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**POTENTIAL SET-OFFS AND DEFENSES AVAILABLE TO A
PROBATE SURETY**

PRESENTED BY:

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INTRODUCTION

The Probate experience, to the uninitiated, can be both perplexing and disconcerting. The rules and procedures are often prescribed by arcane and antiquated statutes for which there is little interpretation or guidance. In many states, what sparse case law exists commonly pre-dates the Spanish-American conflict. Moreover, venturing into Probate Court, which often produces a close-knit crowd resembling small gatherings of the American Legion, can be intimidating. Add to this the tendency of Probate practitioners and Courts to view the surety as the “deep pocket,” and it is not difficult to appreciate the dilemma the surety may face in Probate settings. Recognizing these problems, it is helpful to come into Probate Court equipped with as many defenses and potential set-offs as possible, some of which will be discussed in this paper.

I. Set-offs Available to the Surety.

A. Principal/Fiduciary’s distributive share.

To the extent the principal/fiduciary is entitled to a distribution from the estate, as a beneficiary or heir, the surety also is entitled to set off the principal’s property interest against any losses to the estate which might result from the principal’s breach of fiduciary duties. *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962) (a surety that pays the debt of another is subrogated to all rights of the person it paid and the person on whose behalf payment was made to enforce its right to be reimbursed). The surety’s liability to the estate is reduced by the amount of the distribution that otherwise would be owing from the estate to the principal. *In re Estate of Booker*, 91 N.Y.S.2d 16 (1949), aff’d, 102 N.Y.S.2d 438 (1951).

If there is a will under which the principal/fiduciary is entitled to receive a portion of the estate assets, then the surety is entitled to a set-off in the amount of the principal’s share. If there is no will, then the principal may be entitled to a distributive share of the estate assets. Most states have statutes that govern how estate assets are to be distributed where there is no will. In Alabama, for instance, a spouse with one or more children is entitled to receive the first \$50,000.00 of the estate, plus half of all remaining estate assets. ALA. CODE § 43-8-41 (1975). Other states have enacted similar provisions to address intestate succession. See FLA. STAT. ANN. § 732.101 (West 2003), *et seq.*; TENN. CODE ANN. § 30-2-101 (2001), *et seq.*; LA. CODE CIV. PROC. ANN. art. 880 (2000), *et seq.* A surviving spouse may also be entitled to a homestead exemption which is exempt from and has priority over all claims against the estate. ALA. CODE § 43-8-110 (1975) (\$6,000); FLA. STAT. ANN. § 732.401 (West 2000); TENN. CODE ANN. § 30-2-201 (2001). Further, a surviving spouse may be entitled to a personal property exemption, ALA. CODE § 43-8-111 (1975) (\$3,500), FLA. STAT. ANN. § 732.402 (West 2000), as well as a family allowance for support and maintenance during the period of administration. See, *e.g.*, ALA. CODE § 43-8-112 (1975); FLA. STAT. ANN. § 732.403 (West 2000). These exemptions and allowances can result in significant set-offs to the surety where the principal is the surviving spouse.

B. Credit for unpaid bond premiums.

The surety typically is entitled to a credit for any unpaid or outstanding bond premiums. See, e.g., FLA. STAT. ANN. § 733.406 (West 2000); GA. CODE ANN. § 29-2-40 (2001); LA. REV. STAT. ANN. § 3901 (1997). Otherwise, the estate would be afforded a windfall. The purpose of the probate bond, of course, is to return the estate to the position it would have been in but for the principal's misconduct. *Western Surety Co. v. Wilson*, 484 S.W.2d 45 (Tenn. Ct. App. 1972).

C. Approved expenditures.

Any expenditure that is necessary or reasonable for the proper administration of the estate should be chargeable against the estate's assets. Under a guardianship bond, money spent for the maintenance, support, education and other basic needs of the ward are typically approved. *Rowe v. Johnson*, 108 So. 604 (Ala. 1926) (Court gave credit for expenditures to support and educate minor wards); *Deming v. United States Fidelity & Guar. Co.*, 73 P.2d 764 (Wash. 1937). See also *Caldwell v. Huffstutter*, 116 S.W.2d 1017 (Tenn. 1938). In addition, the principal/fiduciary and surety should receive a credit for amounts paid for legal, accounting and other professional services, filing fees and other payments which the estate otherwise would be obligated to pay. *Id.*

D. Funds paid out of the principal/fiduciary's own assets for the benefit of the estate or ward.

Where the principal/fiduciary's personal assets are used for the payment of obligations of the estate, the principal and surety are typically entitled to a credit. This may include amounts paid for the proper administration of the estate and amounts paid for the benefit and welfare of the ward. 31 Am. Jur. 2d, *Executors & Administrators* § 987 (1989). Courts sometimes also give credit for the value of room and board, plus personal care provided by the principal. In fact, a conservator in Alabama is authorized to expend estate funds for the support of persons legally dependent on the ward and even others who are members of the ward's household who are unable to support themselves, and who are in need of support. See, e.g., ALA. CODE § 26-2A-153(a)(3) (1975). It is rare, however, for courts to give such credit, especially if the principal/fiduciary is the parent of a minor ward. In such instances, courts reason that those living expenses are part of a parent's obligation and responsibility towards that child and the ward's money should not be used for that purpose. In other words, absent proof that the parent is destitute or has few other sources of income, courts are reluctant to let a parent tap into the minor ward's assets for living expenses of the child or dependent family members.

