WHEN FIDUCIARIES GO WRONG

2021 Stetson University National Conference on Special Needs Planning and Special Needs Trusts

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Introduction

A fiduciary is a person or entity in whom another reposes reliance and confidence. A fiduciary must act in the best interests of the person or entity that is relying on the fiduciary and has affirmative duties to those relying on the good faith of the fiduciary. Certain relationships impose fiduciary duties, such as attorneys to clients, doctors to patients, accountants to clients, trustees to beneficiaries, guardians to wards, conservators to conservatees, and attorneys-in-fact to principals, to name a few. When a fiduciary breaches fiduciary duties, the fiduciary may be liable to the beneficiaries for damages.

Personal Representatives

The rights and duties of an executor are derived from the decedent's will, applicable state statutes and court orders in proceedings involving the estate. The duties of an estate administrator are set forth in the governing statutes and court orders, if any. Personal representatives are required to perform their duties in the same manner that a prudent person would manage his or her own affairs and are held to a strict standard of care. They must act in good faith and deal impartially with beneficiaries.

Generally, the personal representative has a duty to settle and distribute the estate expeditiously and efficiently. *See, e.g.,* Uniform Probate Code ("UPC") section 3-703[1]. Specifically, the personal representative must locate the original will, identify and determine the value of the probate assets, secure real property and take possession of personal property, prepare and file tax returns, pay claims and taxes, identify the beneficiaries, manage the assets and

[1] The UPC has been adopted in tis entirety in the following states: Alaska, Arizona, Colorado, Florida, Hawaii, Idaho, Maine, Michigan, Minnesota, Montana, Nebraska, New Mexico, North Dakota, South Carolina, South Dakota and Utah. The other states have adopted parts of the UPC.

distribute the assets pursuant to the terms of the will or the laws of intestacy. *See* UPC Section 3-709.

A personal representative can engage attorneys, accountants, realtors, financial advisors and others to advise and assist them in administering the estate. The personal representative, however, may be held liable if those hired by the personal representative cause harm to the estate.

Trustees

Trustees have a duty to avoid self-dealing, to avoid improper delegation of the trustee's duties, to deal impartially with all beneficiaries and to prudently invest the trust assets. All Trustees are required to keep accurate records, file tax returns and/or accountings and comply with the terms of the trust document. Depending on the state, the actions of the trustee may be governed by the state's Principal and Income Act[2], Prudent Investor Act and Uniform Trust Code.

Most states have enacted the Uniform Prudent Investor Act ("UPIA"). Several other states have enacted prudent investor statutes that are similar to the UPIA. This Act made five fundamental changes to the criteria for prudent investing set forth in the Restatement of Trusts 3d: Prudent Investor Rule.

- The standard of prudence is applied to investments as part of the total portfolio, rather than to individual investments.
- The fiduciary's primary consideration is balancing in all investing between risk and return.

[2] Most states have enacted the Uniform Principal and Income Act, which was designed to provide procedures for personal representatives and trustees in allocating assets to principal and income, and to govern their distribution to beneficiaries.

- Rather than restrict the types of investments, the trustee is permitted to invest in anything that contributes to achieving the risk/return objectives of the trust so long as the other requirements of prudent investing are met.
- The requirement that fiduciaries diversify investments has been incorporated into the definition of prudent investing.
- Trustees are permitted to delegate with the proper safeguards.

The Uniform Trust Code ("UTC"), considered the first national codification of trust law, was promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL")[3] in 2000 and last revised or amended in 2010. According to the Prefatory Note, there was a realization that, given the greatly expanded use of trusts in recent years, trust law was thin and fragmentary in many states. The UTC was drafted to provide a comprehensive guide on trust law issues. The UTC was modeled on California's trust statute in close coordination with Restatement (3^d^) of Trusts.

Although the UTC consists of a set of default provisions that a trust instrument may override, there are a number of notable exceptions. Section 105(b) sets forth the exceptions over which the terms of a trust do not prevail. Included among the mandatory rules are:

- the requirements for creating a trust;
- the duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries;
- the requirement that a trust and its terms be for the benefit of its beneficiaries, and that the trust have a lawful purpose, not contrary to public policy;

[3] NCCUSL is also known as the Uniform Law Commission ("ULC").

