Study L-623 April 6, 2009

Memorandum 2009-22

Presumptively Disqualified Fiduciary (Introduction of Study)

The Commission recently completed its study of Probate Code Sections 21350-21356, which establish a statutory presumption of menace, duress, fraud, or undue influence with respect to a provision of a donative instrument that makes a gift to the drafter of the instrument, a fiduciary who transcribed the instrument, the "care custodian" of a transferor who is a "dependent adult," and certain specified relations and associates of those persons.

In conducting that study, the Commission noted Probate Code Section 15642, which borrows the classifications used in Section 21350, and employs them as grounds for removal of a trustee. Thus:

> 15642. …
> (b) *The grounds for removal of a trustee by the court include the following:*
> …
> (6) *Where the sole trustee is a person described in subdivision (a) of Section 21350, whether or not the person is the transferee of a donative transfer by the transferor, unless, based upon any evidence of the intent of the settlor and all other facts and circumstances, which shall be made known to the court, the court finds that it is consistent with the settlor's intent that the trustee continue to serve and that this intent was not the product of fraud, menace, duress, or undue influence.* Any waiver by the settlor of this provision is against public policy and shall be void. This paragraph shall not apply to instruments that became irrevocable on or before January 1, 1994. This paragraph shall not apply if any of the following conditions are met:
> (A) The settlor is related by blood or marriage to, or is a cohabitant with, any one or more of the trustees, the person who drafted or transcribed the instrument, or the person who caused the instrument to be transcribed.
> (B) The instrument is reviewed by an independent attorney who (1) counsels the settlor about the nature of his or her intended trustee designation and (2) signs and delivers to the settlor and the designated trustee a certificate in substantially the following form:

"CERTIFICATE OF INDEPENDENT REVIEW

I, (attorney's name), have reviewed (name of instrument) and have counseled my client, (name of client), fully and privately on the nature and legal effect of the designation as trustee of (name of trustee) contained in that instrument. I am so disassociated from the interest of the person named as trustee as to be in a position to advise my client impartially and confidentially as to the consequences of the designation. On the basis of this counsel, I conclude that the designation of a person who would otherwise be subject to removal under paragraph (6) of subdivision (b) of Section 15642 of the Probate Code is clearly the settlor's intent and that intent is not the product of fraud, menace, duress, or undue influence.

_____

(Name of Attorney) (Date) "

This independent review and certification may occur either before or after the instrument has been executed, and if it occurs after the date of execution, the named trustee shall not be subject to removal under this paragraph. Any attorney whose written engagement signed by the client is expressly limited to the preparation of a certificate under this subdivision, including the prior counseling, shall not be considered to otherwise represent the client.

(C) After full disclosure of the relationships of the persons involved, the instrument is approved pursuant to an order under Article 10 (commencing with Section 2580) of Chapter 6 of Part 4 of Division 4.

(Emphasis added; form modified nonsubstantively to simplify presentation.)

The Executive Committee of the Trusts and Estates Section of the State Bar ("TEXCOM") has suggested that the policy underlying Section 15642(b)(6) be extended to provide for removal of an executor named in a will when the executor would be a presumptively disqualified beneficiary under Section 21350. CLRC Memorandum 2008-36, p. 20.

This memorandum introduces a study that will consider TEXCOM's specific suggestion and will also examine whether a similar policy should be extended to other types of fiduciary relationships.

Except as otherwise indicated, all statutory references in this memorandum are to the Probate Code.

BACKGROUND

Before discussing the possible expansion of the statutory presumption arising under Section 21350, it would be helpful to quickly revisit that statute's main features and the rationale for its existing scope.

With some exceptions, Section 21350 creates a statutory presumption of menace, duress, fraud, or undue influence when a beneficiary stands in a specified relationship to the transferor (i.e., the beneficiary is a "disqualified person"). See Section 21350.5 (defining "disqualified person").

The three main types of "disqualified person" are:

(1) A donee who drafted the donative instrument.

(2) A donee who is a fiduciary of the transferor and who transcribed the donative instrument (or caused it to be transcribed).

(3) A donee who is the "care custodian" of the transferor (who is a "dependent adult").

Section 21350(a).

