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Punctilio of an Honor—A Trustee's Duties

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I. INTRODUCTION

A. "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd." *Meinhard v. Salmon*, 249 NY 458, 164 NE 545, 564 (1928).

B. "For as a trust is an office necessary in the concerns between man and man, and which, if faithfully discharged, is attended with no small degree of trouble, and anxiety, it is an act of great kindness to accept it." *Lord Chancellor Hardwicke in Knight v. Earl of Plymouth*, 21 Eng Rep 214, 216 (1747).

C. The title of this outline is intended to remind the reader at the outset that the standard of conduct to which a trustee is held under the law is significantly higher than anywhere else in the marketplace. Yet our clients routinely consider appointing as trustee of trusts with complicated dispositive or tax provisions one or more family members or acquaintances whose background, education, experience, and perspicacity rarely qualify them to understand, let alone properly execute the duties of the trustee.

D. Although the powers of a trustee are often set forth in the trust instrument, the trustee's duties usually are not.

E. In addition, this outline discusses a trustee's liability for breaches of trust–failure to perform the required duties according to the accepted standard of conduct.

F. Although executors, administrators, and personal representatives (collectively, "PRs") are clearly fiduciaries, probate is entirely a statutory process. The laws governing probate, including those determining the duties and liabilities of PRs, vary greatly from state to state. Although some of the duties and potential liability to which PRs are subject may be similar to those of a trustee, this outline does not discuss a PR's duties.

II. HOW A TRUSTEE'S DUTIES ARISE

A. Under the trust instrument.

B. Under federal law or administrative agency regulation.

1. Federal law imposes various direct and indirect duties on trustees. The best-known duties of a trustee under federal law are to pay various taxes. However, ERISA also imposes reporting requirements and increases trustee liability.

2. Treasury regulations impose numerous duties in connection with a trustee's duties to pay income and transfer taxes.

3. The Office of the Comptroller of the Currency ("OCC") imposes various duties on trustees subject to its jurisdiction–viz., national banks. See 12 CFR Parts 9 and 19. [A full discussion of Regulation 9 is beyond the scope of this outline.]

C. Under state statute.

1. The nature and extent of statutes concerning a trustee's duties vary widely from state to state. Some states have an extensive statutory scheme dealing with a trustee's duties, while other states have almost no law on the subject. However, the Uniform Trust Code [hereinafter cited as "UTC"], which was adopted by the National Conference of Commissioners on Uniform State Laws in August 2000, "is the first effort by the Uniform Law Commissioners to provide the states with a comprehensive model for codifying the law of trusts." English, David M., "The Uniform Trust Code (2000)," ACTEC 2000 Summer Meeting at 1.

2. As it enacted in more jurisdictions, the UTC will begin to create more uniformity from state to state. Although the UTC stands as the most up-to-date and thorough analysis of a trustee's duties, there are as yet no cases analyzing its provisions. However, as Professor English, Reporter for the UTC points out: "The Uniform Trust Code was drafted in close coordination with the revision of the *Restatement [(Second) of Trusts]*. This coordination has hopefully made both into better products. The UTC offers the benefit of certain rules. The Restatement provides a wealth of background materials for interpreting the language of the UTC." *Id* at 7.

D. At common law. Where the duties of a trustee are not set forth in the trust instrument, trustees are subject to whatever duties are imposed on them by statute or which have "evolved by courts of equity for the governing of the conduct of trustees." Scott, A.W. & W.F. Fratcher

by courts of equity for the governing of the conduct of trustees. *Scott*, A.W. & W.F. Fratcher, The Law of Trusts § 164 (4th ed 1987) [hereinafter cited as "*Scott*"]. The *Restatement of the Law (Second) Trusts,* adopted and promulgated by the American Law Institute in 1959 [hereinafter cited as "*Restatement*"] describes seventeen separate duties imposed upon a trustee by common law (see IV. infra). The text and comment of several of the sections describing those duties (viz., sections 170, 171, 181, 183, and 184) were revised as part of the *Restatement of the Law (Third) Trusts* (Prudent Investor Rule) adopted and promulgated by the American Law Institute in 1990 [hereinafter cited as "Restatement 3d"].

E. Other sources. ACTEC Fellows should be familiar with the "Guide for ACTEC Fellows Serving as Trustees" which represents a "consensus of suggestions and considerations" dealing with trusteeships.

III. DUTIES OF A TRUSTEE UNDER THE UTC

A. Duty to administer trust. UTC § 801. [UTC text is quoted in bold.]

1. **Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with this [Code].**

2. This section is very similar to Restatement § 169.

B. Duty of loyalty. UTC § 802.

1. **(a) A trustee shall administer the trust solely in the interest of the beneficiaries.**

(b) Subject to the rights of persons dealing with or assisting the trustee as provided in Section 1012 [Protection of Person Dealing With Trustee], a sale, encumbrance, or other transaction involving the investment or management of trust property entered into by the trustee for the trustee's own personal account or which is otherwise affected by a conflict between the trustee's fiduciary and personal interests is voidable by a beneficiary affected by the transaction unless:

(1) the transaction was authorized by the terms of the trust;

(2) the transaction was approved by the court;

(3) the beneficiary did not commence a judicial proceeding within the time allowed by Section 1005 [Limitation of Action Against Trustee];

(4) the beneficiary consented to the trustee's conduct, ratified the transaction, or released the trustee in compliance with Section 1009 [Beneficiary's Consent, Release, or Ratification]; or

(5) the transaction involves a contract entered into or claim acquired by the trustee before the person became or contemplated becoming trustee.

(c) A sale, encumbrance, or other transaction involving the investment or management of trust property is presumed to be affected with a conflict between personal and fiduciary interests if it is entered into by the trustee with:

(1) the trustee's spouse;

(2) the trustee's dependents, siblings, parents, or their spouses;

(3) an agent or attorney of the trustee; or

(4) a corporation or other person or enterprise in which the trustee, or a person that owns a significant interest in the trustee, has an interest that might affect the trustee's best judgment.

(d) A transaction between a trustee and a beneficiary that does not concern trust property but that occurs during the existence of the trust or while the trustee retains significant influence over the beneficiary and from which the trustee obtains an advantage is voidable by the beneficiary unless the trustee establishes that the transaction was fair to the beneficiary.

(e) A transaction not concerning trust property in which the trustee engages in the trustee's individual capacity involves a conflict between personal and fiduciary interests if the transaction concerns an opportunity properly belonging to the trust.

(f) An investment by a trustee in securities of an investment company or investment trust to which the trustee, or its affiliate, provides services in a capacity other than as trustee is not presumed to be affected by a conflict between personal and fiduciary interests if the investment complies with the

prudent investor rule of [Article] 9. The trustee may be compensated by the investment company or investment trust for providing those services out of fees charged to the trustee if the trustee at least annually notifies the person entitled under Section 813 [Duty to Inform and Report] to receive a copy of the trustee's annual report of the rate and method by which the compensation was determined.

(g) In voting shares of stock or in exercising powers of control over similar interests in other forms of enterprise, the trustee shall act in the best interests of the beneficiaries. If the trust is the sole owner of a corporation or other form of enterprise, the trustee shall elect or appoint directors or managers who will manage the corporation or enterprise in the best interests of the beneficiaries.

(h) This section does not preclude the following transactions, if fair to the beneficiaries:

(1) an agreement between a trustee and a beneficiary relating to the appointment or compensation of the trustee;

(2) payment of reasonable compensation to the trustee;

(3) a transaction between a trust and another trust, decedent's estate, or [conservatorship] of which the trustee is a fiduciary or in which a beneficiary has an interest;

(4) a deposit of trust money in a regulated financial-service institution operated by the trustee; or

(5) an advance by the trustee of money for the protection of the trust.

(i) The court may appoint a special fiduciary to make a decision with respect to any proposed transaction that might violate this section if entered into by the trustee.

2. This section is far more extensive than Restatement 3d § 170, which also imposes the duty of loyalty on a trustee. In general, this section of the UTC codifies the Restatement 3d Comments, with one important exception. Under UTC section 802, a corporate trustee

may invest trust funds in a regulated mutual fund which it operates if doing so is "fair to the beneficiaries."

C. Impartiality. UTC § 803.

1. **If a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests.**

2. Presumably, just as with Restatement 3d section 183, this duty will apply whether the beneficiaries' interests are simultaneous or successive.

3. "Due regard" will continue to pose a challenge for the trustee in selecting trust investments. An income beneficiary will favor investment in assets that tend to maximize current income, and a remainder beneficiary will favor investment in assets that tend to maximize the value of the trust principal over time, even if such assets produce less current income.

D. Prudent Administration. UTC § 804.

1. **A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.**

2. This section, while similar to Restatement section 174, does not relate the hypothetical prudent person to dealing with his own property (or, as under Uniform Probate Code (hereinafter "UPC") section 7- 302, the property of another).

E. Costs of Administration. UTC § 805.

1. **In administering a trust, the trustee may incur only costs that are reasonable in relation to the trust property, the purposes of the trust, and the skills of the trustee.**

2. Although this section is included with others imposing duties on the trustee, it really expresses a power of the trustee. It is similar to Restatement section 188, Power to Incur Expenses.

F. Trustee's Skills. UTC § 806.

1. **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, shall use those special skills or expertise.**

2. This duty is expressed as part of Restatement section 174.

G. Delegation by Trustee. UTC § 807.

1. **(a) A trustee may delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:**

   (1) selecting an agent;

   (2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and

   (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

   (b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

   (c) A trustee who complies with subsection (a) is not liable to the beneficiaries or to the trust for an action of the agent to whom the function was delegated.