- the power of the court to modify or terminate a trust;
- the effect of a spendthrift provision and the rights of creditors and assignees to reach a trust; and
- the power of the court to require, dispense with, modify or terminate a bond.

The UTC sets forth specific duties of the trustee which are derived from the common law and the principles contained in the Restatement (3^{d}) of Trusts. These include:

- the duty to administer the trust in good faith
- the duty of loyalty
- the duty of impartiality
- the duty of prudent administration
- the duty to use special skills or expertise

The UTC incorporates or supersedes several uniform acts, such as the:

- Uniform Probate Code (Article VIII);
- Uniform Prudent Investor Act;
- Uniform Trustee Powers Act; and
- Uniform Trusts Act.

Special Needs Trusts

The administration of a special needs trust is similar to that of other trusts insofar as accounting and tax law are concerned. The trustee of a special needs trust, however, must also understand the public benefits programs that may be available to the beneficiary and how distributions from income or principal may affect the beneficiary's eligibility for those programs.

There may be others who are assisting the special needs beneficiary in obtaining benefits, such as a legal guardian, parents and advocates. The trustee must work together with those others to ensure that the beneficiary is accessing the public benefits that he or she is entitled to receive.

Agent Under A Durable Financial Power of Attorney

A power of attorney is a written instrument by which a principal authorizes another individual, known as the agent, to perform specified acts on behalf of the principal. The power of attorney is an effective planning tool for those who anticipate needing assistance with financial matters. A power of attorney may eliminate the need for a guardianship proceeding, the associated court costs and a public determination of incapacity. A principal executing a power of attorney intends the agent to act for the principal's benefit. Giving another person the authority to manage one's financial affairs through a power of attorney, however, opens the door to financial abuse of the authority by the agent.

Power of attorney forms are now widely available on the internet allowing a principal to sign a simple document that conveys extraordinary powers without the benefit of counsel. The popularity of the power of attorney has contributed to its use in transactions more complex than originally intended by the law. An unscrupulous agent acting under a broad power of attorney may have authority to conduct transactions that are not in the principal's best interest such as transferring the principal's property without notifying the principal. In an effort to curtail abuses of powers of attorney, states have adopted statutes that address execution requirements, fiduciary obligations, limitations of the authority of the agent and the standard of care required of the agent.

At common law, powers of attorney terminated upon the incapacity of the principal. A durable power of attorney is created by statute to either survive the incapacity of the principal or become effective upon the incapacity of the principal, permitting the extended management of the principal's assets.

NCCUSL made statutory durable powers of attorney part of the Uniform Probate Code in 1969 to provide an alternative to court-oriented protective procedures. The durable powers of attorney provisions of the UPC were amended and a separate Uniform Durable Power of Attorney Act was adopted in 1979. The original Uniform Durable Power of Attorney Act which, at one time was followed by most states, was last amended in 1987.

The current Uniform Power of Attorney Act ("UPOAA") was adopted by NCCUSL in 2006 in response to a national review of state power of attorney legislation. This review determined that many states had enacted provisions with respect to areas that the original Uniform Durable Power of Attorney Act was silent including:

1. authority of multiple agents;
2. authority of a guardian appointed after the execution of the POA;
3. impact of the dissolution of a marriage where the spouse is the agent;
4. portability;
5. authority to make gifts; and
6. standards of agent conduct and liability.

The presumption of the UPOAA is that a power of attorney is durable unless otherwise expressed. It provides a default standard for agent conduct and liability. The UPOAA provides for third party reliance on the power of attorney and liability for unreasonable refusal to accept the power of attorney. The agent may file for a court order to enforce acceptance of the power of attorney. An optional statutory form for creating a power of attorney is included in the UPOAA.

