Common Pitfalls for Trustees & How to Avoid Related Litigation

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Common Pitfalls for Trustees & How to Avoid Related Litigation
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I. INTRODUCTION

A. Legal Trends

1. It is an increasingly risky business to serve as Trustee.
   a. Fiduciary litigation is on the rise.
   b. Beneficiaries have discovered that they, like the rest of society, can seek redress for actual or perceived wrongs in the courts.

2. Perhaps no case has brought more attention to topic of fiduciary litigation than the Pritzker trust lawsuit.
   a. The suit alleged that the Trustees, both past and present, deprived the beneficiary of more than $1 billion of her inheritance.
   b. The facts alleged provide that the former Co-Trustees of the majority of the trusts at issue appointed the beneficiary’s father as Trustee and then resigned, knowing that the proposed transactions regarding trust assets were improper.
   c. The beneficiary’s father, as Trustee, then allegedly proceeded to sell interests in the family business entities to trusts for other family members at less than fair market value and under less than favorable promissory note terms.

   a. Wealthy families frequently engage in sophisticated estate planning techniques, including sales at below-market interest rates.
      (1) Often, children and grandchildren are the beneficiaries of these wealth transfer structures through which assets are funneled to achieve various tax savings.
      (2) What happens when the beneficiary reaches legal majority and questions the transactions?
         (i) If the tax planning and investments did not produce a favorable result, or if the transactions have added restrictions to the beneficiary’s right to access trust funds, the Trustee may find himself in an uncomfortable position.
         (ii) For those of us whose careers involve estate and trust administration on a daily basis, the Pritzker case is merely a public reminder of the precarious nature of serving as a fiduciary.
Appeasing a client by effectuating an asset transfer may create a future lawsuit when the client’s children, the beneficiaries, become adults.

4. Lesson #1: Dealing with people is difficult.
   a. Fiduciaries have a duty of loyalty, a duty to invest reasonably, and a duty to diversify, among others.
   b. Even a cautious and conservative fiduciary will find that when real life circumstances and people are thrown into the mix, the textbook line that a fiduciary may not cross can become blurry rather quickly.

B. Overview
   1. Discussion of common pitfall areas for fiduciaries.
      a. Knowing when you have entered the “zone of risk” is half the battle.
      b. The discussion regarding certain core fiduciary duties and defenses that precedes the section on risk management is intended to assist fiduciaries in defining the “zone of risk”.
   2. Review of case law to highlight actions of fiduciaries that may result in litigation.
   3. Suggest methods for avoiding and, if preventive measures fail, preparing for litigation.

II. COMMON PITFALLS

A. Breach of Duty to Invest “Prudently”
   1. A Trustee has a general duty to act reasonably and competently in all matters of trust administration.
      a. Generally, this includes taking all reasonable steps to protect and conserve trust property.
      b. A trustee almost always has a duty to cause the trust property to produce income. See Bogert, Trusts & Trustees (3rd ed.) § 611.
   2. Prudent Investing
      a. Originally articulated by the Massachusetts Supreme Judicial Court, the “Prudent Man Rule” mandated that a trustee preserve the trust property and make it productive. See Harvard College v. Amory, 26 Mass. (9 Pick.) 446 (1830).
b. Ultimately, the “prudent man rule” has been replaced by the more flexible “Prudent Investor Rule”.

(1) The Prudent Investor Rule generally is considered to afford a Trustee greater flexibility in making investment decisions.

(2) In essence, the trustee is required to preserve the trust property and to make it productive while acting with reasonable care, skill, caution and undivided loyalty to the beneficiaries.

c. In Illinois, the Illinois Trusts and Trustees Act imposes the standards of the Prudent Investor Rule on a trustee. See 760 ILCS 5/5

(1) Duty of loyalty and impartiality to the trust beneficiaries.

(2) Duty to diversify the investments in the interest of the trust beneficiaries.

(3) Duty to pursue an investment strategy that considers both reasonable production of income and the safety of capital.

d. Uniform Prudent Investor Act (UPIA)

(1) Approved in 1994 by the National Conference of Commissioners on Uniform State Law.

(2) The UPIA establishes that fiduciaries be evaluated on the basis of the portfolio as a whole, rather than individual investments.

(3) Since its acceptance, the UPIA has been adopted in whole or in part in a majority of the states, including Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin and Wyoming.

3. Diversification

a. Unless otherwise provided by the terms of the trust instrument (and, perhaps even if otherwise provided in the trust instrument), the trustee is generally under a duty to the beneficiaries to diversify the trust portfolio.
b. The UPIA mandates that the trustee must diversify the investments of the trust unless, because of special circumstances, the trust is better served without diversifying.

c. Generally, in Illinois, the Trustee has a duty to diversify a trust’s investments. See 760 ILCS 5/5(a)(3)

   (1) The trustee must diversify the investment portfolio even if the terms of the trust authorize the trustee to retain unproductive property if retention would constitute a breach of the trustee’s duty of impartiality. Hatfield v. First Nat’l Bank, 317 Ill. App. 169, 178 (Ill. App. Ct. 1942).

