

# **TRUSTEES BEWARE: Discussion of Duties and Dangers**

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# Common Issues

- Duty to Invest Prudently
- Duty of Loyalty
- Duty of Impartiality
- Duty to Keep Beneficiaries Informed
- Trust Litigation
- Homestead

# Duty to Invest Prudently

## Examples:

- Surviving Spouse is income beneficiary and children of a prior marriage are remainder beneficiaries = Spouse wants maximum income and children want growth.
- Decedent died owning a large percentage of assets in real estate, some income producing but others are cash drain.

# Duty to Invest Prudently

- Trust for children owns decedent's closely held business and children can't agree how the business should be run or sold.
- The assets in the trust portfolio have declined in value and there is a very uncertain economic climate.
  - Should the Trustee sell?
  - What if the market rebounds and the trust is in cash?

# Prudent Investor Rule - F.S. §§ 736.0901 and 518.11

- Duty to invest as a prudent investor would.
- A test of conduct and not of performance viewed at time of investment.
- Applied not to each investment, but the investment portfolio as a whole.
- Does the overall investment strategy incorporate risk and return objectives reasonably suitable for the trust?

# **F.S. §736.0806 and §518.11**

## **Duties**

- Duty to diversify.
- Duty to review existing investments of the trust within a reasonable time after acceptance of the trust.
- Duty to develop an investment plan and document the factors considered.
- Duty to use special expertise if Trustee possesses special expertise.

# Investment Plan Factors

- General economic conditions
- Inflation
- Expected tax consequences
- Role of each investment within the portfolio
- Expected total returns
- Costs
- Purposes, terms and distribution requirements of the trust

# Monitor Investment Plan

- Review the portfolio and investment plan at least annually or more frequently depending on market conditions.
- Document reasons for maintaining or changing portfolio.

# Trust Terms

- If the trust document specifically authorizes certain investments, the Trustee can rely on the terms of the trust.
- If the terms of the trust regarding the trust investments no longer seem reasonable, the Trustee can obtain a court order to deviate from the terms of the trust.

# Managing Investment Risk

- Obtain court approval.
- Obtain beneficiary approval.
- Follow investment advice (*Parker* case).
- Delegate investment functions (and liability):
  - Exercise reasonable care in selecting agent
  - Establish scope and terms of delegation
  - Regularly review agent's actions
  - Give notice of intent to delegate to beneficiaries
  - Agent must accept

# ***Parker v. Shullman***

- Beneficiaries complained of decline in value of trust due to Trustee's investments.
- Court held Trustee was not liable because the Trustee:
  - Interviewed multiple investment advisors
  - Followed the advice of his advisors
  - Acted reasonably at the time the investment was made

# Duty of Loyalty

- Must administer the trust solely in the interests of the beneficiaries.
- A trust transaction that benefits the Trustee or in which there is a conflict of interest is a breach of the duty of loyalty and is voidable by the beneficiaries unless:
  - Trust terms authorized
  - Court approved
  - Beneficiaries approved

# Duty of Loyalty

- Conflict of interest presumed when transaction is with Trustee's family members, employees or entities.
- Transaction is not void per se as Trustee may rebut the presumption by showing no conflict of interest existed.

# ***Aiello v. Hyland***

A trust owned land on which a business was located. The Trustee was a shareholder of the business located on the property. The Trustee attempted to sell the property to a trust beneficiary who was also a shareholder of the business for less than full market value. The court concluded that the Trustee had a conflict of interest and voided the sale.

# ***Barnhart v. Hovde***

The Trustee sold the sole asset of the trust and the sale benefited the Trustee's son and resulted in a detriment to the beneficiaries of the trust. The court voided the transaction.

# Managing Risk

- Make sure Trust expressly authorizes the transaction; if not:
  - Obtain court approval in advance.
  - Obtain beneficiary approval in advance.
  - If transaction occurred already, disclose and obtain beneficiary consent.

