Identifying Landmines and Minimizing Battle Scars in Conflicts Between Trustees and Beneficiaries

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A. Attorney-Client Privilege and the Fiduciary Exception – In General

One special problem related to the extent of the Trustee's duty to beneficiaries is when and to what extent the Trustee must disclose to the beneficiaries or successor Trustees the Trustee's communications with the Trustee's lawyer concerning trust matters. Comment f to Restatement (Third) of Trusts ("Restatement Third") § 82 states that:

> The trustee is privileged to refrain from disclosing to beneficiaries or co-trustees opinions obtained from, and other communications with, counsel retained for the trustee's personal protection in the course, or in anticipation, of litigation (*e.g.*, for surcharge or removal). This situation is to be distinguished from legal consultations and advice obtained in the trustee's fiduciary capacity concerning decisions or actions to be taken in the course of administering the trust.

In *Jacob v. Barton*, 877 So.2d 935 (Fla. Dist. Ct. App. 2004), a beneficiary sued a Trustee over alleged mismanagement of a trust's funds. The Florida district court's decision upheld the attorney-client privilege with respect to the Trustee's lawyer's billing records. The court reasoned that the Trustee hired the lawyer to defend her in the dispute with the beneficiary. Therefore, the Trustee, and not the beneficiary, was the client.

The attorney-client privilege in the context of a Trustee's retention of a lawyer is not absolute. Some states' laws recognize a "fiduciary exception" to the attorney-client privilege. The fiduciary exception generally provides that a lawyer may not withhold attorney-client communications from trust beneficiaries or successor Trustees if the communication relates to administration of the trust and the lawyer's services are paid for using trust assets. *See* Skidmore & Morris, *Whose Privilege Is It, Anyway? The Fiduciary Exception to the Attorney-Client Privilege*, 27 Prob. & Prop. 21 (Sept./Oct. 2013); *Riggs Nat'l Bank of Washington, D.C. v. Zimmer*, 355 A.2d 709 (Del. Ch. 1976). Other states have expressly rejected or limited the fiduciary exception by statute, essentially rejecting the idea that the beneficiaries are automatically clients of the Trustee's lawyer. *See, e.g.*, Fla. Stat. § 90.5021; N.Y.C.P.L.R. § 4503(a)(2); Ohio Rev. Code Ann. § 5815.16.

Courts in other states have carved out exceptions to the attorney-client privilege for beneficiaries and have required disclosure of otherwise privileged communications between the

Trustee and the Trustee's lawyer. These courts believe that the professional responsibilities of the Trustee's lawyer run through to the beneficiaries. In *Follansbee v. Gerlach*, 56 Pa. D. & C. 4th 483 (2002), the Court of Common Pleas of Pennsylvania held that there was no attorney-client privilege with respect to communications regarding the management of the trust. The court reasoned that trust law imposes a duty on Trustees to share with the beneficiaries information relating to the trust, including opinions of lawyers that guide the Trustee in his or her administration of the trust. The decision also stated that, on the other hand, if a conflict arose between a beneficiary and a Trustee, and the Trustee hired his or her own independent counsel, paid for by his or her private funds and not out of the trust's assets, their communications would be privileged.

Whether or not communications between the Trustee and the Trustee's lawyer are privileged, the Trustee generally is still bound by his fiduciary duty to disclose material facts regarding the administration of the trust to the beneficiaries. Thus, the Trustee or the Trustee's lawyer must consider whether this duty will be met if the Trustee and the lawyer do not disclose certain communications.

B. Court Applies Fiduciary Exception to a Corporate Trustee's Attorney-Client Privilege

Hammerman v. The Northern Trust Company, 329 P.3d 1055 (Ariz. App. 2014)

Northern Trust Company ("Northern") served as Trustee of a trust under Section 3.4 of the Dorothy B. Kipnis Survivor's Trust Agreement (the "Section 3.4 Trust"). Jane Kipnis Hammerman ("Jane") was the sole beneficiary. A dispute arose between Jane and Northern regarding the sale of real estate held by the Section 3.4 Trust. Jane removed Northern as Trustee and appointed Bank of Arizona as successor Trustee. Jane and Bank of Arizona requested from Northern files regarding its administration of the Section 3.4 Trust. Northern produced most of its files but withheld certain electronic mail messages that it claimed were subject to the attorney-client privilege. These electronic mail messages concerned the conflict between Northern and Jane regarding the real estate. Bank of Arizona and Jane filed a petition to compel Northern to produce the electronic mail messages, and the trial court ordered Northern to produce these documents.

