AS THE TRUST WORLD TURNS

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INTRODUCTION

Revocable trusts gained in popularity in California because of the perceived ability by both settlors and beneficiaries to avoid the burden of court administration. This result has for the most part been achieved. Proving once again the law of unintended consequences, however, the explosion in revocable trusts has created an exponential increase in trust related litigation. From the author's jaundiced perspective, this growth does not appear to be in imminent danger of slowing.

In common with other disputes related to decedents, powerful family emotions operate as the imponderable factor that can serve as the catalyst for the litigation. Quite often the dispute materializes unexpectedly, when the trustee, and the trustee's advisors, believe that administration is "just humming along." Invariably, the dispute is the result of the lack of skill exercised or knowledge possessed by a nonprofessional trustee. When family resentment that has simmered for a lifetime is mixed with a less-than-perfect trust administration, and the spice of greed is added, the resulting stew will boil over into a dispute as often as not.

I. WARNING SIGNS

Generalizing about legal disputes is always risky, and this caution should especially be exercised when discussing trust administration. Nevertheless, the author perceives five general circumstances that usually contribute, in varying degrees, to the deterioration of a trust administration into a dispute that results in litigation. These five factors are the following:

- Failure To Appreciate the Change in Client Identity
- Greed
- Animus Between Trustee and Beneficiary
- Negligence in Performance of the Trustee's Duties
- Mental Illness and Family Dysfunction

A. *Failure to Appreciate Change in Client Identity*

Problems are often created in trust administrations because a professional advisor fails to appreciate that his or her client has died. Despite the self-evidence of this statement, its obviousness is ignored far more often than one would expect. The paternalistic attitude of the trustee toward the beneficiaries appears as a factor in these disputes with distressing frequency. A belief that the "trustee knows best" because the trustee had a personal relationship with the decedent often lands that trustee in hot water.

Interestingly, the professional group in which this problem most commonly appears is accountants.

Even though the professional may have represented both husband and wife during their joint lifetimes, after the death of the first spouse, that engagement has terminated. The survivor, in the survivor's fiduciary capacity, is not the same client. Nevertheless, the professional often retains the prejudices of the deceased client in dealing with the remainder beneficiaries. The most typical example exists when the remainder beneficiaries are the children of the decedent. Quite often the decedent shared his or her prejudices and opinions of the children, and their spouses, with the professional.

Unfortunately, all too frequently, the professional fails to forget those prejudices during the course of the trust administration. This inability to appreciate that the beneficiaries possess enforceable rights, and for that reason need to be taken seriously, often causes the trustee, as well as the advisors, to come to grief. This attitude, when coupled with any of the substantive problems discussed below, can often compound problems.

When the professional advisor is the successor trustee, this tendency is aggravated. For example, accountants tend to be more willing than lawyers to serve as successor trustees. These accountants will remember the gratitude of their client, now deceased, but will usually fail to appreciate that the decedent's good feeling may not have been inherited by the children or perhaps even the spouse. A trustee who believes that he or she can administer a trust as he or she feels best, subject to fiduciary duties, because "that's what the decedent wanted," usually ends up in litigation. Many examples exist of a conscientious professional encouraging the decedent to enlarge the gift to a child, albeit making it in trust. Unfortunately for that professional, the child who thereby benefited may not be properly appreciative after the death of the decedent.

Similarly, a surviving spouse serving as trustee may be unable to view the remainder beneficiaries in any capacity other than as children. If the remainder beneficiaries are not the children of the surviving spouse, contempt or other ill will may aggravate this lack of regard.

An attorney participating in the trust administration must guard against these attitudes with vigilance. The ideal solution is for the planner to suggest a disinterested third person to serve as trustee. This solution is not popular but does have the appeal of avoiding hostility as an impediment to smooth administration.

B. *Greed*

As counselors, we are all too familiar with greed. In the context of trust administration, greed usually manifests itself either as a complaint of inadequate distributions to the beneficiary or as a complaint of imprudent investment by the trustee. While these two problems may be intertwined, they are not automatically interdependent. Complaints arise in two areas:

1. *Low Income*

Inadequate distributions typically derive from an asset mix that generates a poor yield in a trust with a "net income" provision. In addition, perceived inadequate distributions may also result when the trustee of a discretionary trust is unwilling to finance the beneficiary's lifestyle, for any number of reasons.