   (d) By accepting a delegation of powers or duties from the trustee of a trust that is subject to the law of this State, an agent submits to the jurisdiction of the courts of this State.

2. This section is consistent with the approach to delegation adopted by Restatement 3d section 171.

3. Exculpation of the trustee for actions of agents under subsection (c) is similar to Restatement section 225 (*see* IX.C. *infra*).

H. Powers to Direct. UTC § 808.

1. **(a) While a trust is revocable, the trustee may follow a direction of the settlor that is contrary to the terms of the trust.**

   (b) If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.

   (c) The terms of a trust may confer upon a trustee or other person a power to direct the modification or termination of the trust.

   (d) A person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary who, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty.

2. This section, while similar to Restatement section 185, features several important additions.

   (a) First, subsection (a) makes it clear that, with respect to a revocable trust, the trustee may follow instructions of the settlor that are contrary to the terms of the trust instrument.

   (b) Second, subsection (c) authorizes modification or termination of the trust by the trustee or another person, who presumably needs have no other relation to the trust. Query: how can the power to modify or terminate a trust be exercised "in good faith with regard to the purposes of the trust and the interests of the beneficiaries"? Should lawyers be drafting purpose clauses in all trusts? Unless the trust has a stated purpose or purposes, how can the power holder begin to determine whether any exercise of the power to modify or terminate is in good faith with respect to the purposes of the trust?

   (c) Third, subsection (d) creates a statutory presumption that a person who has a power to direct the trustee holds such power in a fiduciary (not personal) capacity.

I. Control and Protection of Trust Property. UTC § 809.

1. **A trustee shall take reasonable steps to take control of and protect the trust property.**

2. This provision consolidates in one section the duties imposed separately by *Restatement* sections 175 and 176.

J. Record Keeping and Identification of Trust Property. UTC § 810.

1. **(a) A trustee shall keep adequate records of the administration of the trust.**

   (b) A trustee shall keep trust property separate from the trustee's own property.

   (c) Except as otherwise provided in subsection (d), a trustee shall cause the trust property to be designated so that the interest of the trust, to the extent feasible, appears in records maintained by a party other than a trustee or beneficiary.

   (d) If the trustee maintains records clearly indicating the respective interests, a trustee may invest as a whole the property of two or more separate trusts.

2. The duty to maintain adequate records imposed by subsection (a) is similar to that imposed by *Restatement* section 172.

3. The duty to keep trust property separate imposed by subsection (b) is similar to that imposed by *Restatement* section 179.

4. Subsection (d) authorizes commingling of the property of several trusts, which is generally prohibited by *Restatement* section 179.

K. Enforcement and Defense of Claims. UTC § 811.

1. **A trustee shall take reasonable steps to enforce claims of the trust and to defend claims against the trust.**

2. This section consolidates in one place the separate duties imposed by *Restatement* sections 177 and 178.

L. Collecting Trust Property. UTC § 812.

1. **A trustee shall take reasonable steps to compel a former trustee or other person to deliver trust property to the trustee, and to redress a breach of trust known to the trustee to have been committed by a former trustee.**

2. The *Restatement* does not articulate this duty separately. However, it is contemplated by the Comments as part of the trustee's duty to enforce claims under *Restatement* section 177.

M. Duty to Inform and Report. UTC § 813.

1. **a. A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.** Unless reasonable under the circumstances, a trustee shall promptly respond to a beneficiary's request for information related to the administration of the trust.

   (b) A trustee:

   (1) upon request of a beneficiary, shall promptly furnish to the beneficiary a copy of the trust instrument;

   (2) within 60 days after accepting a trusteeship, shall notify the qualified beneficiaries of the acceptance and of the trustee's name, address, and telephone number;

   (3) within 60 days after the date the trustee acquires knowledge of the creation of an irrevocable trust, or the date the trustee acquires knowledge that a formerly revocable trust has become irrevocable, whether by the death of the settlor or otherwise, shall notify the qualified beneficiaries of the trust's existence, of the identity of the settlor or settlors, of the right to request a copy of the trust instrument, and of the right to a trustee's report as provided in subsection (c); and

   (4) shall notify the qualified beneficiaries in advance of any change in the method or rate of the trustee's compensation.

   (c) A trustee shall send to the distributees or permissible distributees of trust income or principal, and to other qualified or nonqualified beneficiaries who request it, at least annually and at the termination of the trust, a report

who request it, at least annually and at the termination of the trust, a report of the trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values. Upon a vacancy in a trusteeship, unless a cotrustee remains in office, a report must be sent to the qualified ben-eficiaries by the former trustee. A personal representative, [conservator], or [guardian] may send the qualified beneficiaries a report on behalf of a deceased or incapacitated trustee.

(d) A beneficiary may waive the right to a trustee's report or other information otherwise required to be furnished under this section. A beneficiary, with respect to future reports and other information, may withdraw a waiver previously given.

2. UTC section 103(12) defines "qualified beneficiary" as "a beneficiary who, on the date the beneficiary's qualification is determined: (A) is a distributee or permissible distributee of trust income or principal; (B) would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subparagraph (A) terminated on that date; or (C) would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date."

3. Several of Professor English's insights on this section are worthy of replication here:

> Philosophy. Section 813 of the UTC fills out and adds detail to the trustee's duty to keep the beneficiaries informed of administration. When in doubt, the UTC favors disclosure to beneficiaries as the better policy.
>
> Specific Notice Requirements. The drafting committee rejected the more limited approach of letting the trustee decide which provisions are material to the beneficiary's interest; the trustee's version of what is material may differ markedly from what the beneficiary might find relevant.
>
> The Waiver Issue. The most discussed issued in the drafting of the UTC and subsequent to its approval is the extent to which the settlor may waive the requirements of Section 813. This issue is currently addressed in Section 105(b)(8)-(9). Most of the specific notice requirements are waivable. Not waivable is the trustee's obligation to notify the qualified beneficiaries age 25 or older of the existence of the trust. With respect to any beneficiary regardless of age, the trustee [settlor?] also may not waive the trustee's obligation to respond to a request for trustee's report and other information reasonably related to the trust's administration. In other words, if a beneficiary finds out about the trust and makes a request for information, the trustee must respond to the request even if the trustee was not obligated to inform the beneficiary about the trust in the first instance.[1]

IV. DUTIES OF A TRUSTEE UNDER THE *RESTATEMENT*

A. Duty to administer the trust. *Restatement* § 169. [*Restatement* text (but not Comments) throughout this outline is quoted in small capital letters.]

1. UPON ACCEPTANCE OF THE TRUST BY THE TRUSTEE, HE IS UNDER A DUTY TO THE BENEFICIARY TO ADMINISTER THE TRUST.

2. This section seems not to have attracted much attention from the courts. However, as both the *Restatement* Comment and *Scott* point out, this section prohibits a trustee from disclaiming his office after acceptance. Further, a trustee can only resign with the permission of the court or by the consent of all the beneficiaries, unless the terms of the trust provide otherwise. *Scott* § 169 at 311. Moreover, after acceptance, the trustee is bound to administer the trust even if he is to receive no compensation. However, this section makes it clear that a trustee's duties are not contractual in nature.

B. Duty of loyalty. *Restatement* 3d § 170.

1. (1) THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO ADMINISTER THE TRUST SOLELY IN THE INTEREST OF THE BENEFICIARIES.

   (2) THE TRUSTEE IN DEALING WITH A BENEFICIARY ON THE TRUSTEE'S OWN ACCOUNT IS UNDER A DUTY TO DEAL FAIRLY AND TO COMMUNICATE TO THE BENEFICIARY ALL MATERIAL FACTS IN CONNECTION WITH THE TRANSACTION.

2. It is probably fair to say that more has been written about this duty of the trustee, both by the courts and by commentators, than any other. This is due to the fact that "The most fundamental duty owed by the trustee to the beneficiaries of the trust is the duty of loyalty." *Scott* § 170 at 311. Implicit in the duty of loyalty is the duty not to self- deal.

3. In cases involving a breach of the duty of loyalty, it is typically immaterial that the trustee acted in good faith or that the particular transaction was fair and reasonable in all

respects.

4. Prior court approval of a self-dealing transaction can avoid a breach of the duty of loyalty. Also, acquiescence or consent by the beneficiaries to a self-dealing transaction may constitute a defense if the beneficiaries were aware of all of the facts.

C. Duty with respect to delegation. *Restatement 3d* § 171.

1. A TRUSTEE HAS A DUTY PERSONALLY TO PERFORM THE RESPONSIBILITIES OF THE TRUSTEESHIP EXCEPT AS A PRUDENT PERSON MIGHT DELEGATE THOSE RESPONSIBILITIES TO OTHERS. IN DECIDING WHETHER, TO WHOM AND IN WHAT MANNER TO DELEGATE FIDUCIARY AUTHORITY IN THE ADMINISTRATION OF A TRUST, AND THEREAFTER IN SUPERVISING AGENTS, THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARIES TO EXERCISE FIDUCIARY DISCRETION AND TO ACT AS A PRUDENT PERSON WOULD ACT IN SIMILAR CIRCUMSTANCES.

2. This section was substantially revised from *Restatement* section 171, which generally frowned on delegation. However, some delegation was permitted. As Comment d to

   former *Restatement* section 171 stated:

   > A trustee can properly delegate the performance of acts which it is unreasonable to require him personally to perform. There is no clear-cut line dividing the acts which a trustee can properly delegate from those which he cannot properly delegate. In considering what acts a trustee can properly delegate the following circumstances, among others, may be of importance: (1) the amount of discretion involved, (2) the value and character of the property involved, (3) whether the property is income or principal, (4) the proximity or remoteness of the subject matter of the trust; (5) the character of the act as one involving professional skill or facilities possessed or not possessed by the trustee himself.

