusts can probably negate the effects of a printed warning statement. The staff thinks a better solution than a warning statement is needed to curb the worst excesses of aggressively marketed form trusts.

Malpractice Liability

Malpractice liability may not be effective to regulate mass-produced trusts. The immediate loss to the client for an ill-advised trust is small relative to potential loss to trust beneficiaries. The client's loss is merely the cost of drafting the instrument. *Cf.* *Heyer v. Flaig*, 70 Cal. 2d 223, 232, 449 P.2d 161, 74 Cal. Rptr. 225 (1969) (will). The beneficiaries' loss will not occur until the trustor's death. This may be many years after the instrument is drafted. See R. Mallen & V. Levit, *Legal Malpractice* § 354, at 384-87 (2d ed. 1981).

If the attorney's name and address were required on form trusts, that might help beneficiaries find a responsible party years later when the harm has occurred. But this would not guarantee the attorney could be found, and would not solve the problem of finding witnesses and other evidence.

Ethics Opinions

Diana Hastings of the State Bar Probate Section is drafting a proposed ethics opinion for consideration and possible adoption by the State Bar. The opinion will address ethical questions raised by the marketing of living trusts. The typical fact situation involves attorneys working for non-lawyer financial or estate planners. There are cases and ethics opinions on this in Colorado and Illinois.

The Colorado Supreme Court held that preparation and marketing of living trusts by a non-lawyer or corporation constitutes unauthorized practice of law. *People v. Schmitt*, 126 Colo. 546, 251 P.2d 915 (1952). Colorado has suspended attorneys for participating in such ventures. In *People v. Macy*, 789 P.2d 188 (Colo. 1990), an attorney was suspended for reviewing living trust packages prepared by non-lawyers, answering questions from non-lawyer sales personnel about customer concerns, and accepting an hourly fee from a non-lawyer salesperson for those services. The court held the attorney had aided a non-lawyer in the unauthorized practice of law.

In *People v. Boyls*, 197 Colo. 242, 591 P.2d 1315 (1979), a lawyer was suspended for working with non-lawyer salesmen to answer clients' questions on individual trusts, preparing promotional materials, and helping purchasers formulate effective trusts. According to a Colorado ethics opinion, both the "factory" and its non-lawyer salespersons are engaged in the practice of law by preparing and marketing living trust

packages. The attorney's assistance to the "factory" is an integral part of this process. An attorney who does this is aiding a non-lawyer in the unauthorized practice of law.

According to Colorado and Illinois ethics opinions:

- Fee-splitting between a lawyer and a non-lawyer is generally prohibited.

- Solicitation and "feeder operations" are prohibited. An attorney may not avoid this prohibition by associating with a non-lawyer who engages in such conduct. An attorney who participates in an educational seminar must not emphasize his or her professional experience or reputation or that of his or her firm or of an affiliated lawyer, and is prohibited from giving individual advice.

- The attorney's client is the financial or estate planning group for whom the attorney works. Preparing or reviewing trusts for consumers may pose a conflict of interest that precludes the attorney from fairly representing the consumer and acting in the consumer's best interest.

Because of these concerns, the Illinois Bar concluded that "it is professionally improper to prepare or review trust documents for general marketing to consumers by an institution or to share fees for consumer trust preparation" with the institution.

The staff thinks it will be more effective to regulate marketing of trusts through ethics opinions and attorney discipline than to require a warning statement or to try to facilitate malpractice claims. Diana Hastings agreed to send the staff a copy of her draft ethics opinion when it is finished.

Staff Recommendation

The staff recommends the Commission take no action at present. The staff will stay in touch with Ms. Hastings and will report to the Commission on what action the State Bar decides to take on her proposed ethics opinion.

Respectfully submitted,

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