   (2) For example, a trustee did not dispose of the severely underperforming stock of Northwestern Steel & Wire Company because of language in the trust indicating that the grantor considered the stock a proper investments of the trust, even if it constituted a considerable portion of all of the trust property, and authorized the trustee to retain or invest any part or all of the trust property in such stock. Goddard v. Cont. Ill. Nat’l Bk. & Tr. Co., 177 Ill. App.3d 504 (Ill. App. Ct.1988).

   (i) The beneficiaries sued alleging that the trustee breached its fiduciary duty in failing to sell the stock which comprised almost the entire corpus of the trust.

   (ii) The appellate court found that the provisions in the trust did not unambiguously indicate the grantor’s intent to retain the stock under any circumstances.

   (3) Similarly, despite express language in the Will permitting Lincoln First Bank, the corporate fiduciary, to retain the estate’s single stock position in Kodak, the court held that the Bank breached its fiduciary duties by failing to diversify. Ultimately the court surcharged the Bank $21 million. In the Matter of the Estate of Dumont, 2004 NY Slip OP 50647U (Surr. Ct. NY 2004).

   (i) While the Dumont case was ultimately reversed by the Appellate Court on February 3, 2006, some practitioners believe that the decision was fairly narrow and it provides little guidance to trustees holding large, concentrated positions.

   (4) A similar situation to the Dumont case resulted in the opposite outcome. Once again, the testator’s Will provided that the Executor and trustee should retain a single stock position. The trustee proceeded to sell that stock in the interest of diversification, but the court held that the “trustee acted in breach of its trust when
it sold the stock.” In the Matter of the Estate of Kettle, 73 A.D.2d 786 (N.Y. 1979).

d. Liability for failure to diversify

(1) A trustee’s liability for failure to diversify varies depending on the jurisdiction.

(i) Know your governing jurisdiction.

(ii) Consult applicable state case law in determining whether there is a mandatory duty to diversify the assets of a trust notwithstanding waiver in the governing instrument.

(2) Some courts have imposed a surcharge on trustees for failure to diversify trusts assets. In the Matter of the Estate of Janes, 681 N.E.2d 332 (N.Y. 1997).

(i) Facts: The testator died in 1973. The widow and a bank were the Executors in this case, and the bulk of the testator’s estate was comprised of stock in Eastman Kodak Company. In September 1973, Kodak was trading at approximately $139 per share, and by time the bank filed its initial accounting in 1980, Kodak was trading at about $47 per share.

(ii) The court held that the bank “had acted imprudently and should have divested the estate of the high concentration of Kodak stock…”

(iii) The court imposed a surcharge of about $6 million and ordered the bank to forfeit its commissions and attorneys’ fees.

4. Failed Investments

a. Courts have acknowledged that there will be some variance between how different investors, each acting prudently, would choose to invest.

(1) Generally, a fiduciary should not be held liable for a mere error in judgment with respect to investment selection.

(2) Negligence typically is the standard used to judge liability for investment failures.

(3) Case law

1913) (“[a]ll men of honesty, prudence and enlightenment do not think alike concerning investment decisions”).


b. Profit alone does not release a Trustee from liability.


(i) Facts: The Grantor’s son and Boatmen’s First National Bank of Kansas City, N.A., were the co-trustees of the Grantor’s Revocable Trust. The Grantor was 92 years old and had no financial training. Over the course of 15 years, the trust invested in 12 different real estate limited partnerships that were syndicated by the son. The trust also made substantial loans to the son. The investments were not successful.

(ii) The bank argued that the trial court should have offset gains against losses incurred by the trust.

(iii) The court held that “the use of the ‘offsetting theory’ is appropriate when the investments are related.” Therefore, the court found that because seven of the 12 investments in the limited partnerships and the loans to the son were made at different times, these investments “were not related for the purpose of allowing offset.”

(iv) However, because the trust purchased interests in the other five limited partnerships as part of one transaction, the court held that “these five purchases were related investments for the purpose of allowing offset.”

c. Courts view the conduct of a trustee or other fiduciary by the facts the fiduciary knew or should have known at the time the investment decision was made or at the time the fiduciary failed to act.

(1) Weigh all investment factors as they affect the trust assets.

(2) Analyze how investment decisions affect the interests of the income beneficiaries and remainders.
5. Trustee with Special Skill

a. The general standard of care and skill required of a trustee is that of a person of ordinary prudence in dealing with his or her own property.

b. Some courts, however, have declared that the law does not give trustees the same freedom of choice in investments that may be exercised by prudent business men in their own affairs. See e.g., In re Estate of Busby, 6 N.E.2d 451 (Ill. App. Ct. 1937) (court observed that the executor bank held itself out as especially qualified to administer estates entrusted to its care).

c. If a trustee has a greater degree of skill than that of a man of ordinary prudence and represents this higher degree of skill in order to obtain his appointment, he will be held liable for a loss resulting from the failure to use such skill. Restatement (Second) of Trusts, §174, cmt. a.

d. Nonetheless, courts will take into account the facts and circumstances even when a party with special skills is involved. For example, In re Estate of Venturelli, 370 N.E.2d 290 (Ill. App. Ct. 1977), the estate’s executor was a bank that filed the inventory five (5) months after the decedent death. However, the court in Venturelli, recognized the decedent’s limited organizational skills and held that, “The trial court found that the executor did act as a prudent man. We believe that the record in this particular instance does support such a finding. We believe that the acts of an executor must be judged in the context in which he acts.” Id. at 293.

e. Commentators on the subject note the trend that courts tend to hold professional trustees to a higher standard than nonprofessional trustees.

