Selecting and Maintaining Appropriate Fiduciaries in an Estate Plan

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Probate courts are rife with litigation involving fiduciaries. Fiduciaries are individuals or institutions designated to handle financial and health-care matters during client incapacity and to distribute assets to beneficiaries upon death. They are successor trustees of the living trust, executors of the will, and agents under the financial and health-care powers of attorney.

Last year in California, the son of a decedent brought suit against the decedent's elderly girlfriend, who was serving as trustee of the decedent's trust. The court removed the girlfriend as trustee and surcharged her $1.5 million, primarily for breaching the "prudent investor rule" and incurring trust investment losses (although she invested trust assets with a reputable national investment firm).[1] In another case, which the presiding judge described as "tragic," siblings and stepsiblings sued one brother for breach of fiduciary duty for mishandling his father's trust assets.[2] A judgment against the stepbrother was overturned on appeal,[3] but only after hundreds of thousands of dollars were spent on attorneys' fees. Cases such as these highlight the need for your clients to understand the importance of carefully selecting and maintaining appropriate fiduciaries in their estate plans, and building in appropriate mechanisms to remove and replace them.

Health-Care Fiduciaries

In health-care powers of attorney, people often name agents to act consecutively. But sometimes they name two or more to serve concurrently. The problem with naming joint agents is when they disagree (for example, the protracted legal battle between Terri Schiavo's husband and her parents over whether to continue life-prolonging procedures). Therefore, a better approach may be to discuss with and select the people most likely to execute the client's wishes, and then to name them consecutively.

Financial Fiduciaries

Financial fiduciaries handle the financial affairs upon client incapacity and/or death. People most commonly name spouses, if any, followed by family members or friends. However, in conflicted families or in complex estates, these individuals may not be the best choice. Other choices include professional advisers, corporate trustees, or private professional fiduciaries.

Non-incapacitated/Surviving Spouse. Married couples typically have the non-incapacitated spouse serve as fiduciary during the other spouse's incapacity and as sole trustee of all trusts created after the first spouse's death, even if those trusts were designed to ultimately protect the deceased spouse's assets for his or her beneficiaries (such as children from a prior marriage). When trusts are created for such control purposes, couples may want to consider having someone other than the surviving spouse serve as trustee, or having the surviving spouse serve with a co-trustee. Only in friendly families should the trustee or a co-trustee who serves with a surviving spouse be a remainder beneficiary, because any funds distributed to the surviving spouse will reduce the remainder beneficiary's ultimate distribution. This type of conflict of interest has spawned considerable litigation in blended families.

Family Members and Friends. After the spouse, many people automatically name their children consecutively as successor fiduciaries. Although it can be a fine choice, it can be a source of friction and litigation in conflicted families. If they name the children jointly, it may become cumbersome to get all signatures for all actions taken. If more than one serves, there should be a tiebreaking mechanism as well. Although many family members and friends will waive fees for serving as trustee, most trusts provide for "reasonable compensation," which also may be of concern to other beneficiaries.

Professional Adviser. Some people name their CPAs or attorneys as fiduciaries in their estate plan. Whether a drafting attorney may serve is subject to the professional conduct rules of his or her state bar.

Corporate Trustee. A financial institution's trust department or a trust company may be a good choice for a complex estate or a conflicted family situation. Corporate trustees are experienced, objective, and impartial. They will usually base their fees on a percentage of assets under management (for example, 1 percent on a liquid estate worth $2 million). They may be willing to serve as co-trustees (without a reduction in fees). But because they will have minimum fees, they may not be an option for a small estate. Federally regulated, insured, and bonded, their fees may well be offset by professional investment management, though investments will be conservative to avoid liability and to comply with the prudent investor rule. Corporate trustees should always be considered as a backstop fiduciary in an estate plan because of their perpetual existence.

Private Professional Fiduciary. Another option is to name a private professional fiduciary. Abilities and licensing requirements for these individuals vary widely. California is one of the few states that licenses private fiduciaries. Though bondable, private professional fiduciaries are not highly regulated. However, like a corporate trustee, a good private professional fiduciary can bring experience, organizational skills, and objectivity. Sometimes people prefer a private professional fiduciary to a corporate trustee, feeling it can be a more personal relationship. However, like an individual, a private professional fiduciary can become incapacitated, die, or retire. Professional private fiduciaries may charge hourly fees (for example, $100/hour) or base their fees on a percentage of assets. They can also serve as fiduciaries on health-care powers of attorney.

Removing and Replacing Fiduciaries

If a client is incapacitated or deceased, and his or her documents do not specify a manner in which to remove and replace fiduciaries, a court will need to make the determination. Although there are times when clients may want to make it difficult to remove and replace a fiduciary, often they will want to preserve family harmony, avoid litigation, and ensure their affairs are handled as planned by building in other safeguards. Specifically:

Fiduciary Incapacity. If the named fiduciary is incapacitated but will not step down, how can he or she be removed? Often the estate planning documents will require the written certification of one or two physicians to deem someone incapacitated. What if the fiduciary will not submit to a medical evaluation? One mechanism is to have the will, trust, and power of attorney specify that if the successor fiduciary, in good faith, determines the acting fiduciary is incapacitated, the acting fiduciary has 10 days to submit to a medical evaluation to prove otherwise or the successor will step in as fiduciary.

Fiduciary Breaching Fiduciary Duty. Rather than forcing interested parties into court if they suspect a fiduciary is breaching a fiduciary duty, documents may specify that a person, or a group of people, may remove and replace a fiduciary. Choices include the person's spouse, and after his or her death, the children by majority or unanimous consent, an attorney or CPA, another named person, such as the agent named under the power of attorney, or the last resigning fiduciary. A trust protector may even be named for this role, though trust protectors are usually reserved for irrevocable trusts. For additional control, a client can specify the type of replacement fiduciary, such as a corporate trustee.

Fiduciary Vacancy. If the designated fiduciaries are deceased, decline to serve, or are otherwise unable to serve when needed, again, instead of having a court fill the vacancy, documents may specify that a named person or persons may appoint a fiduciary.

Removal and Replacement by Beneficiaries. If clients have ongoing trusts for beneficiaries after their death that allow them to remove or replace trustees at will with a discretionary trustee who is not "related or subordinate"[4] for asset protection purposes, they may want to specify that until the beneficiary attains a responsible age, the trustee may only be a corporate trustee. Otherwise, a beneficiary can name a friend who can distribute all the assets to the beneficiary.

As the cases above illustrate, when there is the potential for conflict in a family, to preserve family harmony and avoid litigation, it may be better to name an objective and impartial corporate trustee or a reputable private professional fiduciary as fiduciaries in an estate plan and/or to have built-in mechanisms to remove and replace acting fiduciaries with such a fiduciary before conflicts escalate.

Endnotes

1. *Amiad v. Cohen*, 4th Dist., Div. 3, 5/25/2011.
2. In re *Estate of Giraldin*, 199 Cal.App.4th 577 (2011).
3. Ibid.
4. Internal Revenue Code 672(c).