

mcle self study

REPRESENTING FIDUCIARIES: THE CHALLENGES

by John A. Hartog

Attorneys representing fiduciaries face a gamut of ethical, malpractice and practical issues. This multiplicity of issues arises because fiduciaries are subject to a host of duties toward beneficiaries. In addition to fulfilling the attorney's professional duties to the trustee-client, the attorney must be well versed in the trustee's duties to the beneficiaries. The high standards of behavior for the trustee-client may spill over to the attorney, creating a duty to a non-client in addition to those to the client. Similar considerations exist for the attorney who engages in estate planning. The plaintiff in a subsequent action is as likely to be a non-client beneficiary as the client-testator.

Ethical and Fiduciary Duties of Attorneys

Often, the ethical, malpractice and practical issues are not discrete issues. Instead they may be more like interwoven threads in the cloth of representing trustees. At each stage of representation, the attorney's conduct and counsel is shaped by all three concerns.

The attorney is a fiduciary and agent of the client. Accordingly, the attorney is subject to the general laws that apply to agents,¹ as well as the ethical rules and fiduciary duties applicable to attorneys in their relationship with clients. The ethical and fiduciary duties to the client include the following: Duty of loyalty; Duty to avoid conflicts of interest; Duty of confidentiality; Duty of competence and diligence;² Duty of communication.³

The ethical standards applicable to attorneys are found in California's Rules of Professional Conduct ("CRPC").⁴ The fiduciary duties to clients applicable to attorneys are also addressed in the State Bar Act [California B&P Code §6000 *et seq.*]. The general principles in statutes and case law regarding fiduciary relationships also apply to attorneys [*David Welch Co. v. Erskine & Tulley* (1988, 1st Dist.) 203 Cal. App. 3d 884, 250 Cal. Rptr. 339; *Alkow v. State Bar of California* (1971) 3 Cal.3d 924, 92 Cal. Rptr. 278].

"It is well established that an attorney's duties to his client are governed by the [CRPC] rules. [Citations omitted.] Those rules, together with statutes and general principles relating to other fiduciary relationships, all help define the duty component of the fiduciary duty that an attorney owes to his client. [Citations omitted]." *Mirabito v. Liccardo* (1992) 4 Cal. App. 4th 41, 46, 5 Cal. Rptr. 2d 571, 573. "The relation between the attorney and client is a fiduciary relation of the very highest character, and binds the attorney to most conscientious fidelity – *uberrima fides*." *Cox v. Delmas* (1893) 99 Cal. 104, 123, 33 P. 836.

"An attorney should be a paragon of candor, fairness, honor, and fidelity in all his dealings with those who place their trust in his ability and integrity, and he will at all times and under all circumstances be held to the full measure of what he ought to be." *Sanguinetti v. Rossen* (1910) 12 Cal. App. 623, 107 P 560.

1 California Civil Code §2296 *et seq.* (Law of Agency). All code sections cited in this outline are California statutes, unless otherwise noted specifically.

2 See CRPC Rule 3-110 Failing to Act Competently. This duty of competence means an attorney must use the diligence, learning and skill, and abilities reasonably required to perform the legal service; Rule 3-400 Limiting Liability to Client; See also ABA MRPC Rule 1.1, Rule 1.3 (in Appendix B of outline); See *Matter of Riley*, 1994 WL 413173, 3 Cal. State Bar Ct. Rptr. 91 Cal. Bar Ct. Aug 04, 1994; *In the Matter of Nunez* (Review Dept.1992) 2 Cal. State Bar Ct. Rptr. 196, 200.) *In the Matter of Bouyer* (Review Dept.1991) 1 Cal. State Bar Ct. Rptr. 404, 415.

3 B&P Code 6068(m); CRPR 3-500; See also ABA MRPC Rule 1.4 (in Appendix B of outline); See *Matter of Nunez* (Review Dept.1992) 2 Cal. State Bar Ct. Rptr. 196, 200.

4 California Rules of Professional Conduct are State Bar rules adopted by the Board of Governors of the State Bar of California and approved by the California Supreme Court pursuant to B&P Code §§ 6076 and 6066.

