Fiduciary Duty – Why Trusts and Powers of Attorney Work

Many of us have created trusts for a large variety of reasons. Among other attractions, trusts can offer privacy, disability planning, probate avoidance, tax avoidance, asset management, and creditor protection for our loved ones. In addition, many Americans have created powers of attorney to provide surrogate financial management and health care decision-making to supplement what we can individually do when we are unable to act alone. When so much faith is being placed in these estate planning tools, have you ever asked yourself how and why they work? Choice of fiduciary and the moral responsibility of the chosen fiduciary of course play a major factor in the success of trusts and powers of attorney, but what if the choices made don't pan out?

The short answer to these questions is that they work because our legal system has deemed them so valuable it has accorded them guaranteed enforceability in our courts. Since the time of the Crusades, English common law has recognized that allowing individuals to trust their assets to the care and decision-making of others is economically important and that to do so, there must be legally enforceable rules about such entrustment. The lynchpin to these strategies is making sure that those entrusting others with property and decision-making authority, as well as those intended to benefit from such entrustment, are assured that their fiduciaries will be held accountable to carry out their agreed responsibilities. This, in essence, is what is provided by our now well-developed law of fiduciary responsibility.

The Law of Fiduciary Responsibility

For years, the law of fiduciary responsibility was a function of case law, not statutes. Knowledge of that law was derived from reading the opinions of judges deciding cases based on its principles and was limited to the situations under discussion in those opinions and to those able to read and understand what the judges were saying. Fortunately, at least for trusts and powers of attorney, most of those principles are now embodied in general written statutes enacted by our legislature to make them more generally available. See, for example, Maryland Trust Act Subtitle 8 and Maryland General and Limited Power of Attorney Act § 17-113.

Under our law of fiduciary responsibility, trustees under trusts ("Trustees") and agents ("Agents") under powers of attorney (both collectively referred to in this article as "fiduciaries") are personally liable for performing various duties with regard to the assets or decisions they have agreed to administer. If they fail to perform those duties or perform them in bad faith, courts may require them to restore fiduciary assets, to include profits that should have been earned, and to otherwise keep beneficiaries whole, all at the fiduciary's personal expense. In addition, courts (and in some cases, beneficiaries or others) may remove the fiduciary in favor of others who are believed to be better able to carry out the fiduciary duties more appropriately. To make sure this underpinning works, persons creating trusts ("Trustmakers") and powers of attorney ("Principals") are always advised that the law of fiduciary responsibility works best when the fiduciaries have sufficiently "deep pockets" with significant personal assets and compensation to make these remedies effective.

The Two Fundamental Fiduciary Duties

The fiduciary duties included in our law of fiduciary responsibility center on two fundamental duties. **First, the fiduciary has a fundamental duty to exercise prudence, diligence, and reasonable care to carry out the Trustmaker's or Principal's intent and to benefit his or her beneficiaries.** This includes keeping appropriate records of all actions taken as a fiduciary and, upon request, sharing those records with those intended to benefit from the fiduciary's actions or inaction. Where the fiduciary has special skills or expertise or is named on the representation of such skill or expertise, reasonable care means that he or she is expected to use that skill or expertise in making decisions.

Second, the fiduciary has a fundamental duty to act loyally for the benefit of the Trustmaker and/or beneficiaries and to put their interests before his or her own. To do so, the fiduciary must avoid conflicts of interest and act solely for the interests of the Trustmaker's or the Principal's intended beneficiaries. In this regard, the fiduciary must keep entrusted assets separate from his or her own property and must act impartially with regard to the assets entrusted to him or her. If there is more than one intended beneficiary, the fiduciary is expected to act impartially in investing, managing, and distributing property, giving due regard to the respective interests of each of the beneficiaries.

While the duty to exercise prudence, diligence, and reasonable care is generally applicable to all fiduciaries, it can be qualified by a Trustmaker or Principal. The appointer of the fiduciary can limit the extent of the duty if the Trustmaker avoids allowing a fiduciary to act in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiary. For example, a Trustmaker wishing to require the Trustee to keep certain assets that reasonable care might otherwise dictate be diversified, the Trustmaker can generally do so as a part of his or her legitimate intent. Recognizing that there may be situations where the duty of loyalty can cause unintended consequences, the law allows a bit more discretion with regard to qualification of the duty of a Trustee or Agent to act impartially. For example, a husband wishing to benefit both himself and his wife might want to limit the liability of the wife as Trustee or Agent for self-dealing and breaches of the duty of loyalty. However, because these fiduciary duties are so important to the overall legitimacy of the trust or power of attorney, special consideration should be given to the situation before any limitation is included in the trust document or power of attorney.

Effective Enforcement of Fiduciary Duties

For beneficiaries to enforce a trust, they need to know about that trust and who holds the fiduciary responsibility to act in their behalf. Under Maryland case law, a Trustee was formerly required to respond to reasonable beneficiary inquiries only when requested to do so and to provide requested accountings for his or her activities. Our case law did not require a Trustmaker or Trustee to tell trust beneficiaries that they had such rights. That shortcoming was remedied with the enactment of the Maryland Trust Act statute. Now, under Section 14.5-813 of that Act, a Trustee is required to give notice of the trust's existence and his or her contact information to qualified beneficiaries within 60 days after accepting the trusteeship. In addition, a Trustee now has such notification responsibility

within 90 days after acquiring knowledge of an irrevocable trust, or when the Trustee acquires knowledge that a formerly revocable trust has become irrevocable. When a formerly revocable trust becomes irrevocable, the notice is required to notify the beneficiaries of their right to request a copy of the trust instrument and to request receipt of annual reports about the trust property. Such reports would include listings of the trust assets (and, if feasible, their market values), liabilities, and the Trustee's receipts and disbursements for the trust.

Finally, while the possibility of remedial action may be sufficient to underpin trust success, it is important to note that enforcement of a trust by breach of fiduciary responsibility litigation may depend on the ability of the enforcer to be made whole with regard to the payment of his or her attorney's fees in the litigation. While the Trustee is entitled to be reimbursed out of trust assets for expenses (including attorney's fees) that were properly incurred in the administration of a trust, the law is not so clear as to a beneficiary's entitlement in this regard. Under our familiar "American Rule", parties are generally required to pay their own attorney's fees, regardless of the outcome of the litigation. However, the common law has carved a possible exception to the "American Rule" with regard to trusts.

Under this "common fund doctrine", a court may award attorneys' fees and expenses to a trust beneficiary if the court finds that the beneficiary has, through a lawsuit brought at his or her expense, created, recovered, preserved, or increased a common fund or common property in which others share. The issue here is whether the litigation benefited the trust as a whole rather than the litigating beneficiary individually. To make sure that the trust will be enforced in the future, a Trustmaker may want to provide in the trust instrument that trust assets are to be used to reimburse beneficiary litigants for their attorney's fees and costs in enforcing the trust or remedying a breach of fiduciary duty.

We hope that this brief review of the law of fiduciary responsibility will give you confidence that your trust and power of attorney-based estate planning will remain effective and carry out your intent in the future. Please do not hesitate to contact us if, after reading this, you have any further concerns in these regards.