3. The philosophy of *Restatement 3d* section 171 is expressed in Comment f:

   > ***Delegation of authority to do particular acts.*** Although the administration of a trust may not be delegated in full, a trustee may for many purposes delegate fiduciary authority to properly selected and supervised agents.
   >
   > Delegation is not limited to the performance of ministerial acts. In appropriate circumstances delegation may extend, for example, to discretionary acts, to the selection of trust investments or the management of specialized investment programs, and to other activities of administration involving significant judgment.
   >
   > . . .
   >
   > In considering whether and under what circumstances and conditions a particular delegation of fiduciary authority is proper, the following circumstances, among others, may be of importance to the trustee or to a reviewing court: (1) the nature and degree of discretion involved; (2) the amount of funds or the value and character of the property involved; (3) efficiency, convenience, and cost considerations in light of the situs of the property or activities involved; (4) the relationship of the act or activities involved to the professional skills or facilities possessed by the trustee; and (5) the fairness and appropriateness of the responsibilities in question to the burdens and compensation of the trustee (see § 188, Comment c).

4. The terms of the trust instrument may authorize delegations of authority by the trustee that would otherwise be improper. Comment i.

D. Duty to keep and render accounts. *Restatement* § 172.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO KEEP AND RENDER CLEAR AND ACCURATE ACCOUNTS WITH RESPECT TO THE ADMINISTRATION OF THE TRUST.

2. *Scott* observes that a trustee's "accounts should show what he has received and what he has expended. They should show what gains have accrued and what losses have been incurred on changes of investments. If the trust is created for beneficiaries in succession, the accounts should show what receipts and what expenditures are allocated to principal and what are allocated to income." *Scott* § 172 at 452.

3. Not only must the trustee maintain accurate records. This section also imposes on a trustee the duty to provide an accounting at reasonable times when requested by the beneficiaries.

   a. The general rule is that a beneficiary who has only a future or contingent interest in the trust may still exercise the right to compel an accounting. However, several recent cases have held to the contrary. *Chicago City Bank & Trust Co v. Lesman*, 186 Ill App 3d 697, 134 Ill Dec 478, 542 NE 2d 1067 (1989); *Schlosser v. Schlosser*, 247 Ill App 3d 1044, 187 Ill Dec 769, 618 NE 2d 360, *appeal denied*, 152 Ill 2d 580, 190 Ill Dec 910, 622 NE 2d 1227 (1993).

   b. If only one beneficiary wants an accounting and the other beneficiaries object because of the cost to the trust, courts have held that the beneficiary requesting the accounting must indemnify the trust against the expense. *In re New England Mutual Life Ins Co Litigation*, 841 F Supp 345 (WD Wash 1994), aff'd mem, 54 F 3d 786 (9th Cir 1995); *Bryan v. Seiffert*, 185 Okla 496, 94 P 2d 526 (1939); *Pollock v. Manufacturers & Traders Trust Co*, 154 Misc 67, 276 NYS 363 (1934).

4. This duty is regulated by statute in many states.

E. Duty to furnish information. *Restatement* § 173.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO GIVE HIM UPON HIS REQUEST AT REASONABLE TIMES COMPLETE AND ACCURATE INFORMATION AS TO THE NATURE AND AMOUNT OF THE TRUST PROPERTY, AND TO PERMIT HIM OR A PERSON DULY AUTHORIZED BY HIM TO INSPECT THE SUBJECT MATTER OF THE TRUST AND THE ACCOUNTS AND VOUCHERS AND OTHER DOCUMENTS RELATING TO THE TRUST.

2. This duty requires a trustee to provide complete and accurate information regarding the administration of the trust. "The beneficiaries are entitled to know what the trust property is and how the trustee has dealt with it." *Scott* § 173 at 462-464.

3. This topic generated considerable traffic on the ACTEC-GEN list-serve during November 2001. Fellows were interested in whether and how they might assist clients who preferred to keep the terms of a trust, or even its very existence, from being known by the beneficiaries.

   a. One Fellow mentioned that he was involved in a case where the trustees were accused of concealing the fact that a person was a potential beneficiary of the trust. Despite extraordinarily good investment performance, the remoteness of any possibility that a distribution would be made to the person involved, and no finding of bad faith, the trial court removed one corporate trustee and surcharged both the corporate and individual trustees. (Apparently the case is on appeal.)

   b. Also, in *Karpf v. Karpf*, 240 Neb 302, 481 NW 2d 891 (1992), where a statute mandated disclosure of the trust's existence to the beneficiaries, the trustee's failure to do so was held to be a breach of trust.

   c. Fellows seemed to conclude that the only way to keep a trust's existence and terms from being known by the beneficiary is by using an offshore trust, the governing law of which might permit complete withholding of information.

4. According to Comment b, "The trustee is privileged to refrain from communicating to the beneficiary information acquired by the trustee at his own expense and for his own protection. Thus, he is privileged to refrain from communicating to the beneficiary

   opinions of counsel obtained by him at his own expense and for his own protection."

   a. In *Moeller v. Superior Court (Sanwa Bank)*, 947 P2d 279 (Cal 1997), the attorney-client privilege for confidential communications between a predecessor trustee and its counsel passed to the successor trustee. The court suggested that a trustee can avoid any problem resulting from such disclosure by retaining and paying counsel with his own funds for legal advice that is personal in nature.

   b. However, in *Wells Fargo Bank, NA v. Superior Court*, 990 P 2d 591 (Cal 2000), the court held that a trustee was not required to produce privileged communications on the subjects of trust administration and possible misconduct in order to fulfill its duties to report to the beneficiaries on the trust and its administration. The fact that the legal advice had been paid for by the trust apparently had no effect on the court's decision.

   c. *See generally*, Report of the Special Study Committee on Professional Responsibility, Counseling the Fiduciary, 28 *Real Prop, Prob & Trust J* 825, 848-855 (1994); Hamel, Louis H., Jr., "Trustee's Privileged Counsel: A Rebuttal," 21 *ACTEC Notes* 156 (1995); Gibbs, Charles F. & Cindy D. Hanson, "The Fiduciary Exception to a Trustee's Attorney/Client Privilege," 21 *ACTEC Notes* 236 (1995);

Gibbs, Charles F., "The Attorney/Client Privilege and the Fiduciary Exception-The Latest Word," 21 *ACTEC Notes* 307 (1996); and Reid, Rust E., William R. Mureiko & D'Ana H. Mikeska, "Privilege and Confidentiality Issues When a Lawyer Represents a Fiduciary," 30 *Real Prop, Prob & Trust J* 541 (Winter 1996).

F. Duty to exercise reasonable care and skill. *Restatement* § 174.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY IN ADMINISTERING THE TRUST TO EXERCISE SUCH CARE AND SKILL AS A MAN OF ORDINARY PRUDENCE WOULD EXERCISE IN DEALING WITH HIS OWN PROPERTY; AND IF THE TRUSTEE HAS OR PROCURES HIS APPOINTMENT AS TRUSTEE BY REPRESENTING THAT HE HAS GREATER SKILL THAN THAT OF A MAN OF ORDINARY PRUDENCE, HE IS UNDER A DUTY TO EXERCISE SUCH SKILL.

2. Note that the *Restatement* standard is that of a prudent person dealing with his own property. In many states that standard has been changed by statute to that of a prudent person dealing with the property of another. (UPC § 7-302 requires a trustee to observe the standards that would be observed by a prudent man dealing with the property of another.)

3. If a trustee has greater skills that those of an ordinary prudent person, he is under a duty to use those skills and will be liable for a loss resulting from a failure to use those skills.

4. Comment *b* states: "Whether the trustee is prudent in the doing of an act depends on the circumstances as they reasonably appear to him at the time when he does the act and not at some subsequent time when his conduct is called in question."

G. Duty to take and keep control. *Restatement* § 175.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO TAKE REASONABLE STEPS TO TAKE AND KEEP CONTROL OF THE TRUST PROPERTY.

2. A trustee is ordinarily under a duty to take and keep possession of tangible personal property owned by the trust.

   a. This duty is sometimes ignored or overlooked when tangible personal property located in a residence, such as artwork, continues to remain in the residence occupied by the beneficiary.

   b. Proper drafting can make sure that the trustee's duty to take and keep control of tangibles is waived for items the settlor intends for the beneficiary to use and enjoy.

3. This duty can lead to potential liability for the trustee, as under CERCLA.

4. Where reasonable to do so, the trustee may entrust possession of trust property to the trustee's attorney, broker, banker, or other agent. Comment *e*.

5. This duty also includes the responsibility to designate property as trust property.

H. Duty to preserve the trust property. *Restatement* § 176.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO USE REASONABLE CARE AND SKILL TO PRESERVE THE TRUST PROPERTY.

2. Consistent with his duty to use appropriate care and skill, it is a trustee's duty to protect the trust property from loss, damage, or other diminution in value. Examples include:

   a. Physical loss of trust property, such as loss of a stock certificate.

   b. Failure to procure appropriate insurance against casualty loss.

   c. Legal loss of trust property from failure to pay taxes or a mortgage. On the subject of a trustee's duties to minimize taxes, see Ascher, Mark L., "The Fiduciary Duty to Minimize Taxes," 20 *Real Prop, Prob & Trust J* 663 (1985).

   d. Loss in value from failure to make repairs necessary to preserve property.