The fiduciary duty to a client includes the duty to represent the client with undivided loyalty [*Cal Pak Delivery, Inc. v. United Parcel Service, Inc.* (1997), 52 Cal. App. 4th 1; *Zador Corp. v. Kwan* (1995) 31 Cal. App. 4th 1285]. “The duty of loyalty forbids any act that would interfere with the dedication of a lawyer’s entire energies to the client’s interests.” *Flatt v. Superior Court* (1994) 9 Cal. 4th 275, 289.

Consider the application of the above standards and duties in the following (not too uncommon) situations:

Case A: A married couple is your joint estate-planning client. They are the settlors and original trustees of the revocable trust. One of them dies and the surviving spouse is the sole remaining trustee. The marriage was enduring and successful. All of the property was community, or some fashion of joint ownership. The survivor has no understanding of the consequences of the multiple subtrusts established by the instrument. The survivor considers all the trust property to be subject to the exclusive dominion and control of the survivor.

Case B. A married couple was the joint estate-planning client. Their marriage is the second for both. Upon the first death, the survivor is the sole trustee. The decedent is survived by the surviving spouse, a child of the marriage, deceased client’s children from a prior marriage, and the surviving spouse’s children from a prior marriage (the “yours, mine and ours” family). The deceased’s children from a prior marriage and the child of the marriage are beneficiaries of the bypass and QTIP trust.

Case C: Your client dies and the surviving spouse is the successor trustee. Your client with substantial separate property is survived by the much younger surviving spouse and the client’s children from a prior marriage, who are the remainder beneficiaries of the bypass trust and the QTIP trust.

Case D: The surviving spouse of your married clients has died and only one of the beneficiary children is named as the successor trustee. The settlors named the child they believed to be the most responsible (because that child is the favorite) of their three children to be the trustee. One of the other children has financial difficulties and the other has a rocky marriage. Alternatively, all three are doing well but there are long-standing family tensions. In any event, the appointment of one in preference to the others itself becomes a source of tension. This strain is usually compounded by a plan that requires the bypass and survivor’s trust to continue for the lifetime of the children and then to be distributed to the grandchildren.

Potential issues to address in the common scenarios above include the following:

- *Clarifying the scope of representation with the surviving spouse trustee or any other successor trustee;
- *Counseling the surviving spouse client about whether to serve as trustee;
- *Providing proper disclosures and obtaining informed consents (waivers), depending on other members of the family previously or currently represented;
- *Providing appropriate disclosures and notice of non-representation to relevant parties (*e.g.* other beneficiaries);
- *Counseling the individual trustee regarding trust administration: funding the subtrusts, investment duties, duty to account and report, etc.; and
- *Assessing the potential for trust litigation: will and trust contests, property disputes or claims by and against the trust estate, actions against the trust or trustee, claims of beneficiaries’ creditors, determination of heirs and beneficiaries.

Knowing what the law requires does not guarantee results: often, the challenge is in not knowing what the law is, but in the implementation. How do you obtain the required informed consent? How can you most effectively guide your trustee-client to comply with what the law requires? How can you minimize the risk of liability to third parties? How do you achieve the outcome your client desires?

A cause of special concern to the attorney representing the trustee-client may be a trustee who is acting improperly. Can the attorney, who is subject to this multiplicity of duties, disclose the improper acts to the courts or to beneficiaries? The answer is probably NO.

A broader question may be: How much responsibility does the attorney have to “police” the trustee? Moreover, when and how can the attorney withdraw?

In general, the attorney will have a certain amount of influence on the trustee-client; from the onset, the attorney can take steps to guide the trustee to act in accordance with the trustee’s duties. For example, if the attorney believes that the trustee may be remiss in keeping records, the attorney may suggest an initial review after three or six months, instead of waiting until the first annual account is due. If the trustee-client does not show the willingness or ability to perform adequately, the attorney should consider withdrawal. To do otherwise may mean assuming the risk of liability to third parties (or even the trustee himself— an irresponsible person usually is eager to point the finger when something goes wrong) relating to the trustee’s failure to fulfill the trustee’s duties.

If the attorney discovers a breach of fiduciary duty, the attorney can guide the trustee to come clean and take steps to rectify the matter immediately. If the attorney is not successful in doing so, the attorney probably will want or be required to withdraw. In these instances, even when not mandatory under the ethical rules, the limit of loyalty may be the attorney’s own self-protection.

