AB 21: New Attorney Conflict Rules Invalidate Transfers and Restrict Compensation

by
MARK J. PHILLIPS

In response to a number of well-publicized cases of abuse in Orange County, the California legislature has adopted numerous statutory changes seeking to protect clients and beneficiaries from the acts of over-reaching attorneys. The reforms fall into two categories: (1) restrictions to prevent attorneys who act as fiduciaries from charging both for fiduciary and attorney services, and (2) rules to invalidate transfers under dispositive documents to drafting attorneys. Although particularly shocking, the latter abuse is sufficiently uncommon and unwise that the rules regarding transfers to drafters are unlikely to affect most practitioners. Far more common, however, will be the circumstances in which estate planning and post-death administration attorneys find themselves in a dual capacity, and accordingly the far-reaching rules prohibiting dual compensation have much broader application.

Rules Restricting Dual Compensation

It has long been the public policy in this state to prohibit an attorney who serves as a personal representative or testamentary trustee from receiving fees both in his fiduciary capacity and for legal services tendered on behalf of the estate or trust. Known as the Parker rule, the prohibition stems from Estate of Parker (1926) 200 C 132, 135, 251 P 907, 909, which stated:

"An executor, administrator, or testamentary trustee who is himself an attorney at law may properly employ another attorney to render the necessary legal services for the estate, and he may be entitled to an allowance out of the estate for the value of such legal services. [Citation omitted.] But if the executor, administrator, or testamentary trustee, being himself a practicing lawyer, elects to act as his own attorney in the performance of the legal services incident to the administration of the estate, the general rule is that he will not be entitled to an allowance against the estate for his professional services, in the absence of some statutory provision entitling him thereto."

The rationale for the Parker rule was twofold. First, personal representatives have the obligation to retain the highest quality legal service available in the community, and if the personal representative is tempted to lure either himself or his own firm he places himself "in a position where there would be a clash between his own personal interests and his duty to employ the ablest counsel obtainable." 200 C at 139, 251 P at 910. Second, if the personal representative shares in any compensation earned by the attorney retained, he will have been allowed compensation in excess of that which would have been allowable to him by statute.

The Parker rule did not absolutely prohibit the charging of legal fees by the law firm of which the personal representative was a member, if it was agreed between the personal representative and the balance of the firm that the former was not to share in the money received by the firm for its services. The Parker court did, however, establish the presumption, in the absence of a showing that a personal representative would not share, that such sharing of fees would take place. Assembly Bill 21 (Umberg and Morrow), signed into law on August 2, 1993 (Stats 1993,

ch 292), broadens the public policy against dual compensation to cover conservatorships, guardianships, and trusts. It does so in a fashion consistent with the overall concept of Parker but differing in a myriad of details. Practitioners who feel comfortable with the Parker rule will find some frustration in the application of the now statutory scheme as it applies to fiduciary relationships other than probates.

Conservatorships and Guardianships

New Prob C §2645 provides that an attorney who serves as a conservator or guardian may not receive legal fees unless the court specifically approves the right to that compensation with a finding that it is to the advantage, benefit, and best interests of the conservatee or ward. There is no requirement that the attorney charge or receive fees for acting as the conservator or guardian for the prohibition to take effect. Because this new section is silent where other new sections are not, it appears that the attorney-conservator may obtain the court's approval after the services have been rendered but before payment is sought. Existing Prob C §§2640-2644 require such court approval before payment in all circumstances.

New Prob C §2645 does not apply if the attorney who is serving as conservator or guardian is related by blood or marriage to, or cohabitates with, the conservatee or ward, but if such relationship does not exist the prohibition against dual compensation applies to the attorney, his relatives, and the law firm of which he is a member. There is no exception for attorneys and firms who agree not to share fees as there is for a personal representative who is an attorney in a probate. Prob C §10804. It can be expected that few practitioners will be discomfited by Prob C §2645, because few attorneys routinely agree to serve as a conservator or a guardian of someone who is not a family member. The task is generally a thankless one.

Probates

The Parker rule was codified in California soon after its issuance. Current Prob C §10804 states that a personal representative who is an attorney may receive the personal representative compensation but not the compensation for services as the estate attorney, unless expressly authorized by the decedent's will.

"The prohibition against dual compensation applies notwithstanding any provision in the decedent's will."

The ability of the testator to approve in advance dual compensation was codification of prior case law, exemplified by Estate of Thompson (1958) 50 C.2d 613, 617, 328 P.2d 1, 3. In Thompson, the California Supreme Court carved out an exception to the Parker rule in which a testator specifically approved the dual compensation in his will. Citing the permissiveness of the Restatement of Trusts, which permitted dual compensation when approved by a trust instrument, the court stated:

"It is well settled that the paramount rule in the construction of a will is that the will must be interpreted according to the intention of the testator. ... In the present case there can be no dispute as to the intention of the testatrix and hence the only problem is the fulfillment of that intention."