3. If there are insufficient funds in the trust estate with which to pay expenses necessary to preserve the trust property, the trustee may:

   a. Raise the funds from the trust property by mortgage, sale, or otherwise; or,

   b. Notify the beneficiaries in order to give them the chance to advance the money.

I. Duty to enforce claims. *Restatement* § 177.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO TAKE REASONABLE STEPS TO REALIZE ON CLAIMS WHICH HE HOLDS IN TRUST.

2. This duty applies to:

   a. Claims against any predecessor trustee;

   b. Claims against the executor or personal representative of a decedent/trustor;

   c. Tort claims; and,

   d. Contract claims.

3. If a claim cannot be collected in full or it appears doubtful that it is enforceable, the trustee can compromise the claim or submit it to arbitration.

4. If it appears reasonable to do so, the trustee need not file suit or appeal an adverse lower court decision.

J. Duty to defend actions. *Restatement* § 178.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO DEFEND ACTIONS WHICH MAY RESULT IN A LOSS TO THE TRUST ESTATE, UNLESS UNDER ALL THE CIRCUMSTANCES IT IS REASONABLE NOT TO MAKE SUCH DEFENSE.

2. A trustee is obligated to appeal an adverse decision to a higher court, unless under all the circumstances it is unreasonable not to appeal.

3. A trustee can properly compromise or arbitrate claims against the trust if it appears to be for the benefit of the beneficiary.

4. A trustee can properly pay a claim, even though it appears not to be enforceable, if the cost and risk incurred in defending the claim are unreasonable.

5. Also, "It is the duty of the trustee to the beneficiaries of the trust to prevent the destruction of the trust. Thus, where the settlor or his successors in interest seek to rescind the trust on the ground that the settlor was induced by undue influence or mistake to create the trust, it is the duty of the trustee to defend the trust and resist the proceeding to the extent to which it is reasonable to require him to do so." *Scott* § 178 at 496.

K. Duty to keep trust property separate. *Restatement* § 179.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO KEEP THE TRUST PROPERTY SEPARATE FROM HIS INDIVIDUAL PROPERTY, AND, SO FAR AS IT IS REASONABLE THAT HE SHOULD DO SO, TO KEEP IT SEPARATE FROM OTHER PROPERTY NOT SUBJECT TO THE TRUST, AND TO SEE THAT THE PROPERTY IS DESIGNATED AS PROPERTY OF THE TRUST.

2. This duty requires that the trustee:

   a. Keep the trust property separate from his own property;

   b. Keep the trust property separate from property held upon other trusts; and,

   c. Earmark the trust property as property of the trust.

3. Comment d states:

   > The trust property should be ordinarily so earmarked as to indicate not only that it is trust property but that it is property of the particular trust upon which it is held. Thus, it is ordinarily not sufficient that the trustee should take title to the property in the name of the trustee "as trustee" without indicating the particular trust upon which it is held. It should be taken in the name of the trustee as "trustee under the will of" the settlor, or "as trustee under a certain deed of trust" or "as trustee for" certain beneficiaries.

4. However, the terms of the trust instrument may authorize the trustee to hold the trust property in his own name without designating the particular trust or even that it is held in trust at all. Therefore, absent statutory authority (which now exists in most states), if securities are to be held in street name with a brokerage house, the trust instrument must permit the trustee to hold trust property in the name of a third person and to register trust securities in the name of a nominee.

5. Commingling assets of various trusts is generally impermissible under this section.

L. Duty with respect to bank deposits. *Restatement* § 180.

1. WHILE A TRUSTEE CAN PROPERLY MAKE GENERAL DEPOSITS OF TRUST MONEY IN A BANK, IT IS HIS DUTY TO THE BENEFICIARY IN MAKING SUCH A

MONEY IN A BANK, IT IS HIS DUTY TO THE BENEFICIARY IN MAKING SUCH A DEPOSIT TO USE REASONABLE CARE IN SELECTING THE BANK, AND PROPERLY TO EARMARK THE DEPOSIT AS A DEPOSIT BY HIM AS TRUSTEE.

2. *Scott* observes that "A trustee cannot properly lend trust money without security. In a sense a deposit in a bank is a loan to the bank of the money deposited." *Scott* § 180 at 526. However, if a deposit is insured by a federal agency, it is not improper as an unsecured loan. *Id* at 539. (See Note, "The Responsibilities of a Lawyer or Fiduciary with Respect to Estate Funds over the Amount Insured by the FDIC," 7 *Conn Prob LJ* 183 (1992).)

3. Nevertheless, a trustee can deposit funds in a bank, subject to the trustee's responsibility to exercise reasonable care and skill. Those responsibilities extend to selection of the bank, earmarking any deposits, not leaving funds uninvested for too long, and not precluding withdrawals.

M. Duty to make the trust property productive. *Restatement* 3d § 181.

1. THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARIES TO USE REASONABLE CARE AND SKILL TO MAKE THE TRUST PROPERTY PRODUCTIVE IN A MANNER THAT IS CONSISTENT WITH THE FIDUCIARY DUTIES OF CAUTION AND IMPARTIALITY.

2. Comment a to this revised section states:

> Productivity generally. A trustee is normally under a duty to manage trust property so that the trust estate can reasonably be expected to produce a total return that is consistent with objectives of caution and impartiality as appropriate to the particular trust and its purposes, requirements, and circumstances.
>
> . . .
>
> The objectives of total return encompass not only income productivity but also returns to principal, with these competing interests being balanced in a way that is appropriate to the particular trust. The principal objectives involve preservation of the corpus, which normally includes a general goal of protecting its purchasing power (that is, protection of real rather than merely dollar value). In some trusts these objectives may even support a goal of enhancing real value.
>
> Fulfillment of a trust's combination of income and principal objectives, of course, need not be assured by the trustee's investment program. The ability to realize these dual objectives will be particularly uncertain over any given period of time, and most notably with respect to principal objectives. Thus, the duties of the trustee require a careful balancing of objectives and uncertainties, taking account of the particular trust's tolerance for volatility and other risks and after giving due consideration to the goals and circumstances of that trust.

3. The cited Comment makes it clear that productivity applies not only to income but also to principal. Moreover, productivity involves the concept of total return. Also, preservation of the value of principal now involves protecting the trust's purchasing power in real terms.

4. Land. Formerly, a trustee was normally required to lease land or manage it to produce income. However, under *Restatement* 3d section 181, "Questions of income productivity and impartiality are properly judged on the basis of the trust estate as a whole rather than asset by asset." Comment *b*. Thus, the manner in which and the degree to which land must be made productive depends on the purposes for which the property is held. "Similarly, the existence, extent, and nature of the trustee's duty with respect to productivity of land are affected by whether the land is improved and, if not, by the prospects of its being leased or otherwise used productively in light of the trustee's possible authority to make improvements and the realistic prospect of those improvements being made." *Id.*

5. Chattels. Unless the trust instrument requires the trustee to preserve, distribute, or utilize chattels (as in a business), the trustee has a duty to sell or lease chattels. However, it may be proper for the trustee to hold tangibles as part of the trust's investment portfolio. Comment *c*.

6. Money. A trustee is normally required to invest money so that it will produce income. However, reasonable delays in investing are permitted. Comment *d*.

N. Duty to pay income to beneficiary. *Restatement* § 182.

1. WHERE A TRUST IS CREATED TO PAY THE INCOME TO A BENEFICIARY FOR A DESIGNATED PERIOD, THE TRUSTEE IS UNDER A DUTY TO THE BENEFICIARY TO PAY TO HIM AT REASONABLE INTERVALS THE NET INCOME OF THE TRUST PROPERTY.

2. "The trustee can properly withhold a reasonable amount of the income to meet present or anticipated expenses which are properly chargeable to income." Comment *a*. "In order to equalize the income from year to year he may estimate in advance probable expenditures and build up a reserve to meet such expenditures." *Scott* § 182 at 551.

3. Trust provisions mandating accumulation of income for a period longer than any applicable rule against perpetuities are invalid. *Restatement* § 62, Comment *t*.

4. Beneficiary under an incapacity. Scott § 182 at 552-555.

   a. The trustee's duty depends on the terms of the trust instrument. If the trust instrument requires payment of income, it is the trustee's duty to pay the income to the beneficiary's guardian or conservator or to the court. (However, if the trustee applies the income for the support of the beneficiary, he will be entitled to credit in his accounting, because otherwise the beneficiary would be unjustly enriched.)

   b. If the trust instrument authorizes the trustee to apply the income for the benefit of the incapacitated beneficiary, the trustee can do so without paying the income to the beneficiary's guardian.

   c. If the trustee is directed to apply the income for the benefit of an incapacitated beneficiary, he may not pay the income to the beneficiary's guardian, because that would be an improper delegation of the trustee's duties.

   d. *But see* UTC section 816(21), which gives the trustee the authority to pay any amount distributable to a beneficiary who is under a legal disability by paying it directly, applying it for the beneficiary's benefit, by paying it to the beneficiary's conservator (or, if none, guardian), a custodian under the Uniform Transfers to Minors Act or custodial trustee under the Uniform Custodial Trust Act (and for such purpose to create either one), an adult relative or other person who has physical custody of the beneficiary, or by managing it as a separate fund.