Withdrawal, even in extreme cases, should not prejudice the client. The attorney should keep in mind that the attorney is bound by the duty of confidentiality and attendant attorney-client privilege, even after the engagement has ended.

Practical Pointers Summary

Ideally, the attorney has a chance to prevent improper acts by the trustee through active education and guidance. A series of innocent acts may accumulate into a breach of duty. To prevent improper acts, both inadvertent and intentional, and to avoid joint liability for any such acts, the attorney should counsel the trustee as to the duties that come with that role, especially the duty of loyalty and impartiality, the duty to avoid self-dealing, and the duty to report and account.

Pointers to remind the trustee:

- *Follow the trust instrument’s expression of the settlor’s intent; not what the trustee believes is the settlor’s “real” intent.
- *Document the basis of the exercise of discretionary principal invasion powers.
- *Provide sufficient information regularly — before the requests come in.
- *Obtain written consents from all beneficiaries prior to any self-dealing transactions. Suggest group meetings where all parties have a chance to air their views.
- *Invest under the “prudent investment rule” and document the investment policy, as protection in case of less-than-expected performance. Delegate, with reasonable care, if necessary.
- *Obtain insurance, if available.

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MCLE TEST “Representing Fiduciaries: The Challenges”

1. Even if there is no intent to do so, a series of innocent acts may lead to a breach of duty by the trustee.
 T or **F**
2. A trustee should follow what s/he believes is the settlor’s “real” intent even if somewhat different from that expressed in the trust instrument because that is what the settler would have wanted.
 T or **F**
3. If a client-trustee is not willing or able to perform adequately the duties of trustee, the attorney should consider withdrawal.
 T or **F**
4. If a client-trustee is not willing or able to perform adequately the duties of trustee, the attorney should *not* consider withdrawal to avoid assuming the risk of liability to third parties.
 T or **F**
5. If the attorney discovers a breach of fiduciary duty by the client-trustee, the attorney cannot guide the trustee to immediately “come clean” about the breach.
 T or **F**
6. Withdrawal, *even in extreme cases*, should not prejudice the client.
 T or **F**
7. Once the attorney’s engagement with the client-trustee has been terminated, the attorney is no longer bound by the duty of confidentiality and attendant attorney-client privilege.
 T or **F**
8. An attorney who knows the client-trustee has committed improper acts should not disclose the acts to the courts.
 T or **F**
9. The ethical standards applicable to attorneys representing fiduciaries are governed solely by the California Rules of Professional Conduct.
 T or **F**
10. The ethical standards applicable to attorneys representing fiduciaries are found in the California Rules of Professional Conduct and relevant case law, but not in the State Bar Act.
 T or **F**
11. An attorney who knows the client-trustee has committed improper acts should not disclose such acts to the beneficiaries affected.
 T or **F**
12. As a fiduciary of the client-trustee, the attorney is subject to the ethical rules applicable to attorneys and not the laws of agency.
 T or **F**

13. The attorney is both a fiduciary *and* an agent of the client-trustee?
 T or **F**
14. The ruling in *Flatt v. Superior Court* holds that the duty of loyalty forbids some acts, but not all, that would interfere with the dedication of a lawyer's entire energies to the client's interests.
 T or **F**
15. The high standards of behavior for the trustee-client may spill over to the attorney creating a duty to a non-client.
 T or **F**
16. The trustee should be counseled by the attorney to invest under the "prudent investment rule."
 T or **F**
17. If the trustee does not obtain written consent from the beneficiaries of a self-dealing transaction, the trustee will forfeit his/her interest unless the transaction conveys adequate consideration.
 T or **F**
18. If the trustee gives notice to the beneficiaries of a self-dealing transaction, *and* adequate consideration, the trustee need not obtain written consent.
 T or **F**
19. The "duty of competence" means an attorney must use the diligence, learning and skill and abilities reasonably required to perform the legal service.
 T or **F**
20. In addition to fulfilling the attorney's professional duties to the trustee-client, the attorney must be well versed in the trustee's duties to the beneficiaries.
 T or **F**

Name _____
 Law Firm _____
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 City & Zip _____
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