(1) The Supreme Court of Hawaii has held that because a trust company is a professional fiduciary, it is bound to use its higher degree of specialized skills. Steiner v. Hawaiian Trust Co., 393 P.2d 96, (Hawaii 1964).

f. Perhaps more importantly, some states have specifically mandated that if a trustee possesses specialized skills, he/she must use them. “A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee’s representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.” North Carolina Uniform Prudent Investor Act §36A-162(f). See also, Chapter 398 of the Acts of 1998, which establishes the Massachusetts Prudent Investor Act.
B. Breach of Duty of Loyalty

a. Trustees are bound by the duty of loyalty to the beneficiaries to administer the trust solely in the interest of the beneficiaries, which requires that a Trustee avoid placing itself in a position of conflict with the trust and its beneficiaries.

b. See, e.g., Restatement (Third) of Trusts § 170(1); Bogert, Trusts and Trustees, §543; In re Estate of Halas, 209 Ill. App. 3d 333, 344 (1st Dist. 1991). For an overview of the nature and extent of this duty of loyalty, see generally the comments to Restatement (Third) of Trusts § 170.

c. The duty generally is defined to require a trustee to exclude all self-interest in his administration of the trust.

(1) The duty generally prohibits a trustee from selling trust property to himself individually or from having a substantial personal interest in the purchase.

(2) The trustee may not sell property to a third person with the understanding that the third person will reconvey the property to the trustee or hold it for him.

(3) A trustee is prevented by the duty of loyalty from entering into any transaction or assuming or continuing in a position in which the trustee’s personal interest is or will become adverse to the interest of the beneficiary.

d. The trustee’s duty of loyalty is governed by statute in some states. See, for example, N.D. CENT. CODE §59-01-9 (2005), S.D. CODIFIED LAWS §55-2-2 (2005), CAL. PROB. CODE §16002 (2005), IND. CODE §30-4-3-7 (2005), and IOWA CODE §633.155 (2004).

e. Self-dealing is considered particularly egregious behavior because of the clear conflict between the trustee’s personal interest and the interest of the trust and the beneficiaries of the trust.

(1) In avoiding a self-dealing transaction, a trustee may not lend funds from the trust to itself, may not acquire from a third party, for the trustee personally, any interest in the trust property, and may not sell or lease the trustee’s own individual property to itself, as trustee.

(2) In Estate of Pitzer, 202 Cal. Rpt. 855 (Cal. Ct. App. 1984), the court concluded that the trustee bank was guilty of self-dealing and in breach of the duty of loyalty where it lent money and took as security a deed of trust covering trust property.
f. Elements of Breach

(1) A trustee must act with the utmost fidelity and good faith while engaged in administration of the trust.

(i) For that reason, the trustee must not deal with the subject matter of the trust for his own benefit.


(iii) The prohibition against self-dealing applies not only to the trustee as an individual, but also: (A) to transactions with a firm or corporation of which the trustee is a member; and (B) to the trustee’s spouse, agents, employees and other individuals whose interests are closely identified with those of the trustee. See Bogert, Trusts and Trustees § 543.

(2) When the duty of loyalty is breached, a presumption arises that the transaction at issue was fraudulent.

(i) The burden is then on the trustee to prove, by clear and convincing evidence, that the transaction was fair and that the trustee did not breach its duty. See Curtis v. Fisher, 92 N.E.2d 327 (Ill. 1950).

(ii) The burden of proof with respect to a breach of the duty of loyalty is on the party challenging the trustee’s conduct as an act of bad faith or abuse of discretion because the divided loyalty does not create a presumption of bad faith. See, In re Halas, 290 Ill. App. 3d at 345.

(iii) There appears to be a conflict as to where the burden lies as between Curtis v. Fisher and In re Halas. Is the burden on the fiduciary or the challenging party? These two cases are easily distinguishable due to the fact that George Halas Jr.’s Will expressly waived the duty of undivided loyalty. Therefore, the Halas court held that “Where a conflict of interest is approved or created by the testator, the fiduciary will not be held liable for his conduct unless the fiduciary has acted dishonestly or in bad faith, or has abused his discretion...Further, where the will approves the conflict of interest, the burden of proof remains on the party challenging the fiduciary’s conduct as there is not presumption against the fiduciary despite the divided loyalty.” In re Halas, 290 Ill. App. 3d at 345.
In order to prove an action against a trustee, a plaintiff must, as a threshold matter, establish that the trustee breached his duty of loyalty. The plaintiff must establish that:

(i) the defendant owed a duty of loyalty arising from the trustee’s status as trustee, and

(ii) that the trustee breached the duty of loyalty by engaging in transaction involving a conflict of interest or self-dealing.

Once the plaintiff has met this burden, the burden generally shifts to the trustee to justify his actions.