Net income provisions theoretically allow the trustee to escape liability for distributing only the income. Unfortunately, beneficiaries too often view "net income" as synonymous with "maximum income." "The beneficiary of a trust to pay income . . . is ordinarily dependent upon the existence of income, the amount received by him fluctuating with the income."[1]

In the current financial market environment, low yielding assets have become commonplace. The remarkable capital appreciation experienced during the last decade has gratified remainder beneficiaries. This same growth has pained the income beneficiaries, however, because yields have become so small. This lack of increase in income may be especially aggravating to the beneficiary of a net income trust. The most common example is the income beneficiary of a QTIP Trust that does not have a principal invasion power.

From a planning perspective, the current financial environment encourages practitioners to draft a "total return trust."[2] From an administration perspective, however, the overwhelming majority of trusts currently being administered are net income trusts. The newly Revised Uniform Principal and Income Act[3] may provide some relief, but will not be a cure-all. In consequence, the author believes that a trustee's inability to provide a satisfactory income to the life beneficiary will serve as a continuing irritant.

2. *Scope of Discretionary Invasion Powers*

Many trusts that are administered in California provide discretion to the trustee to invade principal for specified reasons. Typically, this invasion power is limited to an "ascertainable standard" as enumerated in Internal Revenue Code § 2041 because the trustee is also the income beneficiary. The impact of such a standard in trust administration may not be as straightforward as would appear at first glance. For example, a common assumption among California practitioners is that the state law definition of the ascertainable standard does not impose a meaningful restriction on the exercise of this power by the income beneficiary-trustee. This assumption may be presumptuous.[4]

The trustee who cavalierly invades principal without demonstrating the exercise of reasonable discretion may therefore create exposure toward the remainder beneficiaries.

Conversely, trustees and their advisors also often assume that the trustee's exercise of an invasion power is only subject to judicial review based upon a standard of bad faith or unreasonableness. This assumption may also be presumptuous.[5]

> [W]here the trust provision directs the trustee to disburse portions of the principal for a given purpose, the trustee's authority to pay is not discretionary, but is merely conditional upon the existence of a reasonable necessity for the disbursement to accomplish the purpose. Upon proof of such a necessity, a court will compel the trustee to make the disbursement, and usually will direct him as to the amount to be paid.[6]

On the other hand, beneficiaries often wish to expand the scope of the distribution standard, as, for example, in seeking to compel a principal invasion to fund litigation.[7]

Nevertheless, the author is acquainted with probate judges who have not found *Estate of Marré* to be compelling. This point may become quite important in the course of a trust dispute because beneficiaries often wish to use the trust assets to fund the litigation. Beneficiaries often are equally concerned that the trustee will feel free to use trust property to defend the fiduciary in the course of that same dispute.

The implication of these misperceptions can have important consequences in a trust administration. A trustee who adopts an attitude of "stonewalling" the beneficiaries because their resources to fight are limited may be rudely disabused by the probate court. On the other hand, a beneficiary who successfully persuades the court to order an invasion of principal to assist the beneficiary in pursuing the trustee should soon come to realize that the money being spent is the beneficiary's own.

C. *Animus Between Trustee and Beneficiary*

Hostility, antagonism and inevitable future conflict can justify an order for removal of a trustee when those factors impair the proper administration of the trust.[8] However, courts rarely remove a trustee simply because the beneficiary and the fiduciary cannot get along. Antagonism between the trustee and beneficiaries generally does not warrant removal of the trustee when the settlor contemplated the potential for hostility and conflicts in the trust administration and nevertheless proceeded with the particular plan.[9] On the other hand, if a beneficiary is also able to demonstrate some breach of trust, even if not egregious, the existence of antagonism assumes more importance.[10]

The effect of this case law is often double-edged. Trustees can fulfill their responsibilities without possessing undue concern about unstable beneficiaries. However, this level of protection may cause a trustee to administer the trust arrogantly or insensitively, thereby generating resentment that could otherwise have been avoided.[11]

Approaching this aspect of trust administration may be awkward for professionals who are not educated in the dynamic and psychology of interpersonal relationships or are reluctant to use these tools. Such discomfort may derive from a professional need to be practical and may also be controlled by the financial or legal principles involved in the immediate circumstances of the particular case. Nevertheless, the genuine consequences

of failing to appreciate the powerful motivation these attitudes create can lead to the most disagreeable of disputes.

An objective method by which a trustee, and the trustee's advisors, can forestall such problems is to communicate with the beneficiaries at every reasonable opportunity. For example, a trustee who regularly advises beneficiaries of intended actions has established a control mechanism to reduce the trustee's arrogance. The trustee may consider it bothersome to assume this extra task. In so doing, however, the trustee in effect reminds herself that the trustee is answerable to the beneficiaries. The simple fact of a reminder can reduce the trustee's inclination to become oblivious to beneficiary concerns.