# Permitted Transactions

- The following are not voidable if fair:
  - Payment of reasonable Trustee compensation
  - Advance by Trustee to protect trust
  - Employment of professional advisors (even if they are the Trustee or someone related to the Trustee)

# Duty of Impartiality

- The Trustee owes a duty to administer the trust impartially among the beneficiaries.
- Review the trust for guidance
  - Certain beneficiaries may have priority
  - Ascertainable standard or full discretion?
  - Interested Trustee limitation?
  - Consider beneficiary's other resources?
- Obtain Court Approval
- Obtain Consent of Affected Beneficiaries

# Duty to Keep Beneficiaries Informed

- Within 60 days of becoming Trustee of an irrevocable trust, the Trustee must give notice to the “qualified beneficiaries” of the:
  - Trust’s existence
  - The identity of the settlor
  - The right to request a copy of the trust
  - The right to receive accountings

# Duty to Keep Beneficiaries Informed

- Consider the following at the outset:
  - Waiver of future trust accountings.
  - Limiting action for contesting the validity of a revocable trust.
  - Obtaining a release from the duty to institute a proceeding against a prior Trustee.
  - Representation:
    - POA
    - Designated Representative
    - Virtual
    - Court Appointed

# Trust Accountings

- Must provide accountings to qualified beneficiaries annually, on change of Trustee, and on termination of the trust
- Accounting must include:
  - Trust name, the Trustee, and the time period covered
  - Trust transactions
  - Receipts and disbursements
  - Realized gains and losses
  - Identity and value of assets on hand at close
  - All non-contingent liabilities
  - Allocation of receipts and disbursements between income and principal
  - For final accountings, a plan of distribution

# Waiver of Trust Accountings

- Beneficiaries can waive the right to receive accountings.
- Still consider at least providing an “informal accounting” (trust disclosure document) to make the waiver a “knowing waiver” and start the limitations period.
- “Informal accounting” should provide enough information so that the beneficiary could know of a claim or reasonably should have inquired into the existence of a claim.

## Includes:

- Bank and investment account statements.
- Letter from the Trustee to the beneficiary describing transactions of the trust.

# Statute of Limitations

- Benefit of providing trust accounting is the statute of limitations for bringing an action against a Trustee is reduced for actions adequately disclosed.
- Applicable statute of limitations:
  - **No accounting = 40 years after a trust terminates or the Trustee resigns. Extended 30 years for active concealment.**
  - **Accounting with adequate disclosure = 4 years for matters adequately disclosed.**
  - **Accounting with adequate disclosure AND “limitations notice” = 6 months.**
- “Limitations notice”:

*“An action for breach of trust based on matters disclosed in a trust accounting or other written report of the Trustee may be subject to a 6-month statute of limitations from the receipt of the trust accounting or other written report. If you have questions, please consult your attorney.”*

# Statute of Limitations: The Devil is in the Details

- A “limitations notice” will only shorten the statute of limitations for matters “adequately disclosed” by the Trust accounting
- *Turkish v Brody*
  - Recent case
  - Court takes an incredibly broad view of what is necessary for “adequate disclosure” in order to bar a claim for breach of trust
  - May be a case of bad facts make bad law, but currently case has not yet been overturned or limited

# **Final Distributions: Not Necessarily Where The Road Ends**

- Trustee should obtain receipts and releases from all beneficiaries before making the final trust distribution.
- Otherwise, a beneficiary may bring a claim against the Trustee and the Trustee would have no source of funds with which to defend the claim.

# Burden of Proof

- Initial burden of proof is on the beneficiaries to prove a breach occurred which proximately caused an injury. Once established, the burden shifts to the Trustee to demonstrate that the loss or injury would have occurred absent the breach. *Fort Myers Memorial Gardens, Inc. v. Barnett Banks Trust Company, N.A.*
- Trustee has a duty to keep clear, distinct, and accurate records. If the Trustee fails to keep accurate records and accounts, all presumptions are against the Trustee. *Traub v. Traub*

# Exculpatory Clauses

- Clause in a trust relieving a Trustee of liability for breach of trust is valid in Florida, but it does not relieve the Trustee from acts of bad faith or reckless indifference.
- If, however, the Trustee caused the exculpatory clause to be drafted, the exculpatory clause is invalid unless:
  - The Trustee proves that the clause is fair under the circumstances; and
  - The term's existence and contents were adequately communicated directly to the settlor or the independent attorney of the settlor.