(i) The plaintiff ordinarily does not bear the burden of proving that the defendant acted in bad faith, profited from the dealing, or caused harm to the trust estate.

(ii) For a transaction involving self-dealing, generally it is not necessary that the plaintiff establish the trustee had either the intent to benefit or actually benefited to the detriment of the beneficiary. Rather, the question is whether the trustee placed itself in a position where its interest was or might be in conflict with its duty to the beneficiaries. However, a court likely will consider the actual administration of a trust, not just possible conflicts of interest, to determine if the trustee and its agents have acted in the best interests of the trust beneficiaries.


g. Where a self-dealing transaction is found, the dealing is not absolutely void, and the beneficiary generally may elect whether or not to void the transaction. See In re Kilmer’s Will, 61 N.Y.S.2d 51, (N.Y. Surr. 1946).

h. Not all conflicts of interest involve self-dealing on the part of the trustee.

In Childs v. National Bank of Austin, 658 F.2d 487 (7th Cir. 1981), Patrick Filter served as chairman of the board of the trustee bank, was a member of the bank’s trust committee and was also chairman of the board of a corporation where a portion of the shares of that corporation (67.7%) were part of the trust property. Filter was also a senior partner at a law firm that represented both the bank and the corporation. Filter abstained from related matters at the corporation’s board meetings and refused to participate on the bank’s trust committee when the trust was considered.
(i) The district court found that the Grantor intended for the conflict to happen.

(ii) The appellate court recognized the well-recognized exception to the general rule in Illinois that a conflict of interests is permitted to exist to the extent it was “contemplated, created, and expressly sanctioned by the trust instrument.” In addition, the appellate court recognized several cases that suggest it may be proper when interpreting a trust “to consider extrinsic events subsequent to the execution of the will.”

(iii) Even though the appellate court acknowledged that the Grantor’s intent was not expressly provided for in the trust, it upheld the district’s finding that the Grantor intended the conflict. Therefore, despite the conflict of interests, the bank did not breach their fiduciary duties to the trust.

2. Defenses

a. The best defense is a good offense….

(1) In situations where a conflict arises, courts have held that it is not only the trustee’s right, but its duty to seek court advice.

(2) The trustee has the option to inform the court and request approval of its actions.

(3) If the trustee fails to proceed according to any of these options, the trustee proceeds at its own risk.

b. Good faith and absence of damages generally are not adequate defenses.

(1) With respect to defenses to an allegation of self-dealing, a trustee is unlikely to have success with an argument that the dealing was made in good faith. See 76 Am. Jr. 2d Trusts § 580 (1992) (“it is immaterial to the invalidity of the purchase by the trustee that in fact he acted in good faith, gave full consideration, or derived no profit or advantage from the transaction”)

(2) A trustee also is unlikely to defend successfully against a charge of self-dealing with the argument that he paid fair value or that the beneficiary suffered no loss. See Restatement (Third) of Trusts § 170, cmt. b.
c. Fairness, consent and equity are the trustee’s best defense.

(1) A trustee may succeed in defending himself against a charge of self-dealing if he can show the transaction was fair and that the beneficiaries consented to the transaction after receiving full disclosure of its terms. See Stegemeier v. Magness, 728 A.2d 557, 563.

(2) Courts have acknowledged that there are rare and justifiable exceptions when the court, employing its inherent equitable powers, may authorize a purchase of trust property by the trustee. Such authorization is permissible where:

(i) the trustee has made complete disclosure of all of the facts,

(ii) the sale would materially promote the best interests of the trust and its beneficiaries, and

(iii) there are no other purchasers willing to pay the same or greater price offered by the trustee.

d. Where a conflict is contemplated, created and expressly sanctioned by the trust instrument, the conflict may be permissible.

(1) This exception is triggered when the trust clearly shows the settlor’s intent to allow such a conflict.

(2) Circumstances existing at the time the trust is created may establish waiver of the conflict by the settlor.

(i) The Grantor of a trust may waive the duty of undivided loyalty “by implication by knowingly placing a trustee in a position that might conflict with the interests of certain beneficiaries.” Dick v. Peoples Mid-Illinois Corp., 242 Ill. App. 3d 297.

(ii) A waiver of the duty of loyalty, however, does not excuse the trustee from acting in good faith and exercising reasonable care in managing investments, and does not eliminate the trustee’s duty to remain impartial. See Giagnorio v. Emmet C. Torkelson Trust, 292 Ill. App. 3d 318, 326-9 (2nd Dist. 1997); Mucci v. Stobbs, 281 Ill. App. 3d 22 (5th Dist. 1996) (“No Trustee has unrestricted authority. The requirements of loyalty and fair dealing and good faith are at the core of every trust instrument, whether specifically stated or not.”).

e. A trustee may also defend by demonstrating waiver of the conflict or self-dealing by the beneficiaries.
f. Consent and ratification.

(1) Restatement (Second) of Trusts §216 states the following:

(1) Except as stated in Subsections (2) and (3), a beneficiary cannot hold the trustee liable for an act or omission of the trustee as a breach of trust if the beneficiary prior to or at the time of the act or omission consented to it. (2) The consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust, if

(a) the beneficiary was under an incapacity at the time of such consent or of such act or omission; or

(b) the beneficiary, when he gave his consent, did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or

(c) the consent of the beneficiary was induced by improper conduct of the trustee.

