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Cleaning Up After the Rogue Fiduciary

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I. Introduction

This article is adapted from the presentation "Cleaning Up After the Rogue Fiduciary," Real Property, Probate, & Trust Section, WSBA, Midyear Meeting and Seminar, 2012.

The primary issues that flow from the removal of a rogue fiduciary (i.e., a fiduciary removed for cause) are twofold: the routine administration of assets that would follow any change of fiduciary and the pursuit of any remedies for past wrongs of the rogue fiduciary. This article, which is based upon the observations and experiences of the author rather than a comprehensive analysis, focuses on the successor fiduciary pursuing remedies against the removed fiduciary. Section II describes the procedural status as a precondition to seeking remedial liability. Sections III and IV focus on imposing liability. Section V presents considerations for preserving a judgment against the rogue fiduciary if he seeks to discharge the liability in bankruptcy proceedings.

II. Understanding Current Status, Both Procedurally and Administratively

A. Procedural Status

Upon the appointment of a successor fiduciary, you should review the potential actions against the removed rogue fiduciary and any available remedies related to such actions. Consequently, you must learn the circumstances that led to the removal. To understand the procedural posture, you should determine whether the court has discharged the rogue fiduciary and whether the court has ordered the rogue fiduciary to deliver assets or to provide an accounting.

1. Discharge. The court has personal jurisdiction over court-appointed fiduciaries (i.e., when the person appointed files an oath for the purpose of qualifying, the court has *in personam* jurisdiction over him). This

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personal jurisdiction over the fiduciary is a valuable tool to compel the personal representative to perform his duties and for the court to impose sanctions when the rogue fiduciary fails to perform. The issue of discharge is discussed more fully at III.C. below.

2. Order To Account. The accounting is a practical tool to understand the finances of the previous administration. It also sets the stage to pursue remedies against the former fiduciary. For a personal representative, see RCW 11.28.250 and for a trustee, see RCW 11.98.039.

3. Other Notices and Time Tables. The other notices and time tables of a routine administration must be observed, such as the notice of appointment to the interested parties, notice to any party filing a Request for Special Notice, the filing of an inventory, creditors, tax obligations, and any required periodic reports.

B. Status of Administration

All successor fiduciaries must review the current status of administration regardless of whether the predecessor was a rogue fiduciary. The new fiduciary must evaluate how to manage the tangible assets or accounts that come within his possession as well as organize a plan for the administration of such assets.

The new fiduciary must also review earlier tax returns, available records, and gather input from family, friends, or business associates. In addition to fulfilling the requirements of a routine administration, this information is also likely to give a rough picture of the diminution of assets during the administration of the rogue fiduciary, of potential taxable events, and of potential credits or debits to the distributive shares of heirs and beneficiaries.

Practice tip: It is wise to present a Petition for Approval of Administrative Plan that describes your goal and shows how you plan to reach that goal. The petition should set forth your hourly rate, any issues presented and how you intend to respond to them as well as how to invest funds or to sell or retain real estate or other assets, whether to seek an accounting from the predecessor, and authorization to commence litigation on any civil causes of action. The approval of such a plan will provide safety to the fiduciary if disgruntled heirs attack the administration. If the court does not approve the plan, then you should consider resigning.

III. Issues That Typically Follow Removal of Rogue Fiduciary

A. After Removal of a Trustee

The authority to compel an accounting is provided by statutes at RCW 11.106.030 - .070. RCW 11.106.030 sets forth specific information required in the accounting. RCW 11.106.070 provides that the court shall hear evidence, determine the "correctness" of the account and "the validity and propriety of all actions of the trustee or trustees set forth in the account," shall either approve or disapprove the accounting, and then may take action "surcharging the trustee or trustees for all losses, if any, caused by negligent or willful breaches of trust."

B. After Removal of a Personal Representative

The removed personal representative must file an accounting and deliver assets pursuant to RCW11.28.290. The lawyer drafting the order compelling the accounting and delivery should set forth a reasonable time for completing the accounting.

A personal representative who is removed may be liable for attorney's fees. RCW11.68.070 provides that when a personal representative is either removed or has the non-intervention powers restricted "in all such cases the cost of the citation, hearing, and reasonable attorney's fees may be awarded as the court determines." See also RCW 11.76.070, which provides that a personal representative may be personally assessed with liability for the attorney fees of the party who is "reasonably required to employ legal counsel" to compel an accounting.