The UPOAA addresses legislative trends and best practices and balances the need for acceptance of an agent's authority against the need to prevent and redress financial abuse. While all 50 states have power of attorney statutes, twenty-nine states have adopted the UPOAA.[4]

There is little dispute that an agent under a power of attorney is a fiduciary. Many state statutes, however, are silent as to the agent's standard of care. In those state statutes that address the standard of care, there are substantial differences among the states. Illinois and Indiana, for example, employ a standard of "due care." 755 Ill. Comp. Stat. Ann. 45/2-7 ("Whenever a power is exercised, the agent shall act in good faith for the benefit of the principal using due care, competence, and diligence in accordance with the terms of the agency and shall be liable for negligent exercise."); Ind. Code Ann. § 30-5-6-2 ("Except as otherwise stated in the power of attorney, the attorney in fact shall use due care to act for the benefit of the principal under the terms of the power of attorney."). Florida and Missouri, on the other hand, use a standard of care akin to that of a trustee. Fla. Stat. Ann. § 709.08(8) ("Except as otherwise provided [in the statute], an attorney in fact is a fiduciary who must observe the standards of care applicable to trustees …."); Mo. Ann. Stat. § 404.714 ("A person who is appointed an attorney in fact under a power of attorney, either durable or not durable, who undertakes to exercise the authority conferred in the power of attorney, has a fiduciary obligation to exercise the powers conferred in the best interests of the principal, and to avoid self-dealing and conflicts of interest, as in the case

[4] The following states have enacted the UPOAA: Alabama, Arkansas, Colorado, Connecticut, Georgia, Hawaii, Idaho, Iowa, Kentucky, Maine, Maryland, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin and Wyoming. Legislation is currently pending in Massachusetts and the District of Columbia.

of a trustee with respect to the trustee's beneficiary or beneficiaries….”). Section 114 of the UPOAA addresses the minimum mandatory standard of care that must be employed by an attorney in fact. It states that the agent under a power of attorney must “act with the care, competence, and diligence ordinarily exercised by agents in similar circumstances.”

Section 114 of the UPOAA requires the attorney-in-fact to act in accordance with the principal’s “reasonable expectations” to the extent they are known by the agent. If those expectations are not known, the attorney-in-fact must act in the principal’s “best interest.” The agent must act in good faith and only within the scope of authority granted in the power of attorney.

Guardians and Conservators

Guardianships and conservatorships are governed by state statutes. As a result, the duty of care owed by guardians to the wards or conservatees varies from jurisdiction to jurisdiction.

In 1982, the NCUSSL approved the Uniform Guardianship and Protective Proceedings Act. That Act was replaced in 1997 and was enacted by Alabama, Colorado, District of Columbia, Hawaii, Massachusetts, Minnesota and the U.S. Virgin Islands. Section 314 of the 1997 Act states that a guardian “shall act in the ward’s best interest and exercise reasonable care, diligence, and prudence.”

In 2017, the NCUSSL approved the Uniform Guardianship, Conservatorship, and Other Protective Arrangement Act which, according to the NCUSSL, is a “comprehensive statute for the twenty-first century.”[5] This Act, which has been enacted in Washington and Maine, promotes person-centered planning to incorporate the preferences and values of the incapacitated person into the guardianship order, requires courts to order the least-restrictive alternative.

[5] *See,* https://www.uniformlaws.org/committees/community-home?communitykey=2eba8654-8871-4905-ad38-aabbd573911c&tab=groupdetails

Power of Attorney for Health Care

Every state has statutes authorizing the use of advance health care directives. Concerned about the fragmentation of these laws and the inconsistency of advance health care directive statutes from state to state, the National Conference of Commissioners on Uniform State Laws approved the Uniform Health-Care Decisions Act in 1993. Since that time, however, only seven states, Alaska, Delaware, Hawaii, Maine, Mississippi, New Mexico and Wyoming, have enacted the Act.

A power of attorney for health care, also known as an advance health care directive or health care proxy, authorizes an agent to make medical decisions for the principal when he or she is no longer able to give informed consent to medical treatment. While the state statutes may vary, there are some common concepts that govern health care agents.