O. Duty to deal impartially with beneficiaries. *Restatement* 3d § 183.

1. WHERE THERE ARE TWO OR MORE BENEFICIARIES OF A TRUST, THE TRUSTEE IS UNDER A DUTY TO DEAL IMPARTIALLY WITH THEM.

2. This duty applies whether the interests of the beneficiaries are simultaneous or successive. Comment *a*.

3. The trust instrument may authorize the trustee to favor the interests of one beneficiary over another. *Id.*

P. Duty with respect to co-trustees. *Restatement* 3d § 184.

1. IF THERE ARE SEVERAL TRUSTEES, EACH TRUSTEE IS UNDER A DUTY TO THE BENEFICIARIES TO PARTICIPATE IN THE ADMINISTRATION OF THE TRUST AND TO USE REASONABLE CARE TO PREVENT A CO-TRUSTEE FROM COMMITTING A BREACH OF TRUST, AND IF NECESSARY TO COMPEL A CO-TRUSTEE TO REDRESS A BREACH OF TRUST.

2. Generally, it is improper for one trustee to allow a co-trustee to have such control of the trust property as would enable that co-trustee to misappropriate it. Comment *a*. That is why, unless it is proper to hold securities in the name of a nominee, trust property should be titled or registered in the names of all of the trustees.

3. "Where there are several trustees, unless the terms of the trust or of an applicable statute provide otherwise, action by all of them is necessary to the exercise of powers conferred upon them." Comment *b*. (See Uniform Trustee Powers Act.)

4. The trust instrument may authorize one or more (but fewer than all) trustees to have possession or control of trust property or to perform specific functions.

Q. Duty with respect to person holding power of control. *Restatement* § 185.

1. IF UNDER THE TERMS OF THE TRUST A PERSON HAS POWER TO CONTROL THE ACTION OF THE TRUSTEE IN CERTAIN RESPECTS, THE TRUSTEE IS UNDER A DUTY TO ACT IN ACCORDANCE WITH THE EXERCISE OF SUCH POWER, UNLESS THE ATTEMPTED EXERCISE OF THE POWER VIOLATES THE TERMS OF THE TRUST OR IS A VIOLATION OF A FIDUCIARY DUTY TO WHICH SUCH PERSON IS SUBJECT IN THE EXERCISE OF THE POWER.

2. The person holding the power to control the actions of the trustee may be a co- trustee, a beneficiary, the settlor, or a third person otherwise unconnected with the trust.

beneficiary, the settlor, or a third person otherwise unconnected with the trust.

3. The trustee's duty under this section depends on whether the person who possesses the power holds it in a purely personal capacity or in a fiduciary capacity.

   a. Power held personally. "Where the holder of the power holds it solely for his own benefit, the trustee can properly comply and is under a duty to comply with his directions, provided that the attempted exercise of the power does not violate the terms of the trust." *Scott* § 185 at 574.

   b. Power held as a fiduciary. "But where the holder of the power holds it as a fiduciary, the trustee is not justified in complying with his directions if the trustee knows or ought to know that the holder of the power is violating his duty to the beneficiaries as fiduciary in giving the directions." *Id.* The trustee is under a duty to take reasonable steps to inquire whether the power holder is violating his fiduciary duty to the beneficiaries.

   c. See discussion of UTC § 808(b) *supra*.

V. EXCULPATORY PROVISIONS

A. In general.

1. Exculpatory clauses are also sometimes referred to as "immunity" clauses.

2. Professor Bogert describes two types of exculpatory clauses:

   a. "One provides that the trustee is not to be accountable to anyone for his actions. This type of clause is not upheld." Bogert, George Gleason & George Taylor Bogert, *The Law of Trusts and Trustees* § 542 (2d ed 1979) at 188.

   b. "The second type of exculpatory clause provides that the trustee is not to be liable for specified acts or certain conduct." *Id.* at 189.

3. Professor Bogert also observes that "It would doubtless be regarded as against public policy to excuse a trustee from liability for the consequences of willful negligence or default, or bad faith or gross negligence." [Footnote omitted.] *Id.* at 208.

4. Exculpatory clauses are strictly construed by the courts. *In Re Trusteeship of Williams*, 591 NW 2d 743 (Minn Ct App 1999).

B. UTC.

1. Exculpation of Trustee. UTC § 1008.

   (a) A term of the trust relieving the trustee of liability for breach of trust is unenforceable to the extent that it:

   (1) relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries; or

   (2) was inserted as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor.

   (b) An exculpatory term drafted or caused to be drafted by the trustee is invalid as an abuse of a fiduciary or confidential relationship unless the trustee proves that the exculpatory term is fair under the circumstances and that its existence and contents were adequately communicated to the settlor.

2. Note, however, that under UTC section 105(10), the terms of the trust instrument cannot prevail over the effect of an exculpatory term under this section.

3. Whether an exculpatory term has been "drafted or caused to be drafted by the trustee" is sure to spawn litigation.

   a. If a professional fiduciary refers a prospective trust customer to an estate planning attorney who drafts a trust, has any exculpatory term in the trust instrument been "caused to be drafted by the trustee"?

   b. Regardless of how the client comes to the estate planning lawyer, if that lawyer uses the professional fiduciary's trust form and the trust instrument names as trustee the professional fiduciary whose form was used, was any exculpatory provision "caused to be drafted by the trustee"?

4. How will a trustee ever prove that an exculpatory term is "fair under the circumstances"?

a. "Fair" to whom? Presumably, it will be fairness to the beneficiaries that will be the test. That presents a serious problem for any trustee, because it would seem that an exculpatory provision would never be fair to the beneficiaries if the alternative is that the beneficiaries would have a cause of action against the trustee for breach of trust.

b. What "circumstances"? When are the circumstances to be determined? Are they the circumstances at the time the trust is created? Or are they the circumstances at the time when what would otherwise be a breach of trust occurs?

5. How will the trustee ever prove that the "existence and contents" of an exculpatory provision were adequately communicated to the settlor?

a. Should exculpatory provisions be separately identified and initialed by the settlor?

b. What is the drafting attorney's responsibility to the trustee, if any, for ensuring that the existence and contents of an exculpatory term were adequately disclosed?

6. Note also that UTC section 1106 contemplates that the UTC will apply to all trusts created before, on, or after enactment in a particular state. It is not clear if and how the limited exceptions to retroactivity might apply to exculpatory clauses and acts performed in reliance thereon.

C. *Restatement*.

1. In general, the trustee can be relieved of liability for a breach of trust by use of an exculpatory provision in the trust instrument. *Restatement* § 222.

2. However, an exculpatory provision cannot relieve the trustee of liability:

a. For a breach of trust committed in bad faith;

b. For a breach of trust committed intentionally;

c. For a breach of trust committed with reckless indifference to the interest of the beneficiary; or

d. For any profit which the trustee derives from a breach of trust. *Id*.

3. An exculpatory provision is ineffective to the extent inserted in the instrument as the result of the trustee's abuse of a fiduciary or confidential relationship to the settlor. *Id*.

4. Furthermore, exculpatory provisions are strictly construed. *Id*., Comment *a*.

VI. **FIDUCIARY BONDS**

A. In general.

1. "A fiduciary bond is a signed promise to be personally responsible for carrying out certain obligations. It neither increases nor decreases the trustee's general fiduciary responsibility nor does it affect the trustee's liability. … It may be appropriate to have a surety on the bond. A surety is either an individual or a company who agrees to be responsible (up to the dollar limits specified in the bond) in the event the beneficiary cannot be made whole in an action against the trustee. Surety fees are a proper trust expense generally charged to trust income." [Footnote omitted.] Rounds, Charles E., Jr., *Loring A Trustee's Handbook* (1999 ed., Panel Publishers) § 3.5.4.3 at 73.

2. Most states now have statutes that obviate the need for a trustee to file a bond. See Bogert, George Gleason & George Taylor Bogert, *The Law of Trusts and Trustees* § 151 (2d ed 1979).

B. UTC.

1. Trustee's Bond. UTC § 702.

(a) A trustee shall give bond to secure performance of the trustee's duties only if the court finds that a bond is needed to protect the interests of the beneficiaries or is required by the terms of the trust and the court has not dispensed with the requirement.

(b) The court may specify the amount of a bond, its liabilities, and whether sureties are necessary. The court may modify or terminate a bond at any time.

[(c) A regulated financial-service institution qualified to do business in this State need not give bond, even if required by the terms of the trust.]

2. Thus, if the trust instrument is silent on the issue, under the UTC no bond is required of

the trustee unless the court finds it necessary to protect the interests of the beneficiaries. Query: if the trust instrument is silent on the issue of bond, does a new trustee have any duty to bring the issue to the attention of a court of competent jurisdiction?

C. *Restatement*. The *Restatement* is essentially silent on the subject of a fidelity bond. Its only reference is in Comment b to § 107 where a trustee's refusal to give bond, if required, is grounds for removal.

VII. TYPES OF LIABILITY

A. Personal liability. "A person is subject to personal liability if an action can be maintained against him as an individual and his individual property can be subjected by judicial proceedings to the satisfaction of a judgment entered therein." *Restatement* § 261, Comment *a*.

B. Liability in a representative capacity. "If a person is subject to liability only in a representative capacity, an action cannot be maintained against him as an individual and his individual property cannot be reached by judicial process, but only such property as he holds in his representative capacity can be reached." *Id*.

VIII. TRUSTEE'S RIGHT TO INDEMNITY FROM THE TRUST ESTATE

A. General rules.

1. THE TRUSTEE IS ENTITLED TO INDEMNITY OUT OF THE TRUST ESTATE FOR EXPENSES PROPERLY INCURRED BY HIM IN THE ADMINISTRATION OF THE TRUST. *Restatement* § 244.

a. The right to indemnity applies to expenses incurred in:

(1) Defending suits to set aside the trust, to terminate the trust prematurely, and to remove the trustee without justification.

(2) Defending or prosecuting actions for the benefit of the trust, where the litigation is not the trustee's fault.