(3) Where the trustee has an adverse interest in the transaction, the consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust not only under the circumstances stated in Subsection (2), but also if the transaction to which the beneficiary consented involved a bargain which was not fair and reasonable.

(2) The beneficiaries should obtain independent counsel to advise the desired transaction. See Stephan v. Equitable Sav. & Loan Ass’n, 522 P.2d 478, 487 (Or. 1974).

(3) If a beneficiary does not wish to retain independent counsel, the fiduciary should be certain that the relevant facts and circumstances surrounding the transaction are set forth in a written document through which the beneficiary gives its consent or ratifies the actions of the fiduciary.

3. Excessive Fees

a. A trustee violates its duty of loyalty where it receives excessive compensation for services to the trust.

(1) A trustee is entitled to reasonable compensation for services performed in administration of the trust. See 760 ILCS 5/7
In other words, a trustee may receive a reasonable fee based upon the nature and amount of the work he performed in administering the trust.

b. When assessing the reasonableness of a trustee’s compensation, courts will consider factors such as the trustee’s skill and experience.

c. A trustee who takes excessive compensation may be ordered to refund it.

C. Breach of Duty of Impartiality

1. A trustee has a duty to deal impartially with all beneficiaries of a trust and to protect each of their interests.

a. This rule applies whether the beneficiaries’ interests are simultaneous or successive.

b. Unless the terms of the trust instrument provide otherwise, a trustee’s fiduciary duty to each beneficiary precludes it from favoring one party over another.


2. Many trust agreements provide that the trust should be primarily for the benefit of the current beneficiaries, not the remaindermen.

a. Therefore, trustees should be mindful of whether a breach of the duty of impartiality exists when dealing with current beneficiaries and remaindermen.


(1) Facts: The trusts provided the co-trustees with a discretionary distribution standard for the current beneficiaries.

(2) Plaintiffs, current beneficiaries, requested that the trustees convert the distribution standard of the trusts and modify the trust agreement such that the funds be distributed at a rate of 5% of the total fair market value of all of the plaintiffs’ trusts (instead of the 3.5% that co-trustees were distributing), and that the funds only be distributed from the trusts that were non-exempt from GST taxes.
(3) The trust agreement stated that the primary concern is the comfortable maintenance and support of the current beneficiaries during their lifetime. Plaintiffs alleged that the trustees breached their fiduciary duty by: (A) showing a preference for the remainder beneficiaries by preserving the principal rather than focusing on plaintiffs' comfortable maintenance, (B) adopting arbitrary distribution standards, and (C) wasting the assets of the trusts by unnecessarily subjecting plaintiffs' descendants to GST taxes.

(4) The court concluded that the trustees did not breach their fiduciary duty of favoring the remainder beneficiaries over current beneficiaries, and merely adopted a conservative and responsible distribution plan that incidentally benefits the remaindemen by protecting the principal.

3. The Balancing Act

a. In the same way that an income beneficiary may bring an action against a trustee for failure to pay out income from the trust, a remainderman beneficiary may have a cause of action against a trustee for breach of fiduciary duties.

(1) In Pennsylvania Company for Insurance on Lives v. Gillmore (43 A.2d 667 (N.J. Super. Ct. 1945), the trustee advised the life tenants and remaindemen of the possible sale of certain tax exempts at a price which would increase the corpus of the trust.

(2) While the income beneficiaries and remaindemen objected to the sale, arguing that the sale of the tax-exempt securities would discriminate against and result in great loss of income to them, the representative of the contingent remaindemen supported the sale.

(i) As a result of the disagreement, the trustee petitioned the court asking for instructions regarding its duty in its capacity as trustee with respect to the securities.

(ii) The court acknowledged the three interests and stated that the duty of the trustee to the contingent remaindemen did not carry with it a requirement to increase the corpus unless it could be accomplished without detriment to the income and vested remaindemen beneficiaries.

(iii) As a result, the court concluded that it was not the duty of the trustee to sell all or any part of the tax exempt securities in order to capture for the corpus the profit that was realizable.

(3) It is important that a trustee not ignore conflicts between beneficiaries.
“If there are conflicting claims between beneficiaries, a trustee who ignores the demand of one beneficiary in order to comply with the demands of another can be held liable for resulting damages.” Bornstein v. First United, 232 Ill. App. 3d 623, 628 (1st Dist. 1992).

The trustee does not need to decide between the rights of the beneficiaries; instead, the trustee should file an interpleader action or seek court approval to avoid a breach of care. Bornstein v. First United, 232 Ill. App. 3d 623, 628 (1st Dist. 1992); See, e.g., Herget Nat’l Bank v. Lampitt, 133 Ill. App. 3d 418, 420 (3rd 1985).

b. Standing

(1) Remainder beneficiaries are considered persons with an interest in maintaining the assets of the estate. Chicago City Bank and Trust Co. v. Lesman, 186 Ill. App. 3d 697, 701 (Ill. App. 1989).