The Arizona Court of Appeals discussed Ariz. Rev. Stat. § 14-10813(A), part of Arizona's version of the Uniform Trust Code ("UTC"), which states that a Trustee has a duty to "keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and the material facts necessary for them to protect their interests." The Court of Appeals also cited to Restatement Third § 82, cmt. f, stating that legal advice obtained in the Trustee's fiduciary capacity is subject to the general rule requiring disclosure of "information that is reasonably necessary to the prevention or redress of a breach of trust or otherwise to the enforcement of the beneficiary's rights." The Court of Appeals adopted the rule of Restatement Third § 82, stating that a Trustee has a duty to disclose "legal consultations and advice obtained in the trustee's fiduciary capacity concerning decisions or actions to be taken in the course of administering the trust."

Relying on *Riggs Nat'l Bank of Wash. D.C. v. Zimmer*, 355 A.2d 709 (Del. Ch. 1976), the Court of Appeals stated that it would determine whether a Trustee sought legal advice in a fiduciary capacity by analyzing whether: (1) the Trustees had sought legal advice that would benefit only the trust, not the Trustees personally (*i.e.*, in defense of claims against beneficiaries); (2) the Trustees had paid for that advice with trust funds, not the Trustees' personal funds; and (3) there was no adversarial proceeding pending against the Trustees, which means that there was no need for the Trustees to seek advice in a personal capacity.

The Court of Appeals stated that the fiduciary exception to the attorney-client privilege does not apply "when a trustee seeks legal advice in a personal capacity on matters not of trust administration, as opposed to in a fiduciary capacity on matters of trust administration," relying on *United States v. Mett*, 178 F.3d 1058 (9th Cir. 1999), and Restatement Third § 82, cmt. f. The Court of Appeals therefore reversed and remanded the trial court's decision to consider whether the legal advice was obtained by Northern in its corporate or fiduciary capacity.

In a footnote, the Court of Appeals discussed the ethical duties of a lawyer who represents a Trustee in both a personal capacity and in matters of trust administration, stating that a lawyer "quickly may be faced with a conflict of interest between the trustee's individual interests and the interests of the trust."

The Court of Appeals then addressed the scope of a Trustee's attorney-client privilege as against a successor Trustee. As in the context of disclosures to a beneficiary, the Court of Appeals held that disclosure to the successor Trustee of otherwise privileged communications is required insofar as such communications involve the Trustee's seeking legal advice in its fiduciary capacity on matters of trust administration. In turn, a successor Trustee succeeds to all the duties of the predecessor Trustee, including the duty to disclose information to the beneficiaries. Where the communications in question include legal advice obtained in the Trustee's fiduciary capacity concerning actions to be taken in trust administration, a predecessor Trustee may not assert the attorney-client privilege regarding such communications to prevent disclosure to a successor Trustee.

The Court of Appeals believed that disclosure was necessary in this context to ensure the effective administration of a trust after a change of Trustee, as well as allowing the successor Trustee to protect the beneficiaries' interests. Accordingly, the Court of Appeals reversed and remanded the trial court's decision on this issue as well.

C. Court Rejects Claim That Communications Related to Potential Fiduciary Liability Were Subject to Attorney-Client Privilege

Morgan v. Superior Court, 23 Cal. App. 5th 1026 (May 29, 2018)

Beverly C. Morgan ("Beverly") restated the governing instrument for her revocable trust (the "Trust") in 2013. She named one of her three children, Thomas E. Morgan III ("Thomas"), as successor Trustee to serve after Beverly failed to act as Trustee.

Beverly died in 2014. Beverly's daughter, Nancy M. Shurtleff ("Nancy"), filed a petition essentially seeking to invalidate the Trust and remove Thomas as Trustee. Nancy alleged that Thomas engaged in self-dealing by using Trust funds to pay his personal lawyers and other personal expenses. The trial court suspended Thomas as Trustee and designated two non-family members, Bruce and Lee Ann Hitchman ("the Hitchmans"), as interim Co-Trustees. The court ordered Thomas to turn over all records related to the Trust, including communications with third-parties, to the Hitchmans. Thomas refused to turn over lawyer invoices and other documents related to the payment of lawyer fees, relying on a provision in the Trust instrument stating that a former Trustee may withhold from a successor Trustee all of the former Trustee's communications with legal counsel. The trial court again ordered Thomas to turn over all such documents. Thomas sought a writ of mandate and/or prohibition from the Court of Appeals relieving him from the trial court's order requiring him to turn over such documents.