Generally, a health care agent is required to make decisions for the principal as if he or she were making those decisions. Obviously, this task is easier if the principal's wishes are expressed in writing or at least have been communicated to the agent. If the principal's wishes are not known, however, the agent must employ substituted judgment to determine what the principal would do or not do. Such decisions may require the agent to consider the principal's religious beliefs, values, previous decisions and personality. If the agent is unable to determine what the person would choose to do under the circumstances, then he or she must make decisions that are in the best interests of the principal.

Elements of Establishing Breach of Fiduciary Duty

1. Existence of fiduciary duty
2. Breach of duty
3. Causation

4. Damages

Remedies for Breaches of Fiduciary Duties

As noted above, state law generally governs the duties owed by fiduciaries. Remedies for breaches of fiduciary duties include:

- actual damages;
- lost profits;
- disgorgement of fees or profits;
- out of pocket losses;
- punitive damages;
- rescission;
- injunctive relief;
- accountings;
- surcharge;
- reformation;
- constructive trust;
- removal of fiduciary;
- attorneys fees;
- criminal penalties.

Following are several reported cases in various jurisdictions dealing with breach of fiduciary duties.

Breach of duty impartiality (self-dealing)

Black v. Black, 422 P.3d 592 (2018)

Renata Black established a special needs trust for her daughter, Joanne, who was diagnosed with chronic schizophrenia and a separate trust for her son, Bernard Black, who was a law professor, and Bernard's children. Renata's will devised 2/3 of her assets to the special needs trust and 1/3 to Bernard and his children. Renata's estate was valued at approximately three million dollars. However, shortly before she died, Renata Black designated one of her largest accounts as payable on death with about 95% of the value of the accounts going to Joanne and 1% going to Bernard's five children from his first marriage. She also named Joanne as the sole beneficiary of her Roth IRA. Bernard, his second wife, and his older children were upset that they were mostly cut out of Renata's estate. Rather than litigate the POD designations, Bernard decided to apply to be appointed Joanne's conservator[6] and then disclaim the assets in the POD accounts so that the assets would revert to the estate. Bernard told the court that their mother inadvertently changed the beneficiary designations and that by disclaiming the assets on behalf of Joanne, the assets would flow into her special needs trust.

Bernard was appointed conservator by the Colorado court and disclaimed both accounts on behalf of Joanne. However, the disclaimer of the Roth IRA resulted in those assets going into accounts in the names of Bernard's children with none of those assets going to Joanne or into her trust.

About two years later, Joanne moved back to New York and a new guardianship petition was filed there. A surcharge petition was filed in Colorado against Bernard. Judgement was entered against Bernard for actual damages as well as damages under Colorado's theft statutes.

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[6] Although Joanne lived in New York, she was homeless and in Colorado at the time that Bernard decided to apply to be her conservator so the conservator action was brought in Colorado.

Bernard appealed, asserting that he did not breach any fiduciary duties he owed Joanne because the court approved the disclaimer. The Colorado Court of Appeals, however, affirmed the probate court's judgment against Bernard.

Failure to apply for public benefits on behalf of the beneficiary

Sargent v. Sargent, No. PC-08-1429, 2009 R.I. Super. LEXIS 109, 2009 WL 3328560 (R.I. Super. July 31, 2009)

In April 1998, Diane Sargent established the Diane M. Sargent Revocable Trust –1998. The grantor was named as trustee. Her daughter, Pamela Sargent, was designated successor trustee. The grantor died in November 1999 and was survived by four adult children. Assets that were not owned by the trust at the time of the grantor's death were passed directly to the trust pursuant to a pourover will. Among other things, the trust provided that after the grantor's death, the assets were to be divided into equal shares for her children. Her son, Kennett's, one-quarter share was to be administered in a special needs trust for his benefit.

The special needs trust provided, in pertinent part:

> My primary intention in establishing the Special Needs Trust is to provide for KENNETT'S special needs in order that he can be maintained at a level of human dignity. As used herein, the term "special needs" means the requisites for maintaining KENNETT'S good health, safety, and welfare when, in the discretion of the Trustee, such requisites are not being provided by any Governmental Authority (as hereinafter defined). "Special needs' includes, by way of illustration and not by way of limitation, dental care, special equipment, program training, education, travel needs and recreation."