D. *Negligence in the Performance of a Trustee's Duties*

In contrast to the subjective nature of handling animus between a trustee and beneficiary, disputes arising from a trustee's failure to act are usually objectively determinable. The list of a trustee's duties is well known.[12] Consequently, the failure to comply with those duties is easily identifiable. Trustees are bound to a fair exercise of reasonable judgment and to the unselfish exercise of good faith; while supine negligence or willful default will render them liable, mere errors of judgment will not.[13]

The Probate Code permits the trustee to be relieved of liability for breach of trust by provisions in the trust instrument.[14] However, such an exculpatory clause will not be effective to relieve the trustee of liability (1) for breach of trust committed intentionally, with gross negligence, in bad faith or with reckless indifference to the interest of the beneficiary; or (2) for any profit that the trustee derived from the breach of trust.[15] A trustor may so limit the trustee's duties that the trustee does not commit a breach in a particular area, but public policy forbids elimination of liability for profits derived from a breach of a duty that the trustee does have.[16]

Typically, family trustees are not sensitive to these distinctions. Additionally, many trust instruments do not limit a trustee's duties so as to reduce the trustee's liability for a negligent breach of trust. These omissions are usually aggravated by the trustee's apparent inability to understand the actual legal burden of fiduciary duty.

A paramount duty imposed on a trustee, of course, is the duty to carry out the settlor's intent, as expressed in the trust instrument.[17] As axiomatic as this proposition may be, it often is forgotten in a trust administration until the dispute has deteriorated into litigation. The litigation attorneys commonly remind the contentious parties of this fact by seeking to prove their case by reliance on the settlor's "intent." Because violation of any duty the trustee owes the beneficiary is a breach of trust,[18] the trustee will often defend his action by arguing good faith, regardless of the settlor's intent. "A trustee must act in good faith in his dealings with a beneficiary and in carrying out the objects for which the trust was created."[19] Using threats to intimidate beneficiaries will obviously run afoul of this requirement. The definition of what constitutes a threat can often extend to ordinary acts of administration. For example, advising a beneficiary who requests an

audit or a petition for instructions that the cost of a proceeding will be charged to her account qualifies as a threat for which the trustee may be surcharged. [20]

A simple way for the trustee to avoid exposure from alleged negligence is to supply periodic accounts to the beneficiaries. The various aspects of accounts are discussed at greater length below. Oftentimes, however, the information provided by the trustee is inadequate, even when the trustee is well intentioned, and a typical successor trustee is not attuned to the depth of detail required by appropriate compliance with a fiduciary's responsibilities.

Equally common, the professional advisors are similarly ignorant. The trustee may believe that reasonable reliance on the trustee's professional advisors should suffice to protect the trustee. Unfortunately, the trustee may discover the inadequacy of this belief only too late, after the dispute has degenerated into litigation. Ascertaining the quality of advice a fiduciary receives is always an awkward proposition and may be aggravated if it is being done after the fact.

E. *Mental Illness and Family Dysfunction*

That money creates dysfunctional family relations through the generations is axiomatic among trusts and estates lawyers. Paradoxically, however, professional advisors appear to give this fact short shrift in the course of a typical trust administration. This disregard is unfortunate, and counter-productive.

Powerful emotions operate throughout the course of a trust administration. Deep-seated resentments, long-standing rivalries, and profound familial anger may all be present. These factors may simmer below the surface as an administration proceeds and then boil over rapidly if a beneficiary perceives the trustee as taking advantage of the trustee's preferred position.

Several preventive measures are available and should be considered from the onset of a trust administration. One approach is periodic meetings between the trustee and the beneficiaries to discuss trust affairs. The trustee may be reluctant to "share the power" in this fashion, but regular communication provides an opportunity to express concerns and frustrations. Often, the mere ability to express oneself avoids the build up of resentment.

Another possible solution, especially if direct communication is resisted, is to employ a psychological advisor. While using such a professional may strike an attorney as frivolous, the efficacy of this assistance should not be automatically dismissed. Lawyers and accountants are not trained in the dynamics of human psychology, yet we freely admit the importance of this area when advising on family wealth issues. It stands to reason that, if human psychology is having an impact on a trust administration, a professional ought to be retained to address those issues.

II. *POINTS OF CONTENTION*

A. Accounts--The Trustee's Leaky Shield

The Trustee's insensitivity to, or complete ignorance of, the duty to account is usually the procedural catalyst for commencing the dispute. If the trustee and the beneficiaries are close relations, accounts may not even have been prepared. Occasionally, trust instruments will contain express waivers of a trustee's duty to account. The trustee then uses this exculpatory clause to conduct administration in a lackadaisical manner, which in turn leads to beneficiary discontent.