The California Court of Appeals denied Thomas' writ. The court reasoned that the attorney-client privilege vests in the office of the Trustee, not in any particular person. The appellate court held that a trust instrument may not allow a former Trustee to withhold from a successor Trustee all communications between that former Trustee and his legal counsel. The Court of Appeals found such a provision violated public policy because it would "permit a trustee to intentionally (or with gross negligence or reckless indifference) violate duties with no check on his or her conduct." The Court found this provision was similar to an overly-broad exculpatory clause, such as a provision that relieves a Trustee from liability for actions taken in bad faith.

Under California law, a Trustee's communications with legal counsel regarding potential fiduciary liability may be protected by the attorney-client privilege if he retained separate counsel and paid such counsel's fees from his personal funds. *See Moeller v. Superior Court*, 947 P.2d 279 (Cal. 1997). However, there was no evidence that Thomas took any steps to separate the advice he received for his personal benefit from advice he received for trust administration matters.

II. Trends in Fiduciary Liability Case Law

A. Beneficiary Standing: Court Allows Beneficiary to Bring Claim Against Successor Trustee of Revocable Trust When Grantor Alive and Not Deemed Incapacitated

Brody v. Deutchman (In re Brody Living Trust), 2018 Mich. App. LEXIS 2971 (August 7, 2018)

Rhea Brody was the settlor of the Rhea Brody Living Trust (the "Trust"). Rhea resigned as Trustee because of diminished capacity but was never adjudicated as lacking capacity. Her husband, Robert Brody, became successor Trustee. The Trust instrument provided that, upon Rhea's death, if Robert survived her, the Trust would be administered for Robert's benefit. Upon Robert's subsequent death, the Trust would be divided into equal shares for the benefit of Rhea's son, Jay, and Rhea's daughter, Cathy.

The Trust owned interests in two family businesses. Robert, as Trustee, entered into a series of transactions with Jay involving these interests. The transactions included granting an option to Jay to purchase a business interest and a sale of business assets to Jay on favorable terms. Cathy did not engage in any transactions involving the Trust's business interests. Cathy sued Robert for breach of fiduciary duty because he favored Jay over Cathy to the detriment of both the Trust and Cathy.

The trial court dismissed Cathy's suit for lack of standing. The Michigan Court of Appeals found that Cathy had standing despite Rhea's being alive and not adjudicated and the Trust's being revocable. The Supreme Court of Michigan disagreed and remanded the case to the Court of Appeals for reconsideration.

Under Michigan law, claims may be brought against a Trustee by an interested person. An "interested person" is a "child…and beneficiary and any other person that has a property right in or claim against a trust estate. Identification of interested persons may vary from time to time and shall be determined according to the particular purposes of, and matter involved in, a proceeding and by the supreme court rules." MCL § 700.1105(c). The Court of Appeals determined that Cathy, despite being a contingent beneficiary, qualified as an interested person by virtue of being a child of the settlor. The Court of Appeals found that the phrase "and any other person that has a property right in or claim against the trust estate" did not limit the type of child who may be an interested person. The Court of Appeals therefore affirmed its initial ruling that Cathy had standing to pursue her claims against Robert.

B. Trust Investments

1. <u>Trustee Did Not Breach Fiduciary Duty Where Stock Portfolio Lost Value During Financial Crisis</u>. In *In Re Estate of Joseph Grahek*, 2017 Pa. Super. Unpub. LEXIS 1618 (2017), *affirming* 2017 Pa. Dist. & Cnty. Dec. LEXIS 905 (2017), Joseph Grahek created a testamentary trust for the benefit of his wife, Marion, for her life, and thereafter for the benefit of his two sons, David and Philip. The trust's asset was income-producing property in Orange County, California, which was sold in 2006 under threat of eminent domain from the Orange County School District. The Trustee intended ultimately to reinvest the sale proceeds in like-kind property to postpone capital gains tax. The Trustee invested $2.1 million of the sale proceeds of the property in money market accounts and invested the remaining $6.5 million in a stock portfolio. Before the Trustee was able to purchase a replacement property, the financial crisis of 2008 occurred, and the trust's stock portfolio lost some of its value. David and Philip petitioned to remove the corporate Trustee and agreed to serve as Trustees *pro tem*. During this time, they purchased two replacement properties and did not pay capital gains tax.

David and Philip subsequently filed suit in the Orphans' Court, arguing that the Trustee was obligated to keep all funds from the sale of the original property liquid and available to purchase a replacement property and that the Trustee was therefore liable for losses in the stock portfolio resulting from the 2008 financial crisis.