# Payment of Attorney Fees: Is it up to the Trustee?

- General Rule: The Trustee can pay reasonable attorney's fees and costs from the trust without court authorization.
- More complicated where Trustee is sued for breach of Trust.
  - Big issue in breach of Trust cases

# Payment of Attorney's Fees in Breach of Trust Actions: Policy Considerations

- Uncontroversial that where a Trustee has clearly engaged in malfeasance, unfair that Trustee uses Trust assets to defend himself or herself in a resulting breach of Trust action
- Flip side of the coin, some breach of trust actions filed against Trustee by beneficiaries out of spite or frustration because they simply disagree with a Trustee's otherwise proper discretionary decision, not fair to make Trustee defend action without access to Trust assets
- However, whether Trustee engaged in malfeasance not always a clear cut issue
  - This is where it gets tricky

# Payment of Attorney's Fees in Breach of Trust Actions: Policy Considerations

- Whether or not Trustee can defend breach of Trust action using Trust assets often has huge strategic implications in the lawsuit
- If Trustee cannot use assets to pay for his or her defense, very likely to force settlement
  - A good thing if Trustee is clearly a bad actor, prevents further waste of trust assets
- However, where case is fairly debatable, maybe not such a good thing
  - In these cases, law should favor resolution on the merits in this case, not based on how deep the Trustee's individual pocket is
- Legislature enacted Fla. Stat. 736.0802(10) to address these competing policy considerations

# Obtaining Authority for Payment of Attorney's Fees In Breach of Trust Actions

## Procedure under Fla. Stat. 736.0802(10):

- 1. Breach of trust claim filed against Trustee**
  - Must be a lawsuit
  - Demand or threat of a claim not sufficient
  - Any fees paid by the trustees prior to the lawsuit being filed cannot be recovered
- 2. If Trustee intends to use trust assets to pay attorney's fees to defend claims, Trustee must provide written notice of the Trustee's intention to do so prior to making any payments.**
  - The notice must be given to all qualified beneficiaries
  - Notice must inform the beneficiary of their rights to apply for an order prohibiting payment and/or compelling the return of such payment, with interest

# Obtaining Authority for Payment of Attorney's Fees In Breach of Trust Actions

**If beneficiary files motion to prohibit Trustee from using Trust assets to pay attorney's fees, Court holds evidentiary hearing**

- Standard of Proof Court required to apply at hearing:
  - Court shall deny the motion prohibiting payment of fees and costs unless it finds a reasonable basis to conclude there has been a breach of trust, and even if such finding is made, the court may still deny the motion upon a finding of good cause.
- Beneficiary has the burden of proof to show Trustee committed a breach of trust.
- Basically a mini-trial in which Court “takes a peek” at the merits of the case.

# Payment of Attorney's Fees In Breach of Trust Actions: Comments

- Statutory “smell test”
- Standard of proof now tends to favor allowing Trustee to use Trust assets to pay attorney's fees, which favors a resolution on the merits for all but the most egregious trustee conduct
- Older versions of the statute put burden of proof on trustee rather than beneficiary

# Payment of Attorney's Fees In Breach of Trust Actions: Case Studies

- *Abromats v. Abromats*
- *Covenant Trust Co. v. Guardianship of Ihrman*
- *But see Kritchman v. Wolk*

# **Payment of Attorney's Fees In Breach of Trust Actions: Final Comments**

- Even if a Trustee successfully defends a motion to prohibit use of trust assets to pay attorney's fees, if Trustee is ultimately found to have committed breach of trust at trial, may still be liable to trust for damages, which could include attorney's fees trust paid
- Fla. Stat. 736.0802(10) only applies to preliminary issue of whether Trustee may use trust assets during the litigation to pay attorney's fees

# Homestead

- Summary of descent rules
- Expenses of maintaining homestead pending its sale or distribution
- Contrast devise of homestead to heirs vs non-heirs
- Order of Homestead Descent

# Questions?

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