However, consistent with the underlying theme of AB 21 that estate planning clients need to be protected from the over-reaching of certain avaricious attorneys. Prob C §10804 has been amended to eliminate the client's discretion to expressly permit dual compensation under the terms of his or her will. Amended Prob C §10804 now provides that the prohibition against dual compensation applies notwithstanding any provision in the decedent's will.

Curiously, courts have not been quick to prevent other professionals from retailing their own services in conjunction with estate administration. Accountants, for example, can retain themselves or their firms to render extraordinary accounting or tax services and pay themselves an additional fee for those services. Estate of Haviside (1980) 102 CAM 365, 162 CR 393. They may not, however, pay themselves an additional accounting fee for services that are ordinary in nature and would otherwise have been performed by them as personal representative. Estate of Billings (1991) 228 CAM 426, 278 CR 439, reported at 12 CEB Est Plan R 125 (Apr. 1991). Although these judicial rules for accountants prevent dual compensation to a single personal representative for the same service, they defeat the underlying principle of the Parker rule of eliminating the temptation to retain less than the ablest professional available.

But the legislature that taketh away can also giveth; under new Prob C §10804 dual compensation to an attorney who serves both as personal representative and as attorney, clearly prohibited before, may now be specifically approved by the court if consent to the arrangement is obtained in advance and the court finds that the dual compensation is to the advantage, benefit, and best interests of the decedent's estate.

Trusts

The most sweeping changes in the dual compensation area affect trusts. Under existing law, a trustee was entitled to indemnity or reimbursement for expenses necessarily incurred in administration, including expenses for attorneys' fees and costs. Batik of Am. v Long Beach Fed Sav. & Loan Ass'n (1956) 141 CA2d 618, 297 P2d 443. Probate Code §15684 codified the prior case law, permitting the trustee to reimbursement for properly incurred expenses. However, if an attorney served as a testamentary trustee, courts would generally apply Parker to permit him only to take his trustee fees and not claim compensation for professional attorney services. See also Estate of Vokal (1953) 121 CA2d 252, 260, 263 P2d 64, 69 and cases that follow that line of authority, including Estate of Gilmaker (1962) 57 C2d 627, 21 CR 585. This line of cases most often applied the Parker rule when it was determined that the trustee had breached the trust, was hostile, or had failed to perform trust obligations. However, particularly in inter vivos trust situations, court review and potential denial of dual compensation rarely occurred.

New Prob C §15687 provides that an attorney who serves as trustee may receive only the trustee's compensation or compensation for legal services, but not both, unless the trustee obtains approval for the right to dual compensation. Unlike the probate and conservatorship rules, the attorney-trustee clearly can elect the greater of the two compensations, an evident retreat from the public policy pronouncements in Parker designed to eliminate the temptation of a fiduciary to select less than the ablest counsel available. Again, the section is not applicable if the trustee is related by blood or marriage to, or is a cohabitant with, the trust settlor. Prob C §15687(c).

Approval is obtained for dual compensation by giving full disclosure of the nature of the compensation and of the relationship, and then obtaining either a court order approving the compensation or the passage of 30 days without objection following the giving of notice to all persons interested in the trust under Prob C §17203. If an objection is received, the attorney-trustee must then obtain the requisite court approval under Prob C §17200. Unlike the advance notice required under amended Prob C §10804 described above, it would appear from a reading of all of the new trust sections that approval under new Prob C §15687 need only be obtained before payment, not before the rendition of services. If the legal services are rendered by relatives of the attorney-trustee or by his or her law firm, fees may not be collected for such services unless the trustee waives compensation for the services as trustee or unless the requisite court approval is obtained. Prob C §15687(b). The section is effective for all services rendered on or after January 1, 1994, and any attempted waiver in the instrument of this section is void in the interest of public policy. Prob C §15687(c), (f).

"If the legal services are rendered by relatives of the attorney-trustee or by his or her law firm, fees may not be collected for such services unless the trustee waives compensation."