The Orphans' Court found no breach of fiduciary duty. The court believed that the 2008 financial crisis was unforeseeable. The court found the Trustee complied with the Prudent Investor Rule by maintaining investments in the stock market, despite the need for liquidity, to provide adequate income for Marion, while simultaneously growing principal seeking to benefit David and Philip. The court also found it was reasonable for the Trustee to maintain a partial reserve of cash in the money market accounts as a "contingency plan" in the event that a replacement property could not be found and purchased -- with the result that capital gains tax would then be due. On appeal, the Superior Court affirmed and adopted the Orphans' Court opinion in its ruling.

2. **<u>Court Finds That Trustee Did Not Breach Duty to Remainder Beneficiaries</u>.** In *Carter v. Carter*, 965 N.E.2d 1146 (Ill. App. 2012), a trust was created for the deceased grantor's second wife ("Spouse"). Spouse was to receive all of the income from the trust. No principal distributions were permitted during Spouse's lifetime. Upon Spouse's death, the trust remainder was to be distributed to the grantor's daughter ("Daughter"), who was Spouse's stepdaughter. Spouse was named as the Trustee of the trust. The trust instrument granted the Trustee the ability to make a wide variety of investments, "regardless of diversification and regardless of whether the property would be considered a proper trust investment." Spouse, as Trustee, invested all of the trust property in tax-free municipal bonds. Daughter filed suit against Spouse for breach of the following fiduciary duties: Duty of impartiality, duty of prudent investment, duty to manage trust assets properly and duty to preserve trust property.

The Illinois Appellate Court held that Spouse's investment of the trust property was consistent with the decedent's intent, and that Spouse's actions were not "wholly unreasonable and arbitrary." The Trustee had broad investment authority, and the court concluded that the trust instrument allowed Spouse, as Trustee, to make whatever investments were necessary to maximize income and that no provision of the trust instrument required the Trustee to grow or preserve principal for Daughter.

C. Trust Distributions

1. **<u>Trustee Abused Discretion in Refusing to Make Discretionary Distributions</u>**. In *In re the G.B. Van Dusen Marital Trust Under the Grosvenor B. Van Dusen Revocable Trust Agreement Dated December 17, 1981, As Amended*, 834 N.W.2d 514 (Minn.App. 2013), Grosvenor B. Van Dusen ("G.B.") established a marital trust for the benefit of his wife, Virginia, and directed the Trustee to pay the income to Virginia for her life. The trust instrument further provided that the Trustee had discretion to distribute principal to Virginia for her health, education, maintenance and care. The trust instrument stated that G.B. intended for the Trustee to distribute principal to Virginia to enable her to maintain the standard of living

to which she was accustomed and to exercise his distribution discretion liberally. The Trustee denied multiple principal distribution requests, and Virginia filed a petition for relief.

The Minnesota Court of Appeals, reversing the trial court, held that the Trustee's denials of Virginia's requests for distributions of principal constituted an abuse of discretion. The court found that G.B.'s dominant intention was to provide for Virginia so as to maintain her standard of living without concern for the preservation of principal, and the Trustee's denial of Virginia's requests was contrary to that intent. The court also determined that the Trustee had a duty to determine Virginia's standard of living at the time of any request for a distribution of principal. Furthermore, although the Trustee had the discretion to consider Virginia's other resources, the Trustee was not permitted to withhold distributions contrary to G.B.'s direction to make liberal distributions of principal to maintain Virginia's standard of living.

2. Corporate Trustee Did Not Violate Duties of Impartiality and Prudent Investment. In *O'Riley v. U.S. Bank, N.A.*, 412 S.W.3d 400 (Mo.App. W.D. 2013), the Trustee of a non-marital trust had discretion to make distributions of income to the settlor's wife, Arlene, and to the settlor's descendants for their care, support, maintenance and welfare. Principal could also be distributed to the same individuals to the extent their income and other financial resources were insufficient to provide for such purposes. Regarding distributions, the Trustee was directed to favor the interests of Arlene over the interests of the settlor's descendants. Upon Arlene's death, the trust property was to be distributed to the settlor's then living descendants. The Trustee honored Arlene's annual requests for distribution of all of the net income to her. The Trustee approved a request for a distribution of principal to one of the settlor's sons but denied two other requests from the same son. The sons sued the Trustee for breach of its duty of impartiality, arguing that the Trustee, by making distributions of all of the net income to Arlene essentially put the trust on "auto-pilot." The sons maintained these income distributions were unreasonable because the Trustee failed to examine and balance all of the beneficiaries' needs and resources.

The Missouri Court of Appeals found that the Trustee's decision to distribute all net income to Arlene each year in accordance with her requests, even though there was no remaining net income for the settlor's descendants, was reasonable. The Trustee engaged in a reasoned and well-documented process that the Trustee used periodically to evaluate its distribution decisions. The appellate court explained that Arlene was the preferred beneficiary, and the Trustee was not required to balance Arlene's needs against the needs of the settlor's descendants.