(3) Obtaining the advice of counsel to aid in the administration of the trust, where such advice is not required as a result of the trustee's own fault.

(4) Making repairs or improvements to trust property or paying commissions in connection with the sale of trust property.

(5) Employing agents. *Scott* § 244 at 324-25.

b. A trustee's right to indemnity may take the form of exoneration or reimbursement. *Restatement* § 244, Comment *b*.

> What is the right of indemnity? I apprehend that in equity, at all events, it is not a right of the trustee to be indemnified only after he has made the necessary payments…but that he is entitled to be indemnified, not merely against the payments actually made, but against his liability…. It seems to me, therefore, that a trustee has a right to resort in the first instance to the trust estate to enable him to make the necessary payments to the person whom he employs to assist him in the administration of the trust estate; that he is not bound in the first instance to pay those persons out of his own pocket, and then recoup himself out of the trust estate, but that he can properly in the first instance resort to the trust estate, and pay those persons whom he has properly employed the proper remuneration out of the trust estate.

In re Blundell, 40 Ch D 370, 376 (1888), 44 Ch D 1 (1889); cited at *Scott* § 244 at 327-28.

(1) Exoneration is the use of trust property to discharge the liability in the first instance so that the trustee will not be forced to use his individual property. *Restatement* § 244, Comment *b*.

(2) Reimbursement is repayment of the trustee for use of his personal funds to discharge a liability. *Id*.

c. The trustee has a security interest in the trust property to the extent he is entitled to indemnity. *Id*., Comment *c*.

d. The rule applies even to spendthrift trusts. *Id*., Comment *d*.

e. Any liability of the trustee for breach of trust can be set off against the amount to

c. Any liability of the trustee for breach of trust can be set off against the amount to which he would otherwise be entitled for indemnity. *Id.*, Comment *e*.

1. With the exceptions described below, the trustee is not entitled to indemnity for his expenses from the trust if those expenses were not properly incurred. *Restatement* § 245.

   a. The trustee is not entitled to indemnity for expenses in employing an agent to perform acts which the trustee ought to perform personally. *Id.*, Comment *b*.

   b. The terms of the trust may permit the trustee to be indemnified by the trust estate for expenses incurred in good faith even though he is not empowered to incur such expenses. The expenses, however, must not have been incurred in bad faith or with reckless indifference to the interest of the beneficiary. *Id.*, Comment *c*.

3. "The trustee is entitled to indemnity for expenses not properly incurred by him if and to the extent to which he has thereby in good faith benefitted the trust estate." *Scott* § 245.1 at 338.

   a. This exception requires that the trustee act in good faith and that there be a benefit to the trust estate.

      (1) However, under certain circumstances it may be inequitable to the beneficiary to permit the trustee to be indemnified. Those circumstances include:

         (a) "[W]hether the trustee acted in bad faith in incurring the expense.

         (b) "[W]hether the trustee in incurring the expense knew that he was not empowered to incur it.

         (c) "[W]hether in incurring the expense he reasonably believed that it was necessary to do so for the preservation of the trust estate.

         (d) "[W]hether the benefit has been or can be realized in the form of money.

         (e) "[W]hether indemnity can be allowed without defeating or impairing the purposes of the trust." *Restatement* § 245, Comment *g*.

      (2) Such benefit to the trust estate may take the form of an increase in rental value or sales value of the trust property. *Id.*, Comment *e*.

      (3) A benefit may also result from preservation of value that would otherwise have been diminished. *Id*, Comment *f*.

      (4) The trustee may have to wait for indemnity until the benefit he conferred has been realized. *Id.*, Comment *g*.

   b. "If such indemnity were not allowed, the beneficiary would be unjustly enriched at the expense of the trustee." *Id.*, Comment *d*.

4. "If the trustee exceeds his powers in incurring an expense, with the result that the trust estate is benefitted thereby, but in such a manner that the beneficiaries are in a position to accept or reject the benefit, the trustee is entitled to indemnity for the amount of expense incurred if, but only if, the beneficiaries accept the benefit." *Scott* § 245.2 at 344. If the beneficiaries decline the benefit, the trustee is not entitled to indemnity but is entitled to take the benefit. *Restatement* § 245, Comment *i*.

B. Indemnity for contractual liability.

1. The general rules discussed above with respect to indemnity of the trustee apply in the area of contractual liability. *Restatement* § 246. Thus, if a contractual liability is properly incurred by the trustee in the administration of the trust, the trustee is entitled to indemnity. If the expense is not properly incurred, the rules under *Restatement* § 245 apply.

2. "Although the trustee breaks a contract properly made by him in the administration of the trust and thereby incurs a liability for breach of contract, he is entitled to indemnity to the extent to which he thereby benefitted the trust estate." *Restatement* § 246, Comment *c*.

C. Indemnity for tort liability.

1. The general rules discussed above with respect to indemnity of the trustee also apply in the area of liability in tort. *Restatement* § 247.

   a. If a tort liability occurs in the proper administration of the trust, and the trustee was not personally at fault in incurring the liability, the trustee is entitled to indemnity. *Id.*, Comment *a*.

   b. Where tort liability to a third person results from the act of the trustee's properly

b. Where tort liability to a third person results from the act of the trustee's properly employed agent, the trustee is entitled to indemnity so long as the trustee was not personally at fault. *Id.*

c. "If the trustee was at fault in incurring the liability, he is not entitled to indemnity." *Id.*, Comment *d*.

2. If by failing to obtain liability insurance the trustee has committed a breach of trust, he is not entitled to indemnity to the extent the insurance he should have obtained would have discharged the liability. *Id.*, Comment *e*.

3. A trustee may be entitled to indemnity from the trust estate for liability incurred from commission of an intentional tort. *Id.*, Comment *g*.

a. The trustee must have intended that the intentional tort would benefit the trust estate. *Id.*

b. The intentional tort must have actually benefitted the trust estate. *Id.*

c. The trustee's claim of indemnity is still limited by the amount of benefit conferred upon the trust estate, and indemnity must not be inequitable under the circumstances. *Id.*, *Restatement* § 245(2).

D. Indemnity for liability as a title holder of property.

1. The general rules discussed above with respect to indemnity of the trustee apply by reason of holding title to the trust property. *Restatement* § 248.

2. "If the trustee in breach of trust acquires or holds property, he is not entitled to indemnity for liabilities incurred by him as holder of the title, unless the beneficiary elects to take the property." *Id.*, Comment *d*. "Thus if a trustee of shares of stock improperly takes the shares in his individual name so that he becomes individually liable to pay calls or assessments with respect to the shares, he is entitled to indemnity, since the ultimate result would have been the same even if he had properly taken the shares in his name as trustee. But if the trustee purchases shares that he is not authorized to purchase, and as a result he is compelled to pay an assessment or call upon the shares, the beneficiary may reject the shares and the trustee is not entitled to indemnity. But if the beneficiary accepts the shares he must accept the burdens with the benefits and the trustee will be entitled to indemnity." *Scott* § 248 at 351.

E. Indemnity where trust estate is insufficient.

1. "In the case of a testamentary trust and ordinarily in the case of a trust created inter vivos, the trustee is not entitled to indemnity from the beneficiary personally in the absence of an agreement to the contrary." *Restatement* § 249, Comment *a*.

2. However, there are two exceptions to this rule.

a. If there was an agreement between the trustee and the beneficiary that the beneficiary would indemnify the trustee, then the trustee is entitled to indemnity from the beneficiary personally. *Restatement* § 249, Comment *b*.

(1) Such agreement can be expressed in specific terms or may be inferred from all the circumstances. *Id.*

(2) Circumstances among those that may tend to evidence such an agreement are:

(a) "[T]hat the settlor is also the sole beneficiary or one of the beneficiaries,

(b) "[T]he duty of the trustee was not merely to care for the trust property but to conduct a business involving considerable risk on the part of the trustee, and

(c) "[T]hat the trust property was shares of stock involving a possibility of calls or assessments which might exceed the value of the shares." *Id.*

(d) An agreement regarding indemnity between the beneficiary and the trustee is normally interpreted as applying only to liabilities incurred in the proper administration of the trust. *Id.*

b. Likewise, if the trustee has distributed property to the beneficiary without deducting the amount to which he is entitled as indemnity, he is entitled to indemnity from the beneficiary personally to the extent of the property so conveyed. *Restatement* § 249(2).

(1) This rule does not apply if the trustee has indicated his intent to forego any claim to indemnity. *Id.*

(2) Nor does this rule apply if the beneficiary has so changed his position that it is inequitable to require him to indemnify the trustee. *Id*.

(3) Although neither the *Restatement* nor *Scott* speaks to this point, it would appear that the trustee's delay in seeking indemnity from the beneficiaries personally could result in his being estopped from making a claim for indemnity. Similarly, delay by the trustee is the single factor most likely to allow the beneficiary to change his position, thereby rendering indemnification inequitable. Query: is a refunding provision incorporated in a trustee's instrument of distribution or the beneficiary's receipt and release sufficient to preserve the trustee's right to indemnity from the beneficiary personally, despite the passage of what otherwise would be considered an inordinate time?

(4) "If the trust property would be insufficient to indemnify the trustee, he is not under a duty to incur a liability unless the beneficiaries are willing to indemnify him." *Scott* § 249.1 at 358.

IX. LIABILITY OF THE TRUSTEE TO THIRD PERSONS

A. Personal liability to third persons. THE TRUSTEE IS SUBJECT TO PERSONAL LIABILITY TO THIRD PERSONS ON OBLIGATIONS INCURRED IN THE ADMINISTRATION OF THE TRUST TO THE SAME EXTENT THAT HE WOULD BE LIABLE IF HE HELD THE PROPERTY FREE OF TRUST. *Restatement* § 261.