The reach of this new section is considerable, and in practice may affect practitioners in circumstances where over-reaching is not exercised and dual compensation not intended. For example, if the drafting attorney serves as trustee of an irrevocable trust used to fund and hold life insurance on the life of the trust settlor, this new section may prohibit the charging for ordinary and necessary services. In such circumstances, the attorney routinely charges only a single time for his hours expended, but those hours may consist of services typical both of trustee and of attorney. The attorney will, for example, make bank deposits, pay premium bills, balance check books, and send out Crummey notices. Because these services are performed in the interest of a client of the attorney's law firm, they are normally charged at the attorney's hourly rate. The services are not legal in nature, but they must be performed by the attorney in his capacity as trustee. If the attorney charges at his legal rate, he may either be overcharging for a trustee service or charging for legal services not consonant with the restriction against dual compensation under new Prob C §15687. In most cases, the attorney-trustee will be able to obtain the consent of the trust beneficiaries under §15687(d)(2). If consent is not available, the attorney-trustee must apply to the court for approval if economically feasible, and if not the attorney is going to he placed in a position of either refusing to serve, in which case another professional trustee is going to have to be obtained at greater expense, or refusing to charge at any rate for services rendered in his legal capacity, which is unfair to the attorney. There is no reason to believe that the prohibition against dual compensation rules can be avoided by having the compensation paid by someone other than the trust; as, for example, when such compensation is paid by the client-trustor of an irrevocable inter vivos trust. The dual compensation rules of AB 21 are rooted in public policy, and are not waivable by statute. Where similar rules have been in existence for probates, the courts have held that agreements for additional compensation are not binding on the court, and, to the extent that they purport to authorize compensation higher than allowed by statute, are void. Prob C §§10803, 10813; Estate of Baum (1989) 209 CAM 744, 750, 257 CR 566, 571. Commentators state that there is authority for State Bar discipline for attorneys who attempt to circumvent these rules against additional compensation.

"The key to these accounting sections, and the sections which follow, is the definition of a 'disqualified person.'"

In the area of required accountings, amendments have been made to Prob C §§16062 and 16064 to stem the ability of drafting attorneys to relieve themselves as future trustees from the obligation to account to beneficiaries. Section 16062, which sets forth the requirement of a trustee to account, was always subject to the exceptions set forth in §16064, which previously stated that a trustee is not required to report information or to account to a beneficiary to the extent that the trust instrument waived the report or account. The legislature has previously tinkered with this exception, instituting effective January 1, 1993, a limitation on such waiver following a showing that it is reasonably likely that a material breach of the trust has occurred. Though still new, that change is of questionable benefit when a beneficiary would need accounting information in order to make the requisite showing of material breach. Assembly Bill 21 has now added language to §§16064(a) and 16062(c) providing that it is against public policy, and void, for a trust instrument to waive an obligation to account as to any sole trustee who is a "disqualified person" as defined in Prob C §21350(b)(1). As an account is more comprehensive than a report, it would appear that the failure of Prob C §16062(e) to find void a waiver of a report is of no real consequence.

The key to these accounting sections, and the sections which follow, is the definition of a "disqualified person."

The definition appears in new Prob C §21350 dealing with the prohibition of transfers to individuals who draft dispositive instruments. Section 21350(b)(1) defines "disqualified person" as any of the following persons specified in §21350(a):

(1) A person, including an attorney, conservator or other person having a fiduciary relationship with the transferor, who drafted, transcribed, or caused to be drafted or transcribed, the instrument.

(2) A person who is related by blood or marriage to, is a cohabitant with, or is an employee of, the person who drafted, transcribed, or caused to be drafted or transcribed, the instrument.

(3) Any partner or shareholder of any partnership or corporation in which any person described in subparagraph (1) or (2) has a 10 percent or greater ownership interest, or any employee of any such person, partnership, or corporation.

The term "disqualified person" excludes situations in which the transferor is related by blood or marriage to, or is a cohabitant with the person who drafted, transcribed or caused to be drafted or transcribed, the instrument. It would appear, therefore, that under Prob C §§16062 and 16064 a waiver of accounting is void if the sole trustee is any person, including an attorney or the fiduciary, who drafted, transcribed, or caused to be drafted or transcribed, the dispositive instrument, but not a relative of such a person, nor would the exception apply if such a person were related to the trustor.

"The presumption applies to persons who drafted the instrument, but does not apply to their relatives."

In order to facilitate removal of a "disqualified person" serving as trustee, new Prob C §15642(b)(6) has been added, establishing a presumption that a sole trustee defined as a "disqualified person" in Prob C §21350(b)(1) should be removed as trustee unless the court finds it fair, just, and equitable that the trustee should continue to serve. In making this examination, the court may consider the intent of the settlor and all other facts and circumstances. Like the accounting sections, the presumption applies to persons, including attorneys and other fiduciaries, who drafted, transcribed, or caused to be drafted or transcribed, the instrument, but does not apply to their relatives, nor is there an exception when the drafting or transcribing individual is a relative of the settlor. New Prob C §15642(b)(6) is not applicable to instruments that became irrevocable on or before January 1, 1994.