Less egregious is the trustee who prepares periodic accounts, but does so incompletely. This incompleteness as often stems from an ignorance of the requirements as from any malevolent purpose. A trustee's ignorance is often compounded by the accountant's lack of expertise. Generally, accountants are unfamiliar with fiduciary accounting principles. A CPA is likely to treat the Probate Code requirement of following "general accounting principles" as the equivalent of using "generally accepted accounting principles" (GAAP) when the two are not the same. The trustee will also not appreciate the distinction, simply assuming that financial reports prepared by an accountant will qualify as a Probate Code accounting.

Alternately, the trustee may not even hire a professional to prepare the account. The trustee may believe that fiduciary accounting duties can be satisfied by sending a copy of the year-end brokerage statement, sometimes accompanied by a copy of the Form 1041, Fiduciary Income Tax Return. Equally frequently, the income tax return is not provided.

The salient fact in all these situations is that none of these approaches will qualify as accountings for the purpose of running the statute of limitations. Many trust instruments contain a shortened statute of limitations for trustee accounts. For example, the document may provide that a beneficiary who fails to object to an account within the stated time period, e.g. 90 days or 120 days, will be forever estopped from raising any objections. Notwithstanding the severity of this language, the author is dubious that a court would enforce such a limitation if the financial information provided fell short of what is required by the Probate Code.

An account is generally understood to be a bookkeeping system that distinguishes between principal and income. An account should also communicate sufficient detail to inform the beneficiaries of the transactions and investments of the trust.[21] The statutory requirements stem from the development of the duty at common law.[22]

A common misconception surrounds the presumptions governing an account. Trustees are under an obligation to render to beneficiaries a full account of all their dealings with the trust property, and where there has been a negligent failure to keep true accounts, all presumptions are against them.[23] Trustees are also under the duty to prove every item of their account by "satisfactory evidence"; the burden of proof is on them and

not on the beneficiary. Any doubt arising from their failure to keep proper records, or from the nature of the proof they produce, must be resolved against them.[24] This presumption is not limited to accounting matters. The burden is also on the trustees to establish the services rendered by them.[25]

Imposing the burden of proof on the fiduciary may strike practitioners as counter-intuitive. This shift in the burden of proof may also appear contrary to Evidence Code §530, which imposes the burden on the party seeking to prove the issue; i.e. the beneficiary objecting to the account. Nevertheless, when a fiduciary has the legal duty to allocate receipts between those in which a beneficiary has some interest and those in which the beneficiary has none, and is fully and singularly capable of making that allocation but fails to do so, the court is justified in calling on the fiduciary to bear the burden of differentiation at trial.[26]

B. *Reports: The Beneficiary's Dulled Sword*

The ability of a fiduciary to demand a "report" from the trustee can serve as a useful catalyst to prod a recalcitrant trustee. Prob. Code §16061 provides that a beneficiary may request a report at "reasonable" intervals. The author is unaware of any case authority defining the limits of reasonableness. Nevertheless, sensible interpretation of this requirement would imply that such reports might be requested semi-annually. This conclusion stems from the general rule that accounts are to be provided annually. A report encompasses a broader range of information, but with less specificity. Since the information requested is intended to paint a "broad-brush" picture of the trust administration, but as a "snap-shot," the beneficiary ought to be able to request this information more frequently than the annual accounts the trustee is required to provide.

Requesting a report is usually done informally. A petition to compel a report is unlikely, since a beneficiary is more likely to use a petition to compel an account. A trustee who fails to respond timely to a beneficiary's request for a report risks creating a distinctly unfavorable impression to the court in the subsequent contested proceedings. In consequence, the request for a report can serve as an effective tool for the (about-to-be) aggrieved beneficiary to determine the extent of the trustee's misconduct or mistakes.

Conversely, however, a request for a report typically will serve as a signal to the trustee that the beneficiary may be disgruntled. The cautious trustee will therefore realize that the request for a report may simply be the opening skirmish in litigation calculated to remove the trustee or to seek a surcharge on the trustee for breach of fiduciary duty. In such circumstances, the trustee should either prepare a report that can easily be revised to become an account or provide an account. The requested report would include the additional required information, which could easily be separated to become a court-filed accounting.

A prudent trustee might view the information required by a report as a useful guideline in keeping beneficiaries reasonably informed regarding the progress of trust

administration. Using the report on a pre-emptive basis, therefore, can help the trustee avoid contention.