E. Unpaid administrative fees or commissions to the principal/fiduciary from the estate.

Some jurisdictions allow a principal/fiduciary and surety a set-off equal to the amount of any administrative fees the principal would be entitled to receive but for the principal's

misconduct. By allowing the credit, the estate is put in the position it would have been in had the principal properly managed the assets of the estate. *In re Estate of Bartlett*, 680 P.2d 369 (Okla. 1984); *Love v. First Nat'l Bank of Clarksville, Tenn.*, 646 S.W.2d 163 (Tenn. Ct. App. 1982). See also *Wilkerson v. Wilkerson*, 60 So. 2d 343 (Ala. 1952) (administration fee allowed unless fiduciary is guilty of willful default or gross negligence). Other jurisdictions, however, have held that when a principal breaches his duties, he loses any right to fees for valid services which were or should have been performed for the estate. See, e.g., GA. CODE ANN. § 29-2-43 (2001); *Lowinger v. Herlihy*, 472 N.E.2d 676 (Mass. App. Ct. 1985); *In re Guardianship of Janson*, 405 So. 2d 1074 (Fla. Dist. Ct. App. 1981) (compensation to a guardian who has seriously breached his or her duty not justified). The problem with the latter view is that it arguably results in a windfall to the estate and unfairly penalizes the surety.

II. Potential Defenses.

A. Penal sum of bond as limit of liability.

Typically, the surety's liability cannot exceed the face amount of its bond. Some jurisdictions, however, recognize exceptions so as to allow an estate to recover interest, attorney's fees and possibly penalties. *In re Davidson*, 642 P.2d 1259 (Wash. 1982) (Court held surety liable for interest on the penal sum from the date the surety was notified of principal's breach or demand for payment); *In re Smith's Estate*, 507 P.2d 189 (Kan. 1973) (Court held interest recoverable from the time liability arises under a guardian bond, allowing surety's liability to exceed penal sum of bond); *Old Republic Sur. Co. v. Reischmann*, 713 So. 2d 434 (Fla. Dist. Ct. App. 1998) (finding bad faith on the part of the surety, Court awarded attorney's fees in excess of penal sum reasoning that, otherwise, the ultimate value of the bond would be diminished by requiring the estate to litigate to secure payment on the bond).

B. Pre-bond acts and omissions.

Depending upon the jurisdiction, a surety may not be liable for improper acts and omissions of a principal/fiduciary prior to the execution of a probate bond. Absent a provision in the bond to operate retrospectively, or a statute to the contrary, a surety is generally not liable for unofficial acts of the principal that occur before appointment or before the execution of the bond. *King v. Jones*, 971 S.W.2d 916 (Mo. Ct. App. 1998); *Martin v. Hanschu*, 738 P.2d 96 (Kan. 1987); *Bolmer v. United States Fidelity & Guar. Co.*, 11 F.Supp. 560 (D. Ky. 1935). Some jurisdictions have held, however, that a bond which is conditioned upon the faithful execution of the principal's office is broad enough to cover pre-bond acts of the principal. *Estate of Camarda*, 425 N.Y.S.2d 1012 (1980); *Owens v. McMahan*, 210 P. 200 (Wash. 1922); *Succession of Reilly v. American Bonding Co. of Baltimore, Md.*, 70 So. 237 (La. 1915); see also *United States Fidelity & Guar. Co. v. Decker*, 171 N.E. 333 (Ohio 1930) (Court suggested that the protections of strict construction of language of bond may not be available to compensated surety). The rationale is that a fiduciary has a continuing obligation to account for estate assets and that the failure to account for the assets does not occur until after the appointment and issuance of the bond.

C. Waiver of claims.

Often, the principal/fiduciary is a family member of the decedent or ward, or has some other close relationship with beneficiaries who are entitled to recover from the estate. Because of the surety's rights to pursue recovery from the principal in the event of a loss as a result of issuing the bond, claimants may agree to waive rights against the principal and surety or consent to certain acts of the principal during the principal's administration of the estate. Waiver of claims most often occurs where a minor ward reaches the age of majority and before the surety is called upon to account for assets of the estate. See *Snyder v. United States Fidelity & Guar. Co.*, 70 Cal. Rptr. 2d 498 (Cal. Ct. App. 1997) (waiver of claims against a principal and surety available only to the extent the beneficiary offering the release or waiver understands and has the capacity to waive rights); *Sawyer v. State Surrogate Court*, 558 N.W.2d 43 (Neb. 1997). Although often a longshot, any such waiver of claims, which will allow the estate to be closed by consent without loss to the surety, is always worth exploring.