(2) Such “interested persons” may institute actions for mismanagement of the trust or may object to a final accounting. Chicago City Bank and Trust Co. v. Lesman, 186 Ill. App. 3d 697, 701 (Ill. App. 1989). See also, In re Estate of Provus, 30 Ill. App. 3d 378, 381 (Ill. App. 1975).

c. Recognizing the conflict that sometimes occurs between a trustee’s duty to invest prudently and his duty of impartiality, equitable adjustment statutes have been developed to alleviate the difficulty faced by trustees.

(1) The Uniform Principal and Income Act (UPIA) specifically addresses the problem with trusts that limit payments to current beneficiaries to income or that restrictively limit principal distributions.

(i) Section 104 of the UPIA allows trustees to make adjustments between principal and income necessary to allow the trustee to fulfill his duty of impartiality...“based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries.” UPIA, §103(b).

(ii) Under Section 104 of the UPIA, the trustee is permitted to characterize receipts that generally would be considered principal to be income.
(iii) UPIA comments point out that if the trust terms “give the trustee discretion to favor one beneficiary over another, a court will not control the exercise of such discretion except to prevent the trustee from abusing it.” UPIA §103 cmt.

(iv) Illinois’ Principal and Income Act (760 ILCS 15/3(b)) states that a trust shall be administered “with due regard to the respective interests of income beneficiaries and remaindermen.”

(2) A second remedy sometimes provided by statute is the ability to convert an existing trust into a unitrust.

4. Breach of Other Duties

a. Accounting

(1) Because the trustee is in the unique position to know all of the facts concerning the administration of the trust, the trustee generally will be liable for any expenses and costs incurred resulting from his failure to keep accurate accounts.

(2) If the trustee is found to have failed to keep proper accounts, the court may deny him compensation for his services in administering the trust.

(3) In Jacob v. Davis, 738 A.2d 904 (Md. App. 1999), the trustee failed to render an accounting to the plaintiff, a remainder beneficiary under the trust established by his father.

(i) The trustee argued that pursuant to the provisions of the trust, he only had a duty to render an annual account to the “current income beneficiaries” of the trust and because plaintiff was not an income beneficiary, he did not have an obligation to provide an accounting to plaintiff.

(ii) Responding to the plaintiff’s claim that he was entitled to an accounting, the court noted that the leading authorities on trusts are “unequivocal” in their articulation of the right of remainder beneficiaries to an accounting during and after the lifetime of the income beneficiary.

(iii) The court also acknowledged that a beneficiary is entitled to demand of the trustee all information about the trust and its execution for which he has any reasonable use.

(iv) As a result, the court held the beneficiary was entitled to an accounting, regardless of the language of the trust instrument.
(4) Some state statutes have established provisions that limit the class of beneficiaries who may compel a trustee to provide an accounting.

(i) In Illinois, the Illinois Trusts and Trustees Act provides a default rule that every trustee shall furnish an accounting to the “beneficiaries then entitled to receive or receiving the income from the trust estate.” See 760 ILCS 5/11.

(ii) Caveat: Although the Illinois Trusts and Trustees Act only requires a trustee to account to current income beneficiaries, Illinois court decisions have held that remainder beneficiaries may be entitled to an accounting on demand (1) where the beneficiary’s purpose is proper, and (2) to see that the trust is properly executed. See Corsi v. Corsi, 706 N.E.2d 956 (Ill. App. Ct. 1998).

(iii) See also Sanders v. Stasi, 951 N.E. 2d 1274 (Ill. App. Ct. 2011). In this case, the court determined that a beneficiary who was not a current income beneficiary was, nonetheless entitled to an accounting. “[P]laintiff is unable to enforce her entitlement if she does not receive an accounting of the trust's receipts, disbursements, and holdings.” Id. at 1279.

(iv) Therefore, a trustee should not assume that a beneficiary who is not entitled to an accounting by statute will not be able to obtain one through exercise of the equity powers of the courts.

(5) Discharging Liability to Provide an Accounting.

(i) 760 ILCS 5/11(a) provides that “a current account shall be binding on the beneficiaries receiving the account and on such beneficiaries' heirs and assigns unless an action against the trustee is instituted by the beneficiary or such beneficiary's heirs and assigns within 3 years from the date the current account is furnished.”

(ii) The trustee is entitled periodically to a discharge of liability by means of a judicial settlement of accounts. The trustee is discharged of any liability for transactions covered by the account. See Bogert & Bogert, Trusts and Trustees §§970, 974 (2d ed. 1991).

(iii) Some trust instruments provide for periodic accountings in a nonjudicial setting, with discharge of further liability upon assent of certain adult beneficiaries. Rounds, Loring, A Trustee’s Handbook §6.1.5.2 (2004).
(6) Special note of caution for attorney-trustees.

(i) In State v. Ingram, 248 N.W. 915 (Wisc. 1933), an attorney was acting as executor and trustee and refused to give an accounting despite a statute that required him to make an annual accounting to the court.

(ii) The court found the refusal to be grounds for the attorney’s disbarment!

b. Protection of Trust Property

(1) A trustee has a duty to protect trust property against damage or destruction.