To the contrary, an oblivious or arrogant trustee may stumble into quicksand if he or she pays no attention to the information encompassed in a report or fails to provide this information in a responsive manner. The professional advisor may find it useful to alert the trustee to the requirements of Prob. Code § 16061 as a defensive measure.

C. *Fiduciary Self-Dealing*

A trustee's self-dealing is a surprisingly common cause of contention in trust administration. Usually the self-dealing has continued for a period of time without recognition of its risk by the trustee of knowledge of its value to the beneficiary in a subsequent dispute. The self-dealing is then seized upon by the astute lawyer seeking to obtain an advantage for the beneficiary client whose original complaints may have been directed at another ostensible administration problem.

"The trustee has a duty not to use or deal with trust property for the trustee's own profit or for any other purpose unconnected with the trust, nor to take part in any transaction in which the trustee has an interest adverse to the beneficiary."[27] Trustees often fail to appreciate that, absent an express or implied agreement, a fiduciary who breaches fiduciary duties by self-dealing may not escape liability by showing that the trustee's activities were fair to and in the best interests of the beneficiaries or other fiduciaries.[28] A trustee's self-dealing, which by definition violates the trustee's duty of loyalty, cannot be justified by the good faith of trustee or by evidence of custom and usage because a trustee may not receive any personal advantage without full disclosure to beneficiary.[29] Similarly, there can be no secret profits allowed to a trustee, inasmuch as it owes the beneficiary the duty of fullest disclosure of all material facts.[29]

Self-dealing often arises when the trustee buys or sells trust property[31] or pays himself compensation for services rendered in a non-fiduciary capacity without court or beneficiary approval. The advisor's challenge is to alert the trustee-client that *everything* a trustee does will be viewed through the filter of fiduciary duty.

III. INVESTMENTS

Much has already been written about the Uniform Prudent Investor Act (*UPIA*),[32] which became effective in California on January 1, 1996. The statute is clear and succinct. Its purpose is to provide flexibility to a trustee when administering trust assets over the life of the trust.[33] Certainly the theory of the Prudent Investor Act is to provide clearer protection for a trustee than existed under prior law. The trustee who complies with the procedural guidelines of the Act, and documents that procedure, will not be judged in hindsight.[34] This emphasis on "procedural compliance" imposes a duty on the prudent trustee to establish written investment objectives and guidelines for investment decision making.

This requirement of "procedural compliance" becomes a two-edged sword. Strict observation will provide a substantial amount of protection for a trustee from disaffected beneficiaries. Conversely, failure to observe its formalities will leave a trustee exposed to serious damages if the trust portfolio suffers losses.

Most trustees being human, the author is skeptical that they will comply with *all* the procedural requirements of the UPIA, despite their best intentions. In consequence, a contentious administration will provide ample opportunity for second-guessing. Advance education certainly will assist the trustee in acting defensively, but occasionally even the best intentions go unfulfilled.

A trust portfolio that does not perform to the *beneficiary's* expectations may become fodder for a surcharge action. An argument will generally be available to such a beneficiary because it will be rare for a trust portfolio to have clearly outperformed the market. Since most portfolios do not perform perfectly, even when they perform well, a disgruntled beneficiary will generally have something to utilize in complaining about the trust administration.[35] In such circumstances the importance of procedural compliance becomes even more important.

A trustee must be wary of undue reliance on the settlor's instructions. For example, trust instruments typically contain language exonerating the trustee from liability for retaining assets within the trust on the day the trustee assumes fiduciary responsibilities. Notwithstanding such protection, a trustee who retains such assets for an extended period will do so at the trustee's peril if the assets do not prove to be a successful investment.[36]

In re Estate of Janes concerned a corporate fiduciary that was surcharged for imprudently retaining an asset. The corporate fiduciary had received a trust portfolio in the mid-1970's with Eastman Kodak comprising approximately 90% of the value of the trust estate. The surviving spouse was a co-trustee with a corporate fiduciary. At the time the corporate fiduciary assumed responsibility, Eastman Kodak was generally considered to be a "blue chip" investment. In the 1970's the corporate fiduciary, with the concurrence of the surviving spouse co-trustee, reduced the concentration of Eastman Kodak from 90% to approximately 70% of the value of the total portfolio. Subsequently, the corporate fiduciary retained the Eastman Kodak stock in this high concentration. The investment performance of Eastman Kodak from the late 1970's through the early 1990's was quite poor. In consequence, the value of the portfolio did not appreciate consistent with overall market indexes. Subsequent to the departure of the surviving spouse co-trustee, the remainder beneficiaries sought to have the corporate fiduciary surcharged for the loss in value of the portfolio.