Finally, RCW11.96A.150 provides for broad authority to award fees to any party from any other party, from the estate, or from any non-probate asset that is subject to the proceeding "as the court determines to be equitable."

C. The Issue of Discharge

When the court "discharges" the personal representative, it no longer has *in personam* jurisdiction over the personal representative. This personal jurisdiction is very important because fiduciary administrations are otherwise *in rem* proceedings concerned only with the control of assets. The exception to *in rem* jurisdiction is the *in personam* jurisdiction over the person acting as the fiduciary.

The concept of personal jurisdiction over the fiduciary is very different from the court's *in rem* jurisdiction to administer the property. The court acquires personal jurisdiction over a personal representative when he signs an oath. A trustee, on the other hand, is typically made subject to *in personam* jurisdiction only upon service of process when he is sued. On occasion, an order removing a personal representative will be drafted inadvertently using the language of discharge. The use of the word "discharge" means that the court has released the fiduciary from the jurisdiction of the court regardless of whether he actually delivered the assets or the accounting. The discharge also provides an inference that the court has approved all of the acts of the former fiduciary. When the discharge occurs inadvertently, you can attempt to restore the court's jurisdiction over the rogue fiduciary by an Order Nunc Pro Tunc or by new service of process. An Order Nunc Pro Tunc runs the risk that jurisdiction was lost upon the entry of the first order and that there is no continuing jurisdiction to enter the corrective order.

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The word "discharge" appears to be used somewhat differently in RCW 11.98, Trusts. RCW 11.98.041 provides for the automatic discharge of a resigning trustee. But see RCW 11.98.039(4), which provides that the court may order discharge when an appropriate petition is filed. Counsel should review these provisions carefully to protect against an inadvertent discharge prior to resolving all issues caused by the rogue trustee who may voluntarily resign prior to judicial removal. It is also not clear if the word "discharge" has the same meaning in RCW 11.98 as in other chapters of Title 11 governing probate and guardianship.

D. The Issue of an Accounting

"Accounting" has no fixed definition. An accounting is the vehicle by which the activities of the fiduciary are presented for others to read and understand. It is also the vehicle by which the fiduciary may be brought to task for any inappropriate activities and the estate be made whole again. Consequently, the format of the accounting varies depending upon the nature of the assets and the kind of activities by the fiduciary. A simple accounting of a small trust may consist of a listing of income and disbursements whereas a trust with large, complex assets may produce an accounting that is complex and requires a CPA to assist with comprehending it.

Various professional associations for trustees, certified public accountants, and guardians define accounting standards. The primary issue for a lawyer in attacking or defending an accounting is whether the accounting meets the standard of an acceptable accounting in the relevant community. Whether it meets that standard is a judicial determination and should rely upon evidence and findings to support the adjudication.

The source of the duty is often found by statute and is supported by case law. The duty for personal representatives is set forth in RCW11.68.065 for annual accountings, at RCW 11.28.290 upon removal, and at RCW 11.76.060 upon final accounting. For trustees, the duty is set forth at RCW 11.106.050 - .070 and 11.96A.030(4) and .080.

When pursuing a claim against a fiduciary, the court should enter an order compelling an accounting and fixing a reasonable date for compliance. If no accounting is delivered, then the fiduciary is in breach of the order and civil contempt would be the remedy. RCW 7.21.030. If an accounting is delivered, then the accounting should be evaluated as to whether it meets community standards.

If the accounting is acceptable, then the court should enter an order that approves the accounting.

If the accounting is not acceptable, then you should move to disallow the accounting and prepare for a contested hearing. The preparation should include an expert to opine on the adequacy of the accounting. The foundation for the testimony should be the experience of the expert and the expert's familiarity with accountings. Ultimately he will opine on whether the accounting meets community standards and whether there are defects in the accounting. The expert should be prepared to discuss the defects.

The pool of expert witnesses to opine on an accounting is usually found among professional fiduciaries and professional accountants. On occasion, the accounting will be so profoundly flawed that a cross-examination of the fiduciary will suffice without an expert.