(i) This duty grants the trustee the right to make all reasonable expenditures necessary to preserve the trust property.

(ii) The duty requires that the trustee actively manage the trust assets so as to protect and preserve the trust res.

(iii) In Hamilton v. Mercantile Bank of Cedar Rapids, 621 N.W.2d 401 (Iowa 2001), the trustee failed to collect revenue, pay taxes, to insure against loss and to preserve the value through routine maintenance and repair. The Supreme Court of Iowa upheld a jury award of compensatory and punitive damages to an income beneficiary based upon trustee’s breach of fiduciary duty in failing to preserve and protect the trust property.

(2) Duty to Pay Taxes and Assessments.

(i) As part of the trustee’s duty to protect and preserve the trust property, it is required to timely pay all taxes and assessments which are, or may become, liens upon the trust property.

(ii) The Trustee must do so in order to ensure that the trust property is not sold for taxes and as a result, lost to the beneficiary.

(iii) A trustee who erroneously pays a tax may be held liable for such an error.

III. REMEDIES

A. Where a trustee is found to have breached his fiduciary duty to a beneficiary, the type of liability resulting and punishment imposed may depend on the type of breach committed.
1. As a general rule, a cause of action for breach of fiduciary duty must set forth allegations, supported by facts, that:
   a. a fiduciary relationship existed between the parties,
   b. the trustee owed certain, specific duties to the plaintiff,
   c. the trustee breached those duties, and
   d. there were resulting damages.

2. Possible remedies include:
   a. actual damages,
   b. interest,
   c. forfeiture of compensation as trustee;
   d. removal of the trustee; and
   e. punitive damages.

B. Actual Damages

1. When a breach of trust occurs, the beneficiary of the trust is “entitled to be put in the position he would have been in if no breach of fiduciary duty had been committed.” Berish v. Bornstein, 437 Mass. 252, 270 (Mass., 2002); citing Fine v. Cohen, 623 N.E.2d 1134 (Mass App. Ct. 1993).

2. The Restatement (Third) of Trusts § 205(b) provides that a trustee who commits breach of trust is “chargeable with the amount required to restore the values of the trust estate and trust distributions to what they would have been if the trust had been properly administered.”

3. A beneficiary may have the option to elect to trace trust property or to seek to be made whole through restoration of value (cash).

C. Interest

1. A trustee who commits a breach of trust incurring liability for a certain amount of money is also liable for the interest on that money.

   a. Facts: The beneficiaries of the trust alleged that the trustees breached various fiduciary duties. One of the key allegations was that the trustees paid more than $200,000 in estate expenses from the trust when the funds should have come from the probate estate.
b. The court instructed that, “A trustee who commits a breach of trust incurring liability for a certain amount of money is also liable...for the interest on that money.”

3. In *Jefferson National Bank v. Central National Bank*, 700 F.2d 1143 (7th Cir. 1983), “A trustee who commits a breach of trust and incurs liability for a certain amount of money and the loss of income thereon is properly accountable not only for the return of the money but also interest actually received by him during that period.”

D. Reduction or Denial of Compensation

1. It is within the discretion of the court whether the trustee who has committed a breach of trust shall receive full compensation or whether his compensation shall be reduced or denied.

2. In exercising such discretion, a court may consider several factors including:
   a. whether the trustee acted in good faith;
   b. whether the breach of trust was intentional, negligent or without fault;
   c. whether the breach of trust related to the management of the whole trust or related only to a part of the trust property;
   d. whether or not the breach of trust occasioned any loss and whether, if there has been a loss, it has been made good by the trustee; and
   e. whether the trustee’s services were of value to the trust.

E. Removal

1. In order to have a trustee removed, the plaintiff must establish cause for the trustee’s removal.

2. The issues of cause for removal of a trustee and breach of fiduciary duty in a damage action require different proof.

3. Conditional & Partial Removal
   a. In addition to eliminating an unwanted trustee, a court may use the power of removal to enforce proper conduct on a trustee.
      (1) This power may be employed where there is only a threatened breach of trust and where it may be desirable to keep the trustee in office.
In such a case, a court may conditionally deny the beneficiary’s request for removal, but on the condition that the trustee alter his course of conduct.

b. A court may also suspend the trustee or remove him for a brief period of time pending the showing of evidence indicating a danger of waste or misappropriation.

F. Punitive Damages

1. A trustee who commits a breach may also be liable for punitive damages as a result of the breach.

2. Although many authorities on the law of trusts have repeatedly stated that punitive damages are not recoverable for breaches of trust, punitive damage awards have indeed been awarded and upheld in many cases. See, BNA 853 T.M., Fiduciary Liability of Trustees and Personal Representatives; Colonial Bank and Trust Co. v. Matoff, 18 Conn. App. 20 (1989); Robinson v. Kirbie, 793 P.2d 315 (Okla. Ct. App. 1990). In fact, courts have increasingly become more willing to award punitive damages. See, Dominic J. Campisi, Representing Estate and Trust Beneficiaries and Fiduciaries, ALI-ABA Course of Study Materials, June 2000.