1. The rule applies to the three typical ways (listed below) in which obligations to third persons generally arise in the administration of a trust. However, it also applies to other liabilities incurred in the administration of the trust. *Id*., Comment *c*.

   a. Contracts made by the trustee.

   b. Torts committed by the trustee.

   c. Ownership of the property held in trust.

2. "Although the trustee is personally liable to third persons on obligations incurred by him in the administration of the trust, he is entitled to indemnity out of the trust estate if the liability was properly incurred by him." *Restatement* § 261, Comment *b*.

3. Note, however, that this general rule may be limited or negated by statute. *See* UPC § 7-306.

B. Contract liability. EXCEPT AS STATED IN § 263, THE TRUSTEE IS SUBJECT TO PERSONAL LIABILITY UPON CONTRACTS MADE BY HIM IN THE COURSE OF THE ADMINISTRATION OF THE TRUST. *Restatement* § 262.

1. "Where a trustee in the administration of the trust makes a contract with a third person, the trustee is personally liable on the contract in the absence of a stipulation in the contract relieving him from personal liability." *Scott* § 262 at 418. "Thus, even if the third party knows that the contract was made by the trustee in the administration and for the benefit of the trust, the trustee is personally liable." *Id*. at 420-21.

2. This rule applies whether or not the trustee is properly performing his duties when he enters into the contract. *Restatement* § 262, Comment *a*.

3. The trustee's personal liability does not depend on whether the existence of the trust or the names of the beneficiaries are known to the third party. *Id*.

4. If the liability was properly incurred by the trustee in the administration of the trust, he is entitled to indemnity from the trust. *Restatement* § 246. However, the trustee remains personally liable even if the trust estate is insufficient to indemnify him, unless the contract expressly or impliedly provides otherwise. *Restatement* § 262, Comment *b*.

5. UPC section 7-306(a) significantly limits the trustee's liability in contract: "Unless otherwise provided in the contract, a trustee is not personally liable on contracts properly entered into in his fiduciary capacity in the course of administration of the trust estate unless he fails to reveal his representative capacity and identify the trust estate in the contract. The Comment to UPC section 7-306 indicates that the purpose of the section is to make the liability of the trust and the trustee the same as that of a decedent's estate and its personal representative.

C. Tort liability. THE TRUSTEE IS SUBJECT TO PERSONAL LIABILITY TO THIRD PERSONS FOR TORTS COMMITTED IN THE COURSE OF THE ADMINISTRATION OF THE TRUST TO THE SAME EXTENT THAT HE WOULD BE LIABLE IF HE HELD THE PROPERTY FREE OF TRUST. *Restatement* § 264.

1. This rule applies regardless of whether the tort was intentional or negligent or whether the trustee was without fault, whether his conduct was an action or inaction, and whether or

not he violated any duty as trustee. *Id.*, Comment *a*.

2. The principle of *respondeat superior* applies to torts committed by agents or employees of the trustee. *Restatement* § 264, Comment *b*.

3. If the liability was properly incurred by the trustee in the administration of the trust, he is entitled to indemnity from the trust. *Restatement* § 247. However, the trustee remains personally liable even if the trust estate is insufficient to indemnify him. *Restatement* § 264, Comment *c*.

4. It is possible that breach of fiduciary duty may itself become an independent tort. See *Hartlove v. Maryland School for the Blind*, 111 Md App 310, 681 A 2d 584 (1996), citing the *Restatement of the Law (Second) Torts* § 874.

5. UPC section 7-306(b) significantly limits the trustee's liability in tort: "A trustee is personally liable…for torts committed in the course of administration of the trust estate

   only if he is personally at fault."

D. Property liability. WHERE A LIABILITY TO THIRD PERSONS IS IMPOSED UPON A PERSON, NOT AS A RESULT OF THE CONTRACT MADE BY HIM OR A TORT COMMITTED BY HIM BUT BECAUSE HE IS THE HOLDER OF THE TITLE TO PROPERTY, A TRUSTEE AS A HOLDER OF THE TITLE TO THE TRUST PROPERTY IS SUBJECT TO PERSONAL LIABILITY, BUT ONLY TO THE EXTENT TO WHICH THE TRUST ESTATE IS SUFFICIENT TO INDEMNIFY HIM. *Restatement* § 265.

1. Unless and to the extent otherwise provided by the trust instrument, a trustee is entitled to indemnity from the trust property for expenses properly incurred in the administration of the trust. *Restatement* § 244. Liabilities incurred by reason of the trustee's holding title to property are within the scope of the right to indemnity. *Restatement* § 248.

2. However, unlike the unlimited personal liability to third parties for the trustee's contracts and torts, the trustee's liability to third parties arising from holding title to trust property is generally limited to the extent to which the trust estate is sufficient to indemnify him. *Restatement* § 265, Comment *a*.

   a. This rule applies to property taxes. *Restatement* § 265, Comment b.

   b. It also applies to assessments on shareholders, if the shares are registered in the name of the person as trustee. *Restatement* § 265, Comment c.

   c. The most financially devastating area in which this type of liability is not limited to the value of the trust estate has recently arisen is environmental liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 USC §§ 9601 et seq. ("CERCLA"). *See generally* Packer, Thomas A. & James W. Miller, Jr., "Inheritance of Contaminated Property: Blessing or Curse?," 10 *Prob & Prop* 13 (Oct/Nov. 1996) [hereinafter cited as "Packer"]; Note, "The Expansive Reach of CERCLA Liability: Potential Liability of Executors of Wills and Inter Vivos and Testamentary Trustees," 55 *Albany L Rev*. 143 (1991).

      (1) Under CERCLA § 9607(a), liability is imposed on four classes of persons:

         (a) Current owners or operators of contaminated property;

         (b) Owners or operators of the property at the time when hazardous waste disposal occurs;

         (c) Persons who arrange for disposal or treatment of hazardous substances at the property; and,

         (d) Persons who accepted hazardous substances for transport to the property.

      (2) "Just as an executor or conservator's CERCLA liability is typically limited to estate assets, a trustee's liability is typically limited to trust assets. See *Restatement* §§ 264, 265. The trustee's personal liability will turn on whether the trustee is a 'responsible person' under 42 United States Code section 9607(a). Some courts have required no more than a confirmation that the trust assets include contaminated property to impose liability. Other courts have sought more significant indicia of ownership, such as control of the contaminated property. A review of trustee cases reveals that trustee liability under CERCLA appears to be expanding." Packer at 17-18, followed by analysis of cases arising from trustee status and on indicia of ownership.

   d. In September 1996 Congress limited a trustee's personal liability under CERCLA by

      enacting the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996, §§ 2501-2505 of the Omnibus Consolidated Appropriations Act, Pub L 104-208, 110 Stat 3009.

(1) Under current law, a trustee's personal liability under CERCLA is limited to the value of the assets in the trust estate.

(2) A trustee may still be personally liable under CERCLA to the extent that the trustee's own negligence caused a release of a hazardous substance. Environmental case law highlights the difficulty of identifying the scope of the trustee's liability caused by his own negligence. See discussion in *Matter of Bell Petroleum Services, Inc.*, 3 F 3d 889 (5th Cir 1993).

(3) The new negligence standard fails to clarify the extent to which a trustee must investigate, discover, and remediate suspected contamination of trust property to be relieved from personal liability. Under 42 United States Code section 9607(n)(4), there are safe harbors which will protect the fiduciary from personal liability:

(a) Undertaking or directing another person to undertake a cleanup.

(b) Responding to an agency enforcement order.

(c) Terminating the fiduciary relationship.

(d) Incorporating special environmental provisions (including indemnification of the fiduciary) into the trust agreement.

(e) Inspecting the trust property.

(f) Providing financial or other advice to the trust grantor or beneficiaries.

(g) Administering trust property which was contaminated before the fiduciary relationship began.

(h) Declining to take any action listed in 42 United States Code section 9607(n)(4).

3. UPC section 7-306(b) significantly limits the trustee's liability arising from ownership of property: "A trustee is personally liable for obligations arising from ownership of property of the trust estate…in the course of administration of the trust estate only if he is personally at fault."

X. LIABILITY OF THE TRUSTEE TO BENEFICIARIES

A. Breach of trust. A trustee is liable to beneficiaries for any loss to the trust estate resulting from a breach of trust committed by the trustee. *Scott* § 201.

1. A breach of trust is a violation by the trustee of any duty which as trustee he owes to the beneficiary. *Restatement* § 201.

a. A breach of trust normally results if the trustee intentionally or negligently does what he ought not to do or fails to do what he ought to do. *Id*, Comment *a*. "In the world of trusts, an intentional breach is usually two breaches: a breach of the duty of loyalty coupled with some other breach…. The breach of the duty of loyalty never travels alone…. Like the intentional breach, the negligent breach is actually two or more breaches: a breach of the duty to be generally prudent in conducting the affairs of the trust couple with some other breach." Rounds, Charles E., Jr., *Loring A Trustee's Handbook* (1999 ed, Panel Publishers) §§ 7.2.1 and 7.2.2 at 215.

b. However, if a trustee acts under a mistake of law or fact, a breach of trust can occur even where the trustee is not personally at fault. *Id.*

(1) A trustee commits a breach of trust where he violates a duty resulting from his mistake regarding the extent of his duties and powers. *Id.*, Comment *b*.