Practice tip: When representing the rogue fiduciary and defending an accounting, your client should retain a certified public accountant or a professional fiduciary to prepare the accounting. Although your client as fiduciary will have the ultimate responsibility for the accounting, the CPA or fiduciary will be the witness at trial rather than your client. This will give you better control of the scope of the examination in defense of the accounting and the vilification of the rogue fiduciary by opposing counsel. On the other hand, the cross-examination of the rogue fiduciary will be distilled to only those events that tend to vilify the rogue fiduciary when

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the niceties of accounting standards have been covered with the expert witness(es).

IV. Fiduciary Misconduct and Related Remedies

Fiduciary misconduct may consist of breaches of common law or statutory duties, of breaches of the written document, of conversion or embezzlement, or of negligence. In my practice, the most common scenarios are breaches of duty and inappropriate distributions, all of which are followed by a failure to provide an adequate accounting.

Breach of a fiduciary duty at common law imposes liability in tort. *Micron Enhancement International, Inc., v. Coopers & Lybran*, LLP, 110 Wn. App. 412, 433-34, 40 P.3d 1206 (2002). See also *McFerran v. McFerran*, 55 Wn. 2d 471, 476, 348 P.2d 222 (1960). In probate administrations, RCW 11.28.300 gives the successor personal representative a cause of action against "any delinquent former personal representative." See also RCW 11.76.070. For trustees, see RCW 11.106.070. The court may in its discretion enter judgment for damages, including reasonable attorneys' fees and statutory costs. Finally, the common law imposes liability in damages upon a fiduciary who fails to account for property and funds that come into his possession. *Restatement (Second) Trusts*, Section 172, comment b. The essence of many common law breaches of duty are premised upon the prohibition of a fiduciary from acting in his own interest.

A. The Burden of Proof

When a fiduciary's conduct is challenged, the fiduciary generally bears the burden of proof in showing that he did not breach any duties. *Hetrick v. Smith*, 67 Wash. 664, 667-68 (1912); *Wilkins v. Lasiter*, 46 Wn. App 766, 778 (1987). Anything not explained in the accounting will be disallowed as against the fiduciary.

B. Remedies

The remedies of the court (e.g., to compel the return of converted property, to set aside gifts, to disgorge fees, to disgorge unjust enrichment or the profit obtained from any self-dealing, the imposition of a constructive trust or of an equitable lien, the imposition of monetary damages, and fee awards) are very broad and flow largely from equity. How to seek these remedies is the subject of many other articles and seminar materials concerned with estate litigation and is not discussed further here. This article will now focus on seeking judgment in a hearing on a contested accounting and the drafting of that proposed judgment. The drafting of the Findings and Conclusions of the Judgment will be very important if the former fiduciary (now judgment debtor) files for bankruptcy protection. If you file an objection to the discharge in bankruptcy, then a contested proceeding in bankruptcy court will result. Your goal in that contested proceeding is to avoid the necessity of reproving the same case in the bankruptcy court as was done in state court.

C. Judgment on Disallowance of the Accounting

The court's options are to allow or disallow the accounting. Any party can note a hearing on the accounting after it is served or filed. The remedy for not submitting an accounting is contempt. RCW 7.21.040 concerns punitive contempt and criminal-like proceeding and RCW 7.21.030 concerns remedial contempt and remedies.

1. Remedial Sanction

The governing statute is RCW 7.21.030 Remedial Sanction – Payment For Losses. See especially subsection 2, (1) which provides, "The court may initiate a proceeding to impose a remedial sanction on its own motion or on the motion of a person aggrieved by a contempt of court in the proceeding to which the contempt is related. Except as provided in RCW 7.21.050, the court, after notice and hearing, may impose a remedial sanction authorized by this chapter," subsection 2(d), which provides for "*any other remedial sanction,*" and subsection (3), which provides for the recovery of a reasonable attorney fee. [Emphasis added.]

