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CRITICAL ISSUES IN ESTATE ADMINISTRATION

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1. Introduction.

(a) Practitioners often face unexpected issues in the context of an estate administration.

(b) This presentation is intended to highlight certain challenging issues which may arise in an estate administration and how best to address the issues.

(c) Probate laws vary greatly from state to state, even among states which have adopted the Uniform Probate Code.

(d) References are made to the Uniform Probate Code in some instances, but practitioners obviously must consult local law with respect to particular issues.

2. Counseling the Personal Representative.

(a) The practitioner must review local law to determine the proper initial steps for the administration of the estate.

(1) Initially, the practitioner must file the decedent's will in the appropriate county.

(2) The practitioner must determine whether it will be necessary to administer a probate estate.

(A) First, the practitioner must consider how the assets of the estate are titled.

(B) Generally, the following assets will not be subject to probate administration:

(i) Property held in joint tenancy with right of survivorship;

(ii) Transfer on death accounts or payable on death accounts;

(iii) Annuities; and

(iv) Retirement accounts.

(C) Next, the representative must determine the applicable state's exemption for estates of a certain size.

(i) For example, Section 3-1202 of the Uniform Probate Code ("UPC") provides that for estates that do not exceed $5,000, the person claiming to be the successor of the decedent may present an affidavit to a person who is in possession of the decedent's property in order to request the distribution of those assets.

(ii) Under Virginia law, a decedent's successor may use a Virginia Small Estate Act Affidavit in certain circumstances if the value of the estate does not exceed $50,000.

(iii) Under Illinois law, a Small Estate Affidavit may be used in certain circumstances if the value of the estate does not exceed $100,000.

(3) Even if the practitioner determines that it would not be necessary to open a probate estate, the practitioner should consider whether there would be advantages from opening a probate estate, such as shortening a claims period or addressing other creditor issues.

(4) The practitioner also must determine whether the decedent owned property, such as a vacation home, in another state which would require an additional estate to be opened in that state, which is referred to as ancillary administration.

3. Marshaling and Managing the Assets of the Estate.

(a) Often the first charge of the representative is to identify and collect the decedent's assets.

(b) Section 3-709 of the UPC provides that the representative must take possession of the estate property and take all steps necessary for the preservation, protection and management of the property.

(c) When the representative is appointed, title to the decedent's property rests in the representative, and the representative is charged with managing the assets in order to preserve the estate.

(d) The representative must prepare an inventory of all estate assets and all liabilities of the decedent.

(e) In addition to maintaining an inventory of assets which are included in the probate estate, the representative also must maintain an inventory of decedent's interest in non-probate property, such as assets held in trust or joint tenancy.

(f) These tasks can be difficult depending upon the financial and property records maintained by the decedent and the family.

(1) Initially, the representative should obtain asset information from the decedent's family, financial advisors and insurance agents.

(2) The representative should confirm with the decedent's bankers and family members to determine whether the decedent held a safety deposit box.

(3) In addition, it is often helpful for the representative to review the decedent's most recent income tax returns to determine the decedent's assets.

(i) For example, the decedent's income tax return may list deductions for real estate taxes or mortgage interests.

(ii) Also, the additional sources of income listed on the returns may provide clues as to other assets of the estate (for example, if the returns list earnings from commercial real property).

(g) The representative also must consider any intangible assets.

(1) For example, at the time of decedent's death, the decedent may have had a valid cause of action against a party.

(A) The decedent's cause of action is considered personal property and constitutes part of the decedent's probate estate.

(B) Wrongful death awards generally are not part of the estate.

(2) In addition, the decedent may have held valid contract rights, such as payments due under a promissory note.

(3) Also, the decedent may have royalty or other interests which need to be included as a part of the estate.

(h) After the representative has collected the assets of the estate, the representative must ensure that the assets are properly valued, and the representative must engage qualified valuation experts when necessary.

4. Continuing a Decedent's Business.

(a) Managing a decedent's assets can become particularly challenging if the estate includes significant interests in a business.