Basis for Presumption

The first two categories of disqualified persons involve those who are directly involved in creating the donative instrument that benefits them.

The statutory presumption of menace, duress, fraud, or undue influence that arises when a gift is made to such persons is largely consistent with the common law, which presumes that a gift is the product of fraud or undue influence when (1) there is a confidential relationship between the transferor and the beneficiary, (2) the beneficiary participates in the creation of the donative instrument, and (3) the beneficiary receives an undue profit. See *Rice v. Clark*, 28 Cal. 4th 89, 97, 47 P.3d 300, 120 Cal. Rptr. 2d 522 (2002).

A fiduciary who transcribes a donative instrument is in a confidential relationship to the transferor, and so satisfies the first prong of the common law standard. Both a drafter and transcriber are directly involved in creating the gift, and so satisfy the second prong. It is likely that the third prong will also be satisfied, because the statutory presumption only applies to *non-family members* (as discussed below). Such persons are less likely to be the natural object of the transferor's bounty and are therefore more likely to receive "undue profit" from a gift.

The third category of "disqualified person" is the care custodian of a transferor (who is a dependent adult). That classification seems grounded in legislative concern that a care custodian has a heightened opportunity to exert undue influence over a person who may be especially vulnerable to such influence. The statutory presumption reflects that heightened risk of abuse.

Basis for Family Exception

As noted above, there is an exception to the statutory presumption for a gift to the transferor's spouse, domestic partner, or relative (within five degrees of relation). Section 21351(a), (g). Similarly, there is an exception for an instrument drafted by such a person. *Id.*

That exception appears to be grounded in the expectation that family members are the most natural objects of a transferor's bounty. A gift to such a person is natural and expected, and therefore less likely to have been the product of fraud or undue influence.

RATIONALE FOR POLICY EXPANSION

Section 21350 is based on an assumption that certain relationships between a beneficiary and a transferor present such a high risk of fraud or undue influence that any gift resulting from the relationship should be presumed invalid. In more colloquial terms, the law does not trust a gift to the person who drafted or transcribed the instrument making the gift, or a gift from a dependant person to that person's care custodian, unless the beneficiary is closely related to the transferor. There is too much of an incentive and opportunity for foul play.

Section 15642(b)(6) extends those principles to the removal of a sole trustee who is a "disqualified person." Under that section, the law provides for removal of a sole trustee if the trustee drafted or transcribed the trust, or is the care custodian of a trustor who is a dependent adult.

That expansion makes sense, because appointment as a trustee is similar to the receipt of a gift. Like a gift, appointment as a trustee can result in some enrichment. A trustee often receives monetary compensation, and the duties of a trustee, which are largely unsupervised by the court, provide opportunities for a dishonest person to gain improper benefits (e.g., overcompensation, self-dealing, theft, or favoritism toward favored beneficiaries).

For that reason, there is a financial motive for a wrong-doer to use fraud or undue influence to obtain appointment as a trustee. That motive, combined with

the special opportunity for misconduct presented when the person benefited by a trust is the drafter or transcriber of the trust, or is the care custodian of a dependent trustor, justifies the Legislature's decision to apply the same general presumption of invalidity to both a provision making a gift to a disqualified person and a provision naming a disqualified person as trustee.

That principle would seem to **support the creation of a similar statutory presumption** when the drafter or fiduciary transcriber of an instrument, or the care custodian of a dependent adult, is granted fiduciary powers that confer a benefit on the fiduciary or could be abused to the benefit of the fiduciary.

Does the Commission agree with this policy assessment? If so, the first step in implementing it will be to determine what types of fiduciary powers may confer a benefit on the fiduciary or be abused to the benefit of the fiduciary.

SCOPE OF POLICY EXPANSION

In considering whether a presumption of menace, duress, fraud, or undue influence should be extended to an instrument conferring a particular fiduciary power on a "disqualified person," the key questions would seem to be:

- Would the grant of power confer some benefit on the person granted the power?
- Could the power be abused to obtain an improper benefit?
- Are there institutional checks in place, adequate to police against abuse of the power?

With those questions in mind, the following fiduciary powers should be examined as possible candidates for expansion of the statutory presumption: (1) executor of a will, (2) conservator, (3) power of attorney, and (4) power of appointment. Each of these fiduciary powers is discussed below.