2. Measure of Damages: Liquidating the Sanction For Remedial Contempt
   a. Failure to Deliver: the measure of damages is the value of the item not delivered, loss of use, loss of income.
   b. Failure to account or to a disallowed accounting: the measure of damages is the difference between the value of the assets inventoried (or last accounted for) and the value of the assets received. The assets set forth on the inventory or, alternatively, on the last periodic accounting is always a convenient starting point. Of course, the reliability of the inventory or of the last accounting may be called in question.
   c. If there is no inventory and no interim accounting, then you have no starting point from which to calculate damages. Without such a starting point, then you have a serious conceptual issue as to how to a judgment that meets the requirement of being supported by evidence. The answer to this issue is provided by case law: that you present the best evidence available and then ask the court to shift the burden to the former personal representative to rebut. This satisfies any concerns for fundamental fairness because the former personal representative is the person who actually had the assets. By shifting the burden, the court puts the burden upon the person having possession rather than upon the innocent heirs. Consequently, the innocent heirs or the successor fiduciary reconstructs the reasonable

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value of the estate from whatever facts are known to the parties and then asks the court to make reasonable inferences from that reconstruction.

Both case law and the *Restatement* provide for the liability of a fiduciary who fails to account for property and funds that come into his possession. *Micron Enhancement International, Inc., v. Coopers & Lybran, LLP*, 110 Wn. App. 412, 433-34, 40 P.3d 1206 (2002); *McFerran v. McFerran*, 55 Wn. 2d 471, 476, 348 P.2d 222 (1960); *Hart's Estate*, 156 Wash 255, 286 P. 650 (1930); *In Re Foster's Estate*, 39 Wash. 224, 246 P.2d 290 (1926); *Berlage v. Boyd*, 206 Md. 521, 532, 112 A.2d 461, 465 (1955); *Restatement (Second) Trusts*, Section 172, comment b.

3. Drafting the Judgment to Survive Bankruptcy
   a. You should have detailed findings of fact and conclusions. An example that I have used successfully contains a recitation of the following elements; namely, that the rogue fiduciary:
      - Qualified and served as personal representative
      - Was not discharged
      - Was ordered to deliver, to account
      - Failed to deliver
      - Failed to account or, alternatively, that the accounting failed to meet community standards
      - The accounting is disallowed
      - The inadequate accounting by the former personal representative is a breach of duty (statutory breach of RCW 11.28.290, also a breach of duty set forth in the order to deliver and to account)
      - The failure results in contempt with remedial sanctions
      - The damages imposed per both common law and RCW are remedial
      - Identify any admitted evidence to support the amount of damages
      - The amount of the judgment

V. Bankruptcy

If the former personal representative (now judgment debtor) files a Chapter 7 Petition, there are procedures to protect the judgment creditor against the discharge being sought by the debtor. The first procedural steps are as follows:

- You will receive a Notice of Stay.
- You should file an Appearance and serve a copy on the trustee.
- File a Proof of Claim. You should receive a notice advising you of your right to file a claim. You must file a claim. At this point, I recommend that you retain counsel who practices in bankruptcy law.

A. Objection to Discharge and Issue Preclusion

11 U.S.C. §523(a)(4) prevents the discharge of any debt incurred by fraud or defalcation while acting as a fiduciary. The burden is on the Creditor to prove that the debt is non-dischargeable. The Creditor must prove 1) that the personal representative is a fiduciary and 2) defalcated in his or her duties. If the Debtor denies the allegations, then the record from the probate court may be helpful to apply collateral estoppel as issue preclusion in the bankruptcy proceeding. The application of collateral estoppel will prevent the Debtor or Trustee from forcing the Creditor to re-litigate the same facts as were determined in state court. To apply a doctrine of issue preclusion, the Creditor must establish that 1) the issues were identical, 2) there was a final judgment on the merits, and 3) the Debtor was a party to the adjudication against her. *Bugna v. MacArthur*, 33 F.3d 1054 (9th Cir. 1994).

A full record from the probate court may assist the Bankruptcy Court in applying the doctrine and in sparing the Creditor the time and expense of re-litigating the issue of defalcation.

B. Traps for the Unwary

1. Adversary Proceedings by the Trustee

The trustee may seek assets that you have recovered from the rogue fiduciary as a preferential transfer of assets that will prejudice other creditors. Preferences are transfers of an asset within 90 days of the filing of bankruptcy. Preferences may include prejudgment writs, writs, partial distribution or settlements. The trustee may bring an adversary proceeding against the Creditor to recover any property recovered within 90 days of the Bankruptcy filing.

2. Accountings Against the Personal Representative By the Trustee

The trustee in bankruptcy may also seek an accounting of the Creditor or personal representative in the adversary proceeding. The trustee may be fishing for more assets to take from the probate estate and deliver into the bankrupt estate.