The New York Surrogate's Court held the fiduciary liable for the amount the fiduciary would have earned had it liquidated the concentrated position and reinvested the proceeds. The Court determined the amount of damages by reference to the performance during the same period of one of the corporate fiduciary's own diversified equity funds, rather than by reference to compounded interest at the statutory rate.[37]

Generally, the longer a trust administration has progressed, the greater the risk in retaining assets. This problem is not academic. A common fact pattern has the family business constituting a significant portion of the trust estate. Typically, the younger generation lacks a key management skill to maintain the level of success achieved by the patriarch or matriarch. Usually, all of the members of the younger generation are not managing the business and therefore do not benefit in the same proportion as the operators. Invariably, these facts lead to a dispute between those who are "in" and those who are "out." In those circumstances the "in" group, which usually contains the trustee, will be on the defensive. The trustee may also have difficulty persuading the probate court that retention was indeed prudent.

Similarly, a trustee who diversifies, but who invests poorly, will undoubtedly face exposure from disgruntled beneficiaries. A challenge created by the extraordinary performance of the equities markets during the last decade is increased expectations by beneficiaries. The growth in unrealistic expectations that portfolios will continually increase imposes a dilemma on the trustee. Matching the market may not prevent disputes with greedy beneficiaries. Under-performing the market indices appears to be a guarantee of employment for litigation oriented attorneys. The UPIA serves as a useful opportunity for complaining beneficiaries to add yet another basis for breach of trust to their potpourri of allegations.

A trustee should therefore seek to limit his or her exposure by diligent reliance on the *investment policy statement (IPS)* contemplated by the UPIA. Setting performance criteria in the IPS will protect the trustee if those criteria are met, provided that the criteria are reasonable. Paradoxically, the author believes that setting performance criteria in the IPS will also protect the trustee, even if those criteria are *not* met. If the trust investment performance does not meet the IPS goals, the recovery available to the aggrieved beneficiaries will likely be limited to the difference between the actual performance and the IPS goals. In contrast, a failure to state any goals in the IPS, or the failure to have an IPS at all, will enable the aggrieved beneficiaries to claim a much larger amount, as was done in *Estate of Janes.*

IV. PROBLEM AVOIDANCE POSSIBILITIES

A. Drafting

Reducing the opportunity for disputes is the first goal of every planner. The drafter can reduce the opportunity for an aggrieved beneficiary to create mischief for a trustee. Some of the available methods include use of a gross negligence standard, selective use of a no contest clause, and imposing an abbreviated statute of limitations for objections to a trustee's account. The planner should realize, however, that, in creating shields for a trustee, the planner is establishing obstacles for a beneficiary who may have valid claims.

1. *Gross Negligence*

A gross negligence standard will do much to protect a trustee from a contentious beneficiary. A beneficiary will face a formidable hurdle in proving a breach of trust when the standard exceeds simple negligence. The first obstacle would be persuading the court that the standard contained within the document should be ignored. The second obstacle would be demonstrating that ordinary errors of judgment should be allowed to create liability when the settlor's desires were obviously otherwise. The third obstacle would be persuading the court that the trustee's errors in fact should impose liability for breach of trust.

The author has assumed that the trustee will have not committed breaches constituting gross negligence or intentional misconduct. In such cases, the trustee is more likely to be in court, regardless of the applicable standard in the document.

2. *No Contest Clauses*

Using an *in terrorem* clause as a weapon in the trustee's arsenal can be very effective in avoiding litigation. Simply because this result is so draconian, however, the settlor and the drafter should explore this remedy carefully. The drafter certainly should not include such a clause "willy-nilly," because it will be used by a misbehaving trustee to prevent justified criticism of the trust administration.

Nevertheless, the evolving law of no-contest clauses in California creates interesting possibilities for planners and clients desirous of avoiding contentious trust administrations. The author considers it likely that the settlor can make the beneficiary's *unreasonable* attack on a trust administration a basis for invoking the no-contest clause.[38]

3. *Shortened Statute of Limitations*

Imposing a shortened time period for a beneficiary to object to an account also can limit the ability of a contentious beneficiary to cause trouble. Typically, these clauses provide that a beneficiary who fails to object within 90 or 120 days from receiving an account from the trustee is forever estopped from thereafter objecting. If a beneficiary does thereafter object, the issue will turn on whether the account adequately disclosed the item in dispute. Assuming that the trustee has provided adequate disclosure, drafting an account clause that includes the shortened statute of limitations should be very useful. Nevertheless, readers should take note that the author has been unable to locate any California case construing the effective of a clause imposing this shortened time period.