Another provision in the special needs trust directed the trustee to exercise her best judgment and fiduciary duty" to seek and maintain all available public benefits for Kennett.

In the four and one half years that Pamela administered the special needs trust, she did not make any distributions on his behalf or to him despite requesting information about the trust assets and a request for money to purchase a condominium because the building he lived in was being sold.

In 2004, Kennett and his brother, Jeffrey, whose share also was held in a continuing trust, filed suit against Pamela seeking an accounting and removal of Pamela as trustee.
Although she was directed by the court to prepare an accounting in 004, she completed a "preliminary accounting" in 2006.

In May 2007, plaintiffs renewed their request to remove Pamela as trustee. The court appointed a guardian *ad litem* for Kennett to recommend whether Pamela acted in Kennett's best interests pursuant to the terms of the trust. The guardian *ad litem* concluded that the trustee had acted "arbitrarily in denying distributions to Kennett for his health, maintenance and support."

In September 2007, Pamela resigned as trustee. The beneficiaries' father and Coastline Trust Company were appointed successor co-trustees. In 2008, the successor co-trustees filed suit against Pamela contending that she had breached her fiduciary duties. The case was tried without a jury.

Kennett engaged several attorneys who explained to Pamela that Kennett was receiving Social Security Disability benefits ("SSDI") and therefore, the distribution of trust benefits for the purchase of a condominium would not adversely impact those benefits. Nevertheless, Pamela stated that she would not distribute the funds unless Kennett produced a letter from the Social Security Administration stating that he was receiving SSDI and that the distribution of assets would not disqualify him from receiving those benefits. Kennett testified that he enjoyed living in Boston and doing volunteer work there but had to move to Rhode Island because he didn't receive enough money from his Social Security benefits to place a deposit on a new apartment there. He testified that he became so depressed that he started drinking again after years of sobriety, attempted suicide, was hospitalized and spent the next few years in rehabilitation centers.

The court found that Pamela had a duty under the terms of the trust to make her own inquiries regarding Kennett's public benefits but failed to do so. Instead, she shifted the burden to Kennett. In so doing, she created "unnecessary administrative barriers against his receiving some of the roughly $400,000" trust share at a time when he urgently need it.

The court further found that "Pamela did not perform even the most basic duties of a special needs trustee, educating herself as to the type of benefits Kennett was receiving." Therefore, the court held that Pamela breached her duty to administer the SNT in accordance with its terms by "acting arbitrarily and without knowledge of, or inquiry into, Kennett's basic life circumstances. The court required Pamela to disgorge her trustee's fees and pay reasonable attorneys' fees directly related to efforts to compel Pamela to comply with a consent order.

Failure to investigate whether Medicaid would pay for home health care services

Liranzo v. LI Jewish Education/Research (N.Y.Sup. Ct., Kings Cty., No 28863/1996, June 25, 2013)

A corporate fiduciary was surcharged for paying for home health care services without investigating whether Medicaid would pay for those services and for making payments on behalf of family members that disqualified the beneficiary from receiving SSI and Medicaid benefits. In this case, a special needs trust was funded with over $400,000 from a personal injury settlement for the benefit of a child. The trust directed the trustee to endeavor to ascertain whether Medicaid would cover home health care services before using trust funds for that purpose. Six years later, the trust was valued at $3,253.03. The corporate trustee filed an accounting action to be released.

The court found that the trustee paid $118,064 for home health care services without inquiring whether Medicaid could pay for those services in violation of the trust terms. The trustee also paid $56,320 for cab fares for the beneficiary's family and made payments to the family that rendered the beneficiary ineligible for SSI and Medicaid benefits.

The court held that the trustee breached its fiduciary duty to properly administer the trust and to preserve the trust assets for the lifetime needs of the beneficiary. The trustee was ordered to repay the trust $176,905.99.

Failure to proactively identify the needs of the trust beneficiary

Matter of J.P.Morgan Chase Bank N.A. (Marie H.), 956 N.Y.S.2d 856 (N.Y.Surr.Ct., 2012)

All special needs trusts confer discretion upon the trustees. However, the words "absolute discretion", "unfettered discretion" and "sole discretion" do not insulate the trustees from liability for failure to act affirmatively on behalf of the trustee.