(b) These issues can be avoided by thoughtful planning before the decedent's death.

(1) The client and the practitioner should discuss the client's wishes regarding the ownership and governance of the business following the client's death.

(2) The practitioner should prepare the appropriate documentation reflecting the client's objectives, such as buy-sell agreements or other succession planning documents.

(c) However, if proper planning was not implemented before the decedent's death, the representative must decide how to manage the decedent's business holdings.

(d) Generally, a representative does not have authority to continue a decedent's business.

(e) However, a representative may be able to continue a decedent's business in certain circumstances.

(1) For example, under California law, if it is to the advantage of the estate and in the best interests of the interested persons of the estate, the personal representative, with or without court authorization, may continue the operation of the decedent's business in certain circumstances for a limited period of six months from the date on which letters were first issued to the representative. Cal. Prob. Code § 9760(b).

(2) Under Illinois law, a representative has authority to continue the decedent's unincorporated business for one month following the date of issuance of his letters unless the court directs otherwise, and for longer periods if authorized by the court, without personal liability except for malfeasance or misfeasance for losses incurred. 755 Ill. Comp. Stat. 5/19-6.

(3) The UPC provides that a personal representative may continue an unincorporated business for four months if continuing the business would be a reasonable approach to preserving the value of the business, including goodwill. UPC § 3-715(24).

5. Decedent as Sole Member of LLC.

(a) Particular attention should be paid if the decedent owned a single member limited liability company.

(1) Typically, if the decedent was the sole owner of the LLC, the decedent's death would cause the LLC to dissolve.

(2) This result could subject the estate to exposure for claims.

(b) For this reason, the representative must carefully review the LLC documents and state law immediately after decedent's death.

6. Addressing Creditors' Claims.

(a) The representative must determine and pay, to the extent possible, the decedent's valid outstanding debts and liabilities.

(b) The representative must make reasonably diligent efforts to locate known creditors. *Tulsa Professional Collection Services, Inc. v. Pope*, 485 U.S. 478 (1988).

(c) The representative must exercise prudence in evaluating claims against the estate to ensure that only valid claims are paid.

(d) In fact, the representative has a fiduciary duty to contest claims which she believes are invalid.

(e) Under the UPC, if the representative disallows a claim, the claimant may file a collection petition within sixty days. UPC 3-806.

(f) Because state law varies greatly on these issues, the practitioner must study local law regarding the payment of claims.

7. Fiduciary Duties and Standards of Conduct.

(a) The practitioner must educate the representative on his fiduciary duties under common law and the governing documents.

(1) The representative must act in accordance with the highest degree of fidelity and utmost good faith.

(2) The representative must understand how to apply the duty of loyalty, the duty to act in good faith and the duty of care.

(3) In addition, the representative must make arrangements to fulfill his duties to maintain accurate records and to avoid commingling estate assets with his own assets.

(4) The representative should consider how best to keep the beneficiaries of the estate informed regarding the estate administration.

(b) It is critical that the representative understand these duties and others which will be imposed so that the representative can limit his exposure to challenges.

(c) The practitioner must be familiar with local law in order to properly advise the representative as to the standards of conduct to which the representative will be held.

(d) If the representative breaches his fiduciary duty, the representative will be held personal liable for any losses sustained by the decedent's estate.

(e) For example, if the representative allows the estate to remain idle, the representative may be liable for depreciation, lost interest, or other damages.

(f) The following cases illustrate how a representative's conduct will be evaluated.

(1) In *In re Chalmers' Estate*, 297 N.Y.S. 176 (N.Y. Sur. Ct. 1937), the court found that the executor unduly delayed in administering the estate.

(A) The executor failed to distribute the assets of an estate to the trustee in order to set up the trusts described in the decedent's will.

(B) The court noted that while an executor is entitled to take a reasonable time to complete the administration of an estate, the period at issue (over four years) was not a reasonable time, given the circumstances, and the court ordered the executor to account and distribute assets to the trustee to establish the trusts described in the decedent's will.