D. Standing.

A defense sometimes available to the surety is whether the party seeking recovery has proper standing or is otherwise sufficiently affected to assert an interest under the bond. Traditionally, only the named obligee on the bond has standing to enforce the surety's liability thereon. See, e.g., *Davis v. Dickson*, 2 Stew. 370, 1830 WL 578 (Ala. 1830). More recently, however, courts have recognized a much broader class of claimants who may be entitled to pursue recovery from the surety in the Probate context. In fact, in many states, guardianship and probate statutes specifically authorize the successor fiduciary or "any interested person" to initiate a proceeding against a surety for its fiduciary/principal's breach of the obligations of the bond. See, e.g., ALA. CODE § 26-2A-140(a)(3) (1975); ALA. CODE § 43-2-852(a)(3) (Supp. 2002); GA. CODE ANN. § 22-2-48 (2001); TENN. CODE ANN. § 30-1-208 (2001); TEX. GUARDIANSHIP CIV. ANN. § 763 (2003). In such states, it is very difficult, if not impossible, to maintain a defense based on lack of standing. The standing defense, however, should not be automatically abandoned, particularly in the minority of states that continue to limit claimants to the traditional bond obligees. The surety should always evaluate the status of the person or entity bringing a claim under the bond and, if there is any uncertainty regarding standing, the surety should still challenge the person or entity's standing as early as practicable in the estate proceedings.

E. Principal's reliance upon professionals.

Depending upon the complexity of a particular estate, and the extent and nature of estate assets, a principal/fiduciary may retain the services of professionals such as attorneys, accountants, financial planners and appraisers, to provide counseling and other services relative to the administration of an estate. A number of courts have held that where a fiduciary/principal has retained the services of a professional, neither the principal nor the surety should be liable for the professional's negligence or mishandling of estate assets. *Jewish Hospital of St. Louis v. Boatman Nat'l Bank*, 633 N.E.2d 1267 (Ill. App. Ct. 1994); *In re Estate of Heller*, 401 N.W.2d 602 (Iowa Ct. App. 1986); *Wohl v. Lewy*, 505 So. 2d 525 (Fla. Dist. Ct. App. 1987). The Florida District Court of Appeals has held that a fiduciary was not

responsible for the misappropriation of funds by an attorney hired to assist with the sale of the decedent's residence. *In re Estate of Rosenthal*, 189 So. 2d 507 (Fla. Dist. Ct. App. 1966). There, the decision was based in large part on the court's finding that the attorney was an independent contractor of the estate rather than an agent of the fiduciary.

Other jurisdictions, however, have held that fiduciaries and their principals may be liable for acts of professionals retained to provide services to the estate, particularly where the principal/fiduciary improperly relied on the professional or where the fiduciary completely abdicated his responsibilities. *Firemen's Ins. Co. of Newark, N.J. v. Pugh*, 686 So. 2d 281 (Ala. Civ. App. 1996); *In re Estate of Thomas*, 532 N.W.2d 676 (N.D. 1995); *In re Estate of Spiritos*, 109 Cal. Rptr. 919 (Cal. Ct. App. 1973); *Cox v. Williams*, 3 So. 2d 129 (Ala. 1941); *Laramore v. Laramore*, 64 So. 2d 662 (Fla. 1953); *In re Chandler Estate*, 297 P. 841 (Ore. 1931). In *Pugh*, the principal/fiduciary hired an attorney to assist with the management of estate assets and the attorney converted a portion of the assets to his own use. The Alabama Court of Civil Appeals held that the principal/fiduciary was ultimately responsible for the ward's estate, regardless of the fact that she hired an agent to handle the financial matters. The court, after concluding that the principal/fiduciary "filed a bond . . . for protection in case something unforeseeable happened to her ward's estate," *Pugh*, 686 So. 2d at 284, held that the surety's liability was not limited to enforcement in the event that the principal committed intentional or negligent acts, and that the surety too should be answerable for the attorney's misdeeds. *Id.*

CONCLUSION

Because principals often do not take an active role in defending claims and rarely retain counsel to vigorously and independently oppose the claims, it is important for sureties to be aware of all potential defenses available to the principal/fiduciary in order to limit exposure under the bond. Typically, the surety must take the lead in pursuing discovery to confirm facts necessary to settle the estates and establish defenses to its liability, and the surety often must do this with little or no cooperation from the principal. Such extensive involvement can be costly to the surety, which only increases the importance of asserting all available defenses and set-offs and confirming the facts necessary to establish the surety's right to the defenses and set-offs.