B. Mediation

Inserting a mediation clause in a trust document can be a useful method to prevent uncontrolled litigation. The parties can control the process, and there is no risk of an

adverse decision[39]. Nothing said during the mediation can later be used as evidence in a trial.[40] The process is confidential, and the parties can speak freely about sensitive issues. The parties are not bound by the rules of evidence. The mediation can take place in any agreed location. The resulting settlement can sometimes afford the parties a form of relief that would not be available in court. Additionally, a settlement resulting from mediation can avoid much of the high cost of trial preparation.

Since most trust and estate disputes occur within families, the mediation process sometimes permits people to confront and resolve "hidden" issues in a manner that preserves relationships.[41] "Some parties to a dispute may be less concerned about property issues than about an opportunity to air grievances, receive an apology, or get an explanation for behavior that upsets them. Mediation provides an outlet for those emotions and an opportunity to resolve emotional issues as well as legal issues. In addition to the potential emotional benefits of mediation, parties using mediation to resolve their dispute may avoid some of the emotional costs of litigation."[42] A successful mediation might also preserve the family's relationship with an advisor who has represented family members for many years and can still be seen as the family counselor.[43]

V. CONCLUSION

If an effective trust administration were to be graphed, with one axis the fiduciary's protection, and the other axis the beneficiary's satisfaction, with cost as the variable, an administration that fell precisely in the middle would be considered the "least unsuccessful." A trustee who exercised prudence to the nth degree would incur administration costs that many reasonable observers would consider excessive. Similarly, a trust administration in which a beneficiary was entirely content would more likely than not cause the trustee to conduct an administration that could be dangerously imprudent. For example, making principal distributions would be likely to please the current beneficiary, but could create substantial exposure to the trustee from the remainder beneficiaries. The attached chart attempts to provide visual demonstration of this theory.

Unsurprisingly, no panacea exists to avoid the problems discussed in this article. The most useful guideline the author has discovered in reducing the risk of a trust administration turning into litigation is communication. Although there are exceptions, generally, the more communication between the fiduciary and the beneficiary, the less likely litigation.[44]

BENEFICIARY SATISFACTION

COST
OF
ADMIN-
ISTRATION

FIDUCIARY DILIGENCE

• California Trust and Estate Counselors, LLP; Orinda, California

[1] *In re Markham's Estate* (9146 28 Cal.2d69, 168 P.2d 669

[2] See, for example, Hoisington, William L., *Modern Trust Distribution Design and Implementing Investment Strategies*, 1998 CEB Estate Planning Institute; Wolf, Robert B., *Total Return Trusts-Can Your Clients Afford Anything Less?* 33 Real Property, Probate & Trust Journal 327 (1998)

[3] As of this writing the Revised Uniform Principal and Income Act has been adopted by several states, including California. The new RUPIA would allow a trustee to adopt the total return approach, even when the language of the instrument provided for a net income approach.

[4] See, e.g., *In the Matter of the Estate Of John W. F. Smith*, (1981) 117 Cal.App.3d 511, 172 Cal.Rptr. 788 (grant of absolute discretion does not relieve trustee of duty to account within reasonable boundaries of distribution power circumscribed in ascertainable standard)

[5] *In re Marré's Estate* (1941) 18 Cal.2d 191, 114P.2d 591

[6] *In re Greenleaf's Estate* (1951) 101 Cal.App.2d 658, 225 P.2d 945

[7] *In re Marré's Estate* (1941) 18 Cal.2d 191, 114P.2d 591

[9] *In re Memorial National Home Foundation* (1958) 162 Cal.App.2d 513, 329 P.2d 188

[10] *Copley v. Copley* (1981) 126 Cal.App.3d 248, 178 Cal.Rptr. 842

[11] For an excellent example of a beneficiary run amok *see Wells Fargo Bank v. Boltwood*, 49 Cal.App.4th 1320; 57 Cal.Rptr.2d 335 *Review Granted*

[12] Prob. C. §16000: *On acceptance of the trust, the trustee has a duty to administer the trust according to the trust instrument and, except to the extent the trust instrument provides otherwise, according to this division.* Prob. C. § 16003: *If a trust has two or more beneficiaries, the trustee has a duty to deal impartially with them and shall act impartially in investing and managing the trust property, taking into account any differing interests of the beneficiaries.* Prob. C. § 16040: *The trustee shall administer the trust with reasonable care, skill, and caution under the circumstances then prevailing that a prudent person acting in a like capacity would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the trust as determined from the trust instrument.*

[13] *Ainsa v. Mercantile Trust co. of San Francisco* (1917) Cal. 504, 163 P.898

[14] Prob. C. §16461(a)

[15] Prob. C. §16461(b)