(2) In *Estate of Gerber*, 73 Cal. App. 3d 96 (1977), the representative was surcharged for not acting quickly enough to sell stock from the estate. The court measured the damages as the difference between the value of the stock when the representative should have sold the stock to the value of the stock when ultimately sold by the representative.

(3) In *In re Estate of Kugler*, 117 Wis. 2d 314 (1984), the court found that the duty of a representative to

manage the estate as a prudent person ordinarily included a duty to reasonably invest estate funds not needed to meet current estate claims and administration expenses. The *Kugler* court found that the representative had a duty to invest the accumulated estate funds and that he failed to invest any of the funds that were not needed to pay administration expenses, without any special circumstances which would have justified allowing the funds to remain idle.

(4) A leading case in this area is *Matter of Janes,* 681 N.E.2d 332 (N.Y. 1997), which involved a corporate fiduciary charged with improperly retaining a high concentration of stock in Eastman Kodak Company in the decedent's estate for seven years.

(A) The Kodak stock constituted approximately 71% of the estate's assets. As of the decedent's date of death, the stock was worth approximately $135 per share, and the value plummeted to approximately $47 per share seven years later.

(B) At the time, New York followed the prudent person rule of investment. The Court of Appeals explained there is no precise formula for determining whether the prudent person standard has been violated in a particular situation.

(C) Instead, the court explained that the determination depends upon an analysis of the facts and circumstances of each case, looking to the trustee's action or inaction with respect to each individual investment.

(D) In analyzing the trust portfolio, the court determined that the fiduciary failed to diversify the portfolio.

(E) The court also found that the Kodak stock failed to generate sufficient income and that the retention of the high concentration of Kodak jeopardized the interests of the income beneficiary.

(F) The court concluded that the fiduciary failed to exercise due care and the skill it held itself out as possessing as a corporate fiduciary by:

(i) failing to conduct a formal analysis of the estate and establish a proper investment plan,

(ii) failing to follow its own protocol regarding concentrated portfolios, and

(iii) failing to conduct more than routine reviews of the estate, without considering additional investment choices.

(g) *Janes* emphasizes the need for a representative to review the assets of the estate immediately upon the decedent's death in order to determine the proper course of action.

(h) To guard against challenges, the representative must be educated regarding his duties to act prudently and timely.

(i) The practitioner must work with the representative to put appropriate systems in place in order to address his fiduciary duties.

(j) In fact, the systems and processes used by the representative to make decisions can be as important as the final conclusions made by the representative and can sometimes provide a defense to the representative in the face of a challenge.

(1) For example, in *In re Estate of Atkinson*, 148 A.D.2d 839 (1989), a beneficiary argued that the fiduciaries had diminished the estate and violated their obligations under New York law by prematurely selling the decedent's securities shortly after the will's admission to probate and imprudently reinvesting the proceeds in several certificates of deposit and bonds.

(2) The court explained that the standard of conduct owed by a fiduciary, including an executor who invests funds during administration, is to be diligent and prudent, and to exercise that degree of care which prudent men of discretion employ in like matters of their own.

(3) The court stated that it is not sufficient that hindsight suggests that another course of action would have been more beneficial.

(4) The court found that although the fiduciary's investment decision was a conservative one, the record showed that it was taken after consultation with the fiduciary's trust committee and was considered a vehicle for a reasonable return on the funds without being unduly speculative. The court concluded that it would not second-guess that decision.

(k) As illustrated in *Atkinson* and also in *Janes*, the representative's process for making decisions can help demonstrate that due care and prudence was exercised, and for this reason, practitioners must counsel representatives about how best to make and document their decisions.

8. Conclusions.

(a) Practitioners must review local law to determine the necessary steps to administer an estate.

(b) Beyond implementing the practical steps needed to administer an estate, practitioners must counsel representatives regarding their fiduciary duties and how best to plan and make decisions in order to prevent challenges.