Practice tip: In anticipation of such a tactic by the trustee, the personal representative should seek approval in the probate court of: 1) a recent personal representative accounting to assert as a defense against a trustee's fishing expedition into the probate administration and 2) obtain

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Spoliation Basics for Estate Planning and Probate Lawyers: What You Don't Have May Hurt You

by Miles A. Yanick

As a legal concept, spoliation has been around a long time. But the age of the Internet, electronically stored information, and cloud computing is giving spoliation new vitality: suddenly there are so many forms evidence can assume, places it can reside, and ways to "destroy" it. Civil litigators are well tuned to these issues and the developing case law surrounding them; given the possible consequences of failing to preserve evidence, it would be foolish not to be.

But the civil litigator hired when litigation has commenced, or is clearly about to, has the advantage of being on notice of the duty to preserve from the start. Not so for the probate lawyer who may take the helm when the skies are clear and the seas calm, only to find herself later in the middle of a storm. At that point, if not before, a duty arises to preserve evidence relevant to the dispute.[1] The probate lawyer, as well as the estate-planning lawyer, has to be able to spot the storm clouds on the horizon, make a judgment call as to how threatening they are, and assist the client in taking appropriate action to ensure that evidence is preserved.

First the Bad News: The Consequences of Failing to Preserve

The consequences for spoliation can be significant, even dispositive of a case. Historically, spoliation has been treated as an evidentiary matter, most commonly resulting in an inference that the missing evidence would have been harmful to the party guilty of spoliation and helpful to the other party.[2] Courts also may apply a rebuttable presumption, shifting the burden of proof on an issue to a party who destroys or alters important evidence.[3] In egregious cases, spoliation may result in a default judgment against the "guilty" party or dismissal of its claims.[4]

Spoliation also may be addressed as a discovery issue, the remedy for which is a sanction for failure to provide discovery under the civil rules.[5] Under Washington's CR 37, a court may order that a certain matter be taken as established; prohibit a party from supporting certain claims or defenses or from offering certain evidence; strike pleadings; or enter a default or dismissal order.[6] In addition, courts may award fees incurred in connection with the motion for sanctions.[7]

These are serious consequences, especially considering that they could result from a client merely being careless or unaware of the need to retain evidence. As their counsel, it is our job to make sure they understand their duties with regard to retaining documents. To do this, it is important first to understand the scope of behaviors the courts regard as "spoliation."

"Spoliation": It Is What It Is

Spoliation is "the intentional destruction of evidence."[8] In determining whether to sanction a party for spoliation, courts consider "(1) the potential importance or relevance of the missing evidence and (2) the culpability or fault of the adverse party."[9] Thus, spoliation is "a term of art, referring to the legal conclusion that a party's destruction of evidence was in bad faith or under other circumstances such that admissibility and the other negative consequences [resulting from spoliation] should follow."[10] The definition is circular: spoliation is destruction of evidence under circumstances that merit a sanction—i.e., for spoliation.

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court approval of any partial distribution to other heirs to preclude the trustee from asserting that the Debtor (hence, the trustee) had an interest in the distributed asset and hence should have shared in the distribution.

The concept of the "probate exception" to federal bankruptcy law is central to such a contest with the trustee in bankruptcy. See *Marshall v. Marshall*, 547 U.S. 293, 126 S.Ct. 1735, 164 L. Ed. 2nd 480, 2006.

VI. Conclusion

The cleanup after a rogue fiduciary presents an overlap between the areas of law governing the administration of assets and estate litigation. To navigate this area of overlap, it is useful to organize the plan of the successor fiduciary around the court's jurisdiction to administer assets (*in rem* jurisdiction) and the jurisdiction to control the conduct of a fiduciary and impose liability (*in personam* jurisdiction). These basic concepts create a relationship between the delivery of assets from the rogue fiduciary, the accounting and measure of liability for any breaches of duty, and for judgment against the rogue fiduciary. The liability of a rogue fiduciary as judgment debtor is not dischargeable in bankruptcy, but the burden in bankruptcy court is on the creditor. Consequently, you should support the judgment upon detailed findings that the debtor is a fiduciary and identify the specific duties breached and the basis of the damages if the rogue fiduciary seeks relief in bankruptcy court.