[16] *See* Restatement (Second) of Trusts § 222 comments b & C (9157)

[17] *In re Merchant's Estate* (1904) 143 Cal. 537, 77 P. 475

[18] Prob. C. §16400
[19] *Horne v. Title Ins. & Trust Co*.,(S.D.Cal.1948) 79 F.Supp. 91
[20] *Estate of Gump* (1991) 1 Cal.App.4th 582, 2 Cal.Rptr.2d 269
[21] Probate C. §16061
[22] See *Estate of DeLaveaga* (1958) 50 C.2d 480, *Coberly v. Superior Court* (1965) 131 Cal.App.2d 685)
[23] *Purdy v. Johnson*, 174 Cal. 521 [163 P. 893]
[24] *Purdy v. Johnson,* supra; *In re McCabe's Estate* (9148) 87 Cal.App.2d 430, 197 P.2d 35
[25] *In re McLaughlin's Estate* (1954) 268 P.2d 519 *subsequent* 43 Cal.2d 462, 274 P.2d 868
[26] *Rosenfield, Meyer & Susman v. Cohen* (1987) 191 Cal.App.3d 1035, 237 Cal.Rptr. 14
[27] Probate C. §16004(a).
[28] *Broffman v. Newman* (1989) 213 Cal.App.3d 252, 261 Cal.Rptr. 532
[29] *Van de Kamp v. Bank of America Nat. Trust & Sav. Ass'n* (1988) 204 Cal.App.3d 819, 251 Cal.Rptr. 530
[30]*Estate Of Clifford B. Pitzer* (1984) 155 Cal.App.3d 979, 202 Cal.Rptr. 855.
[31] *See e.g*. *Estate Of Howard* (1955) 133 Cal.App.2d 535, 284 P.2d 966 [guardian sold minor's jewelry to himself through another for below appraised value]
[32] Probate C. §§ 16002(a), 16003, 16045-16054.
[33] See Raskin, John D., "*Some Observations on Compliance with the California Prudent Investor Act*" 19 CEB Estate Planning and California Probate Reporter 32 (October '96); Hartog, John A. and Sanderson, Paul, "*A Trustee's Crime and Punishment: Managing Fiduciary Liability under the California Prudent Investor Act*", 4 California Trusts and Estates Quarterly 4 (Summer 1998); Hartog, John A. and Sanderson, Paul, "*Fiduciary Delegation of Investment Power under the California Uniform Prudent Investor Act*", 5 California Trusts and Estates Quarterly 4 (Spring 1999)
[34] Prob. C. § 16051
[35] *Noggle v. Bank of America* (1999) 70 Cal.App.4th 853, 82 Cal.Rptr.2d 829
[36] In re *Estate Of Janes*, 165 Misc.2d 743, 630 N.Y.S.2d 472 (Sur. 1995)
[37] In re *Estate Of Janes*, 165 Misc.2d 743, 630 N.Y.S.2d 472 (Sur. 1995)
[38] *See Estate of Ferber* (1998) 66 Cal. App. 4th 244, 248, 255, 77 Cal. Rptr. 2d 774 (clause imposing forfeiture for any unsuccessful attempt to remove executor, for refusal of executor's request to assist in defense of any contest, etc.)
[39] Hettig, David W. and Klingler, Michael E. "Mediating Probate & Estate Disputes," *California Trusts and Estates Quarterly,* Vol. 2, No. 3, Fall 1996, page 18. *See also* Sochynsky, Yaroslav "Mediating Real Estate Disputes," *Probate and Property,* July/August 1998 (Vol. 12, No. 4), page 23. The latter article, though it deals with real estate disputes, is an excellent discussion of the benefits and effective use of mediation. The concepts discussed apply equally to the mediation of trust and estate disputes.
[40] E.g., California Evidence Code Section 1152.5.
[41] "Disputes over property or legal rights often carry with them unacknowledged emotional issues. The way in which the family resolves the dispute may determine not only the property rights, but also whether the family will survive or suffer irreparable damage." Gary, Susan N. "Mediation and the Elderly: Using Mediation to Resolve Probate Disputes over Guardianship and Inheritance," *32 Wake Forest L. Rev. 397* (Summer 1997).
[42] Id. at 427.
[43] For a very useful discussion of arbitration and mediation in a trusts and estates practice see Landon, Robert D.W. and McDonnell, John L. "Understanding the Applicable Law and use of ADR (Including Mediation and Arbitration) in Wills and Trusts Contests" 1999 ACTEC Annual Meeting Program.
[44] *Noggle v. Bank of America* (1999) 70 Cal.App.4th 853, 82 Cal.Rptr.2d 829.