Finally, new Prob C §17200(b)(21) has been added, providing the court clear authority to determine whether dual compensation is reasonable and in the best interests of the trust. In determining reasonableness, the subparagraph specifically states that the court may consider whether prior approval was obtained for such dual compensation, making it clear that such court approval can be obtained following rendition of the services but before payment.

Rules Restricting Transfers to Drafters

Although never statutorily proscribed before, transfers to attorneys under testamentary instruments drafted by them have historically been suspect. Estate of Morey (1905) 147 C 495, 82P 57; Estate of Lances (1932) 216 C 397, 14 P2d 768; Anno, 19 ALR3d 575 (1968). Where a drafting attorney benefits under the dispositive provisions of the instrument he drafts, the courts have long imposed a presumption of undue influence which the attorney must rebut by clear and convincing evidence. Estate of Clegg (1978) 87 CA3d 594, 603, 151 CR 15 8, 162; Estate of Lind (1989) 209 CA3d 1424,257 CR 853, reported at 10 CEB Est Plan R 154 (June 1989). In Clegg, the court stated the general rule as follows.

The relationship of an attorney to his client is both fiduciary and confidential. Hence, when an attorney, by advice or action, takes part in the preparation or execution of a will, the presumption of undue influence arising from the confidential or fiduciary relationship is applicable where the will benefits the attorney.

Like most presumptions, that of undue influence by attorneys who benefit under wills that they draft can be rebutted. Estate of Teed (1955) 13 6 CA2d 401, 28 8 P2d 92 1. Assembly Bill 21 has added Prob C §§21350-21355, which seek to discourage, and in some cases invalidate, transfers to certain defined "disqualified persons." Under §21350, any donative transfer is invalid if it benefits the disqualified persons" described previously, including drafters, their relatives, and members and employees of their law firms. The term "relative by blood or marriage" is further defined to include a person's spouse or predeceased spouse, relatives within the third degree, and the spouse of any such third degree relation. By specific reference, the intestate definitional sections applicable to half-bloods, posthumous children, and parent-child relationships are incorporated into §21350. Prob C §§6406, 6407, 6408. Specifically excluded from the definition

of a disqualified person" are those circumstances described in §21351, including when the transferor is related by blood or marriage to, or is a cohabitant with, the person who drafted, transcribed, or caused to be drafted or transcribed, the dispositive instrument. Also excluded are circumstances in which the dispositive instrument is reviewed by an attorney not related to, or associated with, the drafter or the beneficiary of the transfer, as long as that independent attorney counsels the transferor and signs and delivers to the transferor a certificate of Independent review. Prob C §2135 1(b). The language of that certificate is specifically set forth in the statute. Also excluded from the prohibited transfers are those circumstances in which the probate court was aware of all of the circumstances and ordered the transfer instituted under the substituted judgment proceedings of Prob C §2580. Prob C §21351(c). Finally, for instruments executed on or before July 1, 1993, the court can, on clear and convincing evidence, find that the transfer was not the product of fraud, menace, duress, or undue influence and that the transfer is fair, just, and equitable to all persons affected. In making its determination, the court is to exclude the testimony of any "disqualified person," and if the court finds that the transfer was the product of fraud, menace, duress, or undue influence, the "disqualified person" bears all costs of the proceeding, including attorneys' fees. Prob C §1351(d).

Not covered by new Prob C §21351 is the issue of whether a transfer which does not fall under the proscription of the subpart can still be challenged as being the result of fraud, menace, duress, or undue influence. If the recipient was a "disqualified person" and the transfer is approved by either the court sitting in the conservatorship matter under §21351(c) or by the probate court following the death of the transferor under §21351(d), presumably the transfer cannot otherwise be challenged in the absence of some compelling fraud or misinformation perpetrated on the court sufficient to eliminate the bar of res judicata. If, however, the transfer is not proscribed simply because of the fact that the transferor is related by blood or marriage to, or is a cohabitant with, the drafting person, there is no converse presumption that the transfer is a valid one.

New Prob C '§§21352-21355 set forth administrative provisions. Section 21352 states that no person is liable for making a prohibited transfer under the new sections unless that person has received actual notice of the possible invalidity of the transfer, presumably eliminating a concern that fiduciaries, and their counsel, would be required to investigate each donee to be certain he or she is not a "disqualified person." Once actual notice is received, the person cannot be held liable for failing to make the transfer unless and until the validity of the transfer has been conclusively determined by a court. Section 21353 states that if a transfer fails under the "disqualified person" rules, the transfer is to be made as if the "disqualified person" predeceased the transferor without spouse or issue. Section 21354 states that the rules apply notwithstanding a contrary provision in the instrument. Finally, §21355 states that the rules are applicable to instruments that became irrevocable, or are executed by persons dying, on or after September 1, 1993.