Executor of a Will

This study was prompted by TEXCOM's suggestion that the presumption of fraud or undue influence under Section 15642(b)(6) be extended to apply when a disqualified person is named as executor of a will.

There may be some merit to that suggestion. Appointment as executor does entail monetary compensation. See Sections 10800-10805. So there could be a financial motive to obtain appointment.

There may also be some latitude for improper enrichment of an executor, through abuse of the executor's authority. However, the probate process is

administered in the courts, with close judicial scrutiny. That may significantly limit the scope for misconduct by an executor.

The staff requests input from TEXCOM and other interested persons on the ways in which an executor might abuse authority for self-enrichment, and the extent to which judicial supervision of probate acts as a check on such misconduct.

Pending the results of that inquiry, the staff is unsure how serious a problem it would be for a "disqualified person" to act as executor.

Conservator

A conservator may be appointed if necessary to protect a person who is unable to provide properly for his or her personal needs for physical health, food, clothing, or shelter, or who is substantially unable to manage his or her own financial resources or resist fraud or undue influence. See Section 1801(a)-(b).

A conservator may be compensated for providing services as a conservator. See Section 2640. So there could be a financial incentive to being appointed as conservator. However, the conservator must periodically petition the court for compensation, limiting the opportunity for overcompensation.

A conservator can exercise considerable control over the property of the conservatee. Some types of transactions, like cashing a check or purchasing personal property, can be done without court authorization. That creates a risk of abuse by a dishonest conservator. However, there is also considerable judicial oversight of a conservatorship, including periodic accounting to the court. See Section 2620. Those oversight provisions should significantly limit the scope for misconduct.

More importantly, *appointment as a conservator is not guaranteed simply because the conservator is nominated for the position by the conservatee*. The selection of a conservator is solely in the discretion of the court, which is guided by the best interests of the conservatee. See Section 1812(a). All other things being equal, the court will favor appointment of a spouse, domestic partner, or relation of the conservatee over a non-relation. See Section 1812(b). The court's decision is made after reviewing the report of a court-appointed investigator, who is charged with interviewing the proposed conservatee, all proposed conservators, the proposed conservatee's spouse, domestic partner, relatives within the second degree, close friends, and neighbors, to determine, among other things "whether the proposed

conservatee objects to the proposed conservator or prefers another person to act as conservator." See Section 1826(d), (f).

Given the degree of judicial involvement in the selection of a conservator, it seems very unlikely that a "disqualified person" who tricks or pressures a person into nominating the disqualified person as conservator would actually be appointed as a result of that misconduct (especially if there are family members available and willing to serve).

For that reason, there seems to be little need to extend the presumption of menace, duress, fraud, or undue influence to a provision nominating a disqualified person as conservator. However, the staff invites TEXCOM and other interested persons to comment on the issue.

Power of Attorney

A person may designate another to act as his or her agent, through the execution of a writing known as a "power of attorney." See Section 4022. The agent is known as the principal's "attorney-in-fact." See Section 4014.

An attorney-in-fact is entitled to compensation. See Section 4204. Therefore, there is some motive for a person to be appointed as attorney-in-fact.

An attorney-in-fact may be granted general authority or specifically limited authority. A grant of general authority authorizes the attorney-in-fact to act for the principal in most ways. See Section 4261; but see Section 4264 (acts requiring express authority). An attorney-in-fact will often have broad authority to manage the principal's finances. This provides a dishonest attorney-in-fact with wide scope for misappropriation of the principal's property.

As a general matter, a power-of-attorney can be created and exercised without the involvement of the court. See Section 4500. That heightens the risk of abuse by a disqualified person who is appointed as a person's attorney-in-fact through fraud or undue influence.

There are many press accounts highlighting the risk of elder financial abuse through abuse of a power of attorney. See, e.g., Sandra Block, *Power of Attorney Can Be Valuable and Dangerous Tool*, USA Today, Dec. 8, 2008 (online at www.usatoday.com). A recent AARP report on the subject acknowledges the ease with which a power-of-attorney may be abused, and specifically notes the risk of fraud or undue influence in the creation of the power:

> … POA abuse may manifest even before the agent starts acting on the principal's behalf. In other words, there may be problems with

> the circumstances surrounding the creation of the POA document. For example, an older person who lacks decision making capacity may be persuaded or tricked into signing a POA. An older person with capacity may sign a POA and name an individual as agent as a result of undue influence, fraud, or misrepresentation by the agent or a collaborator.