   a. Facts: Two brothers owned the stock of the family’s business. Brother 1 owned his shares outright and Brother 2 owned some of his shares by way of a trust. Brother 1 was the trustee of that trust. Brother 1 had been negotiating with a third party for the sale of the company just before a sale was entered into whereby Brother 2 sold all of his shares back to the company, leaving Brother 1 as the sole shareholder. Shortly after that sale closed, Brother 1 sold the company at a price which was approximately 25% greater than the price Brother 2 received for his shares.
   b. The court held that even though Brother 1’s breach of fiduciary duty extended only to the shares held in trust, his fraudulent conduct would apply to the entire transaction. Besides Brother 1 having to pay over $1 million in compensatory damages, he also had to pay $250,000 in punitive damages.
   c. The court found that, “Punitive damages are appropriate to punish and deter conduct where defendant is guilty of fraud, or an intentional breach of fiduciary duty.”

4. In re Estate of E. Davis Wernick, 535 N.E.2d 876 (Ill. 1989), wherein the Illinois Supreme Court held that the fact pattern of the case did not warrant the assessment of punitive damages, but the Court “[agreed] that a breach of
fiduciary duty may warrant the imposition of punitive damages... The ultimate determination, however, is dependent upon the specific facts of the case involved.”

5. Statutory limitations to punitive damages against fiduciaries may exist. Sims v. Heath, 577 S.E.2d 789 (Ga. Ct. App. 2002). In Sims v. Heath, a jury concluded there was a breach of fiduciary duties by the trustees. While reviewing the punitive damages decision of the jury, the appellate court concluded that the award was not so “grossly excessive” that it violated due process. The court noted, however, that “unless the trier of fact finds that the defendant acted, or failed to act, with the specific intent to cause harm,” under a relevant statute, the punitive damages were limited to the maximum amount allowable for any tort action. As a result, the punitive damages award was reduced from $404,633 to $250,000.

IV. ATTORNEY FEES

A. As a general rule, a trustee is entitled to hire an attorney with respect to the trust administration and to pay such attorney reasonable compensation from the trust estate for services rendered.

1. See 760 ILCS 5/4.09; 760 ILCS 15/14.

2. See also Restatement (Second) of Trusts § 244 (“The trustee is entitled to indemnity out of the trust estate for expenses properly incurred by him in the administration of the trust.”).

B. Illinois case law establishes a clear exception to the general indemnity rule, however, when a trustee breaches its duty to administer the trust according to its terms or its duty of impartiality. See Northern Trust Co. v. Heuer, 202 Ill.App.3d 1066, 1070-71 (Ill. App. 1990).

1. In Heuer, the Trustee did not merely seek instruction from the court, but rather advocated interpretation of the trust in favor of one beneficiary over another.

2. The court held that the failure to remain impartial to the beneficiaries destroyed the justification for charging the attorneys fees against the trust estate. (“If we were to hold otherwise, if the trustee could argue on behalf of one beneficiary to the detriment of another in the interests of saving attorney fees and costs for the trust, there would never be a reason for a beneficiary in an action for construction of a trust to retain counsel or argue its position; our well established law concerning the trustee’s duty of impartiality to beneficiaries would be rendered meaningless. Instead, it is preferable that we reiterate established precedent and foster every incentive for a trustee to adhere to its well-established duty of impartiality.”) Heuer at 1072.

C. When a trustee fails to fulfill its legal duties, it may find itself within another exception to the general indemnity rule.
1. When a trustee fails to fulfill its legal duties, it is well established in Illinois case law that a trustee should not be permitted to recover attorneys fees related to litigation necessary to enforce the rights of the beneficiaries. See Bennett v. Weber, 323 Ill. 283, 296 (Ill. 1926); Billings v. Warren, 216 Ill. 281, 287-88 (Ill. 1905); Ellis v. King, 336 Ill.App. 298, 307 (Ill. App. 1949).

2. In Grate v. Grzetich, 373 Ill.App.3d 228 (Ill. App. Ct. 2007), the trustee breached his fiduciary duty by converting trust assets for personal use, and therefore, the court held that the attorney fees he incurred could not be paid from the trust estate.

3. The fact that a trustee is in doubt as to the extent of its duties will not excuse a breach or prevent a denial of reimbursement of attorneys fees from the trust estate. See Waterman v. Alden, 144 Ill. 90, 107 (Ill. 1893).
   a. In Waterman, the trustees failed to keep accurate accounts of the trusteeship and claimed that they were unsure how to classify two kinds of property.
   b. In affirming a denial of fees to the trustees, the Illinois Supreme Court noted that the trustees “were entitled to counsel, at the expense of the trust estate, to assist them, and, if necessary, to the directions of a court of equity in that regard. They certainly had no right to omit a plain legal duty because they may have been in doubt as to how it should be performed.”

D. In Illinois, the circuit court generally has discretion in determining the need for and amount of attorneys’ fees, and its decision will be reversed only in the event of an abuse of discretion. See Heuer at 1071.

1. Many state statutes provide that payment of attorney’s fees and costs from an accounting dispute from the trust corpus depends on the reasonableness of the dispute.

2. Other statutes assess these fees against a trustee personally when a trustee breaches his fiduciary duty.

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