(a) Neither the trustee's good faith nor advice of counsel is a defense. *Id.*

(b) Liability regarding the extent of the trustee's duties and powers is avoided by submitting the matter to the advisory jurisdiction of the court. *Scott* § 201 at 221.

(2) A breach of trust can also be committed as a result of mistake of fact or law concerning the exercise of the trustee's powers or performance of his duties. *Restatement* § 201, Comment *c*. Here, however, negligence is required to subject the trustee to liability for breach of trust. Proper care and caution in the exercise of powers or performance of duties avoid liability. *Id.*

B. Nonliability for loss in the absence of a breach of trust.

1. THE TRUSTEE IS NOT LIABLE TO THE BENEFICIARY FOR A LOSS OR DEPRECIATION IN VALUE OF THE TRUST PROPERTY, OR FOR A FAILURE TO MAKE A PROFIT, NOT RESULTING FROM A BREACH OF TRUST. *Restatement* § 204

MAKE A PROFIT, NOT RESULTING FROM A BREACH OF TRUST. *Restatement* § 204.

2. "A trustee is not a guarantor of the value of the trust property. He is not liable unless he has violated some duty owed by him to the beneficiaries. If a loss to the trust estate is not due to his failure to exercise reasonable care and skill to preserve the trust property or to some other breach of trust, he is not subject to a surcharge." *Scott* § 204 at 234.

   a. This rule applies in the case of the trustee's investment in property which depreciates in value, if the trustee did not commit a breach of trust in making or in continuing to hold the investment. *Id.*

   b. It also applies to the trustee's failure to make a profit. *Scott* § 205.

C. Trustee's liability in case of breach of trust.

1. A trustee who commits a breach of trust is:

   a. [A]CCOUNTABLE FOR ANY PROFIT ACCRUING TO THE TRUST THROUGH THE BREACH OF TRUST; OR

   b. [C]HARGEABLE 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. *Restatement* 3D § 205.

2. IN ADDITION, THE TRUSTEE IS SUBJECT TO SUCH LIABILITY AS NECESSARY TO PREVENT THE TRUSTEE FROM BENEFITTING PERSONALLY FROM THE BREACH OF TRUST (SEE § 206). *Id.*

3. The beneficiary's remedies are alternative in that the beneficiary has the option of affirming the transaction or surcharging the trustee. *Id.*, Comment *a*.

4. If the beneficiary is under an incapacity, the court will enforce the remedy which in its opinion is the most advantageous to the beneficiary and most likely to accomplish the purposes of the trust. *Restatement* 3d § 205, Comment *b*.

5. This rule applies to trust income as well as to principal. "Thus, if the trustee in breach of trust fails to make the trust property productive he is liable for the amount of income which he would have received if he had not committed the breach of trust (see § 207)." *Restatement* 3d § 205, Comment *i*.

XI. SPECIAL AREAS OF CONCERN

A. Successor trustee.

2. The general rule is that a successor trustee is not liable for a breach of trust committed by a predecessor trustee. *Restatement* § 223.

1. However, a successor is liable for a predecessor's breach of trust if he:

   a. [K]NOWS OR SHOULD KNOW OF A SITUATION CONSTITUTING A BREACH OF TRUST COMMITTED BY HIS PREDECESSOR AND HE IMPROPERLY PERMITS IT TO CONTINUE; OR

   b. [N]EGLECTS TO TAKE PROPER STEPS TO COMPEL THE PREDECESSOR TO DELIVER THE TRUST PROPERTY TO HIM; OR

   c. [N]EGLECTS TO TAKE PROPER STEPS TO REDRESS A BREACH OF TRUST COMMITTED BY THE PREDECESSOR. *Id.*

3. A successor trustee must take proper steps to compel the predecessor to redress a breach of trust committed by the predecessor, and the successor is liable to the extent to which a loss results from his failure to take such steps. *Id.*, Comment *d*.

4. "A successor trustee is liable for breach of trust if he neglects to take proper steps to compel the sureties on his predecessor's bond to indemnify the trust estate for liabilities incurred through a breach of trust committed by his predecessor." *Scott* § 223.3 at 401.

B. Breach of trust by co-trustee.

1. The general rule is that a trustee is not liable to the beneficiary for a breach of trust committed by a co-trustee. *Restatement* § 224.

2. However, there are several exceptions. A trustee will be liable for acts of his co- trustee, if he:

   a. [P]ARTICIPATES IN A BREACH OF TRUST COMMITTED BY HIS CO-TRUSTEE; OR

b. [I]MPROPERLY DELEGATES THE ADMINISTRATION OF THE TRUST TO HIS CO-TRUSTEE; OR

c. [A]PPROVES OR ACQUIESCES IN OR CONCEALS A BREACH OF TRUST COMMITTED BY HIS CO-TRUSTEE; OR

d. [B]Y HIS FAILURE TO EXERCISE REASONABLE CARE IN THE ADMINISTRATION OF THE TRUST HAS ENABLED HIS CO-TRUSTEE TO COMMIT A BREACH OF TRUST; OR

e. [N]EGLECTS TO TAKE PROPER STEPS TO COMPEL HIS CO-TRUSTEE TO REDRESS A BREACH OF TRUST. *Id.*

3. Where several trustees are liable for a joint breach of trust or for a breach of trust by a co-trustee under the rules described above, their liability to the beneficiary is joint and several. *Id.*, Comment *a*.

C. Acts of agents. *See generally* Bennett, Charles M., "When the Fiduciary's Agent Errs-Who Pays the Bill-Fiduciary, Agent, or Beneficiary?" 28 *Real Prop Prob and Trust LJ* 429 (1993).

1. With certain exceptions, the trustee is not liable to the beneficiary for acts of the trustee's agents employed in the administration of the trust. *Restatement* § 225(1).

2. Those exceptions involve an agent's act, which if done by the trustee would constitute a breach of trust, if the trustee:

a. [D]IRECTS OR PERMITS THE ACT OF THE AGENT; OR

b. [D]ELEGATES TO THE AGENT THE PERFORMANCE OF ACTS WHICH HE WAS UNDER A DUTY NOT TO DELEGATE; OR

c. [D]OES NOT USE REASONABLE CARE IN THE SELECTION OR RETENTION OF THE AGENT; OR

d. [D]OES NOT EXERCISE PROPER SUPERVISION OVER THE CONDUCT OF THE AGENT; OR

e. [A]PPROVES OR ACQUIESCES IN OR CONCEALS THE ACT OF THE AGENT; OR

f. [N]EGLECTS TO TAKE PROPER STEPS TO COMPEL THE AGENT TO REDRESS THE WRONG. *Restatement* § 225(2)(a)-(f).

3. Accordingly, under appropriate circumstances, a trustee may not be liable for acts of his agent. See *Russell v. Rici*, 213 N E 2d 566 (Ill 1966) (trustee blameless for loss on conversion of sales proceeds where he properly delegated authority to attorney to exchange deed upon payment of purchase price).

4. However, an error of the agent may constitute a breach of trust by the trustee. See *Estate of Lohm*, 269 A 2d 451 (Pa 1970) (co-executors guilty of negligence where untimely filed estate tax return resulted in loss to estate; reliance on properly retained counsel does not excuse failure to ascertain crucial filing dates, as trustees should have known that tax returns were due). Presumably there would have been no trustee liability if the return had been filed on a timely basis but asserted positions that resulted in penalties to the estate, as the co-executors would not have been expected to know that the positions were wrong.

5. *Restatement* § 225(2) limits liability to acts of agents "which if done by the trustee would constitute a breach of trust." Given this language, is a trustee liable if he improperly delegates to an agent who acts reasonably but nevertheless causes a loss? It seems strange the *Restatement* would approve improper delegation so long as the agent acts reasonably. Comment a further confuses the issue and implies that a trustee is always liable for improper delegation: "[A trustee] is not liable to the beneficiary for losses resulting from the improper conduct of the agent, unless the trustee is himself guilty of a breach of trust. The trustee is himself guilty of a breach of trust under the circumstances stated in Subsection (2) and is liable therefor." Thus, any of the actions or inactions listed above is itself a breach of trust for which the trustee is liable.

6. A corporate trustee is liable to the beneficiary for acts or omissions of its own officers and employees committed in the course of their employment. However, they are not considered agents in the administration of the trust for purposes of this rule. *Restatement* § 225, Comment *b*.

D. Payments or conveyances made to persons other than the beneficiary.

1. IF BY THE TERMS OF THE TRUST IT IS THE DUTY OF THE TRUSTEE TO PAY OR CONVEY THE TRUST PROPERTY OR ANY PART THEREOF TO A BENEFICIARY, HE IS LIABLE IF HE PAYS OR CONVEYS TO A PERSON WHO IS NEITHER THE BENEFICIARY NOR ONE TO WHOM THE BENEFICIARY OR THE COURT HAS

BENEFICIARY NOR ONE TO WHOM THE BENEFICIARY OR THE COURT HAS AUTHORIZED HIM TO MAKE SUCH PAYMENT OR CONVEYANCE. *Restatement* § 226.

2. This rule applies to trust income as well as to trust principal. It also applies whether the payment or conveyance is made at or before termination of the trust. *Id*, Comment *a*.

3. Reasonable mistake of fact or law does not absolve the trustee. *Restatement* § 226, Comment *b*.

4. If a creditor of a beneficiary has acquired a legitimate lien on the beneficiary's interest and the trustee has notice of the lien, the trustee is liable to the creditor if he pays or conveys income or property to the beneficiary. *Restatement* § 226, Comment *e*. However, this is an area governed by statute in many states.

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[1]English, David M., "The Uniform Trust Code (2000)," ACTEC 2000 Summer Meeting at 31.

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