AARP Public Policy Institute, *Power of Attorney Abuse: What States Can Do About It*, 4-5 (Nov. 2008).

Existing law does provide a judicial procedure that can be used to challenge the actions of an attorney-in-fact, compel an accounting, or terminate a power of attorney for breach of duty. See Section 4541. That provides a significant measure of protection against fraud. However, it would only be helpful if there is a person who is interested in the principal's welfare who has reason to suspect abuse.

The staff believes that there may be good reason to extend the statutory presumption of fraud or undue influence to a power of attorney that names a disqualified person as attorney-in-fact.

However, the staff is unsure whether the presumption would provide much of a practical deterrent or remedy against abuse. When a person dies, relatives and friends of that person are likely to be attentive when the decedent's assets are transferred on death. If the estate includes a gift to a disqualified person, other heirs are likely to step in and block the transfer until the presumption can be tested.

By contrast, a power of attorney is granted during the principal's life. In many cases, friends and relatives of the principal will have no idea that the power has been granted and is being abused, until the abuse is actually discovered. At that point, the existing judicial mechanism for accounting and revocation, combined with possible criminal sanctions, may be the best remedy possible. It isn't clear that a statutory presumption of the power's invalidity would add much of practical benefit.

The staff invites comment from TEXCOM and other interested persons on this issue. The staff would also be interested to hear other suggestions for protecting elders from power of attorney abuse. That issue might merit separate study.

Power of Appointment

A power of appointment is a power conferred by the owner of property (the "donor") upon another person (the "donee") to designate the person who will ultimately receive the property (the "appointee"). See Section 610.

Under a "general power of appointment," the appointee (who receives the property) may be the donee, the donee's estate, or the creditors of the donee or the donee's estate. See Section 611(a). Although denominated a power of appointment, that would effectively be a gift to the donee. Under a "special power of appointment," the appointee must be someone other than the donee, the donee's estate, or their creditors. However, it appears that the donee could designate close family members or business associates as the appointee.

Thus, a power of appointment clearly could be used to enrich the donee or the donee's close family or associates. That creates an incentive to use fraud or undue influence to obtain a power of appointment. It does not appear that the creation or exercise of a power of appointment must be judicially supervised. So there is no obvious check on abuse of a power of appointment.

For those reasons, the staff believes that a power of appointment should be subject to the statutory presumption of fraud or undue influence when the power is conferred on a "disqualified person." The staff invites comment from TEXCOM and other interested persons on this point. In particular, the staff is interested in whether the granting of a power of appointment is itself generally understood to constitute a gift, in which case the statutory presumption may already apply.

CONCLUSION

The staff invites public comment on whether there are any other fiduciary powers that involve compensation of the fiduciary, the possibility of improper enrichment of the fiduciary, and a lack of adequate judicial supervision, which should perhaps also be examined in this study.

The staff would also like to emphasize the importance of receiving public comment on the various questions raised in this memorandum. Estate planning law is complex, making it especially important that the Commission receive information and advice from experts in the area.

Once the Commission receives input from TEXCOM and other interested persons on the questions raised in this memorandum, the staff will closely

examine each of the fiduciary powers under consideration, to determine whether there is in fact a need to apply the statutory presumption to an instrument granting that power. If so, the staff will prepare appropriate draft legislation.

In addition, the staff intends to examine existing Section 15642, to determine whether there are any technical problems with the drafting of that provision.

Finally, as indicated above, the staff encourages interested persons to comment on the need for additional protections against power of attorney abuse. That seems to be the most serious type of abuse discussed in this memorandum, and may be a type of abuse that would not be adequately addressed by extension of the statutory presumption in Section 21350. We invite other suggestions for protections against such abuse. These could form the basis for a separate study of the problem.

Respectfully submitted,

Brian Hebert
Executive Secretary