In *Matter of J.P.Morgan*, a mother established a special needs trust for her son, Mark, who was on the autism spectrum and was developmentally disabled. Mark was non-verbal and required constant supervision and assistance with all of his activities of daily living. He was 16 years old when his mother died. Prior to her death, Mark's mother placed him in a residential school in New York.

Mark's mother's attorney and J.P. Morgan Chase Bank became co-trustees of Mark's trust, which was funded with almost $3,000,000. The trust provided for distributions of income and principal for Mark's "care, comfort, support and maintenance in the trustees' "sole and absolute discretion." It further provided:

> Before expending any amounts from the net income and/or principal of this trust, the Trustees may wish to consider the availability of any benefits from government or private assistance programs for which the Grantor [sic] may be eligible and that where appropriate and to the extent possible, the Trustees may endeavor to maximize the collection of such benefits and to facilitate the distribution of such benefits for the benefit of the beneficiary."

The trust document further provided that payments could be made to any facility where Mark resided and to any organization where Mark was a client or participant in a program it sponsored for the general uses of such facility or organization.

After Mark's mother died, the attorney/trustee filed a proceeding to be appointed guardian of Mark's person. The attorney disclosed at the hearing that he hadn't seen Mark since Mark was six years old and was applying for guardianship to fulfill a promise he made to Mark's mother on her deathbed. The lawyer had never visited the residential school to ascertain Mark's condition or his needs, nor had the lawyer spoken to the staff at the school to find out Mark's unmet needs. The attorney also revealed that not "a single dollar" from the trust had been expended on Mark in almost three years.

The corporate trustee indicated at the guardianship hearing that it had not expended any funds from the trust on Mark's behalf because of "its lack of institutional capacity" to ascertain or meet Mark's needs. The court noted that if it lacked such expertise it should obtain the services of someone who had such expertise. Accordingly, the co-trustees engaged the services of a care management company.

The care manager assessed Mark's needs and recommended certain services and items that should be purchased by the trust. Mark's gross motor skills, communication skills and social skills improved as a result of those expenditures. The court opined that this case "should provide a clarion call for all fiduciaries of trusts whose beneficiaries are known to have disabilities to fulfill their 'unwavering duty of complete loyalty to the beneficiary' or be subject to the remedies available for breach of their fiduciary obligation."

The court found that the trustees failed to "exhibit a reasonable degree of diligence" toward Mark by failing to do anything for Mark. It noted that even where a trustee has discretion, a court will intervene if the trustee, acting arbitrarily or without knowledge of or inquiry into relevant circumstances, fails to act. The court held that the trustees had a duty to the beneficiary to ascertain Mark's needs and to apply the trust funds to serving those needs and breached their duties to Mark.

The duty of a trustee of a special needs trust to act was similarly addressed in *Matter of Cronin*, 2017 NYLJ LEXIS 3753 (N.Y. Surr. Ct. 2018). During a proceeding to have a guardian appointed for Andrew, a 51 year old man with intellectual disabilities, the existence of a trust for Andrew's benefit valued at almost $100,000 was disclosed. The trustee, a nonprofit organization, had not expended any funds for Andrew's benefit for almost seven years. Andrew testified at the hearing that he didn't have money to go to the movies, attend sporting events or buy his favorite sports jerseys.

The court found it "deeply troubling" that the trustee had taken no steps to ascertain or meet the beneficiary's needs. The court held that the "duty of trustees to act in the best interest of the trust beneficiary carries with it the concomitant obligation that trustees make themselves knowledgeable about a beneficiary's condition and needs.

Conclusion

A fiduciary has a legal obligation that is considered the highest standard of care under the law. There are myriad remedies for breaches of fiduciary duties depending on the governing instrument, state statutes and case law. Fiduciaries who engage attorneys can proactively sidestep breaching their fiduciary duties and potential exposure to personal liability. Informed principals, testators and grantors also should consult attorneys to ensure that they are choosing fiduciaries who will understand and scrupulously attend to their fiduciary duties.