III. Removal or Resignation of a Trustee

A. Beneficiary's Right to Remove a Trustee

It is generally good practice to provide in a trust instrument for some person, whether the settlor, the settlor's spouse, the beneficiary or some other person, to have the authority to remove and replace the Trustee. This power may have a unique purpose with respect to a corporate Trustee, which, through mergers or otherwise, may not be the same institution as the settlor originally appointed. To avoid the tax consequences of providing the settlor or a beneficiary with an unfettered power to remove and replace a Trustee, such a power may be restricted (*see* Rev. Rul. 95-58, 1995-2 C.B. 191) or given to an independent third party, sometimes referred to as a "trust protector."

If a beneficiary has the sole authority to remove the Trustee and appoint a successor, there will be temptation to remove the Trustee whenever the beneficiary does not get his or her every wish satisfied, resulting in a "revolving door" for the Trustees. In addition, there will be a severe conflict of interest with the other beneficiaries. To avoid this problem, the trust instrument can provide that the power to remove and replace a Trustee will be held jointly by the beneficiary and an independent party or by the beneficiary with approval of an independent party. Alternatively, the trust instrument can give the beneficiary the ability to appoint an independent Trustee or special trustee if needed.

If the trust instrument is silent with regard to Trustee removal, a Trustee may be removed only by a court and only upon a clear showing of sufficient grounds. Sufficient grounds for the removal of a Trustee include, but are not limited to, abuse of the office of Trustee, wrongdoing in the administration of the trust, legal incapacity and demonstrated unfitness, such as habitual substance abuse. A mere showing of conflict of interest or hostility between the beneficiaries and the Trustee is generally not sufficient grounds, standing alone, to remove a Trustee. *See, e.g.*, Restatement Third § 37 & cmt. e; UTC § 706.

Factors that affect the fitness and suitability of a Trustee include but are not limited to: (1) conflicts of interest; (2) inability to perform fiduciary duties with care and skill; (3) substance abuse; (4) inadequacies in investment matters; (5) commission of a crime, particularly one involving dishonesty; and (6) changes in the place of trust administration or location of beneficiaries. Restatement Third § 37, cmt. e; UTC § 706.

B. Beneficiaries' Consents, Waivers and Releases

Trustees and beneficiaries sometimes enter into release and indemnification agreements (a "release") that exonerate the Trustee from liability for any breaches of trust and indemnify the Trustee for costs that may arise while winding up the trust, upon either termination or partial termination of the trust or upon the Trustee's resignation. This approach is often preferred to the alternative of the Trustee's filing accountings with and seeking to have them approved by a court of competent jurisdiction – a time-consuming and expensive proposition.

UTC § 1009 provides that a Trustee may be protected from liability if the beneficiary consented to or ratified the conduct at issue or released the Trustee from liability, provided that the Trustee did not engage in any improper conduct in securing this protection and the beneficiary knew the material facts related to the breach. *See also* UTC § 817(c); Restatement of the Law (Second) of Trusts ("Restatement Second") §§ 216-218; Restatement Third § 97. A representative of the beneficiary may also execute a release on the beneficiary's behalf. *See* UTC § 1009, cmt.

In *Hastings v. PNC Bank*, 54 A.3d 714 (Md. 2012), while winding up a trust, PNC Bank, N.A. ("PNC") sent the remainder beneficiaries an accounting of the entire trust and a "Waiver, Receipt, Release and Indemnification Agreement" along with a letter directing that, if they approved of the accounting, they should sign the agreement and return it to PNC. The agreement also contained a provision that released PNC from liability and provided indemnification to PNC for expenses related to the trust termination. In addition, the letter stated that PNC would distribute the trust assets upon execution of the agreement.

PNC's position was that it was not conditioning the distributions on execution of the agreement but rather was presenting an alternative method for concluding trust administration (the other alternative being for PNC to obtain the release and indemnification it sought by petitioning a Maryland court to approve a final accounting).

Three of the remainder beneficiaries (the "Petitioners") filed suit against PNC, seeking a judgment declaring PNC's "demand" for the execution of the agreement to be unlawful on the grounds that the terms of the agreement, particularly the indemnification provision, were "over-broad" and extended PNC more protection than was otherwise available to it under Maryland law. The Petitioners also alleged that, in requesting the agreement, PNC had breached is basic fiduciary duty of good faith.

The Court of Appeals of Maryland (Maryland's highest court) relied on common law in rejecting these claims and holding that PNC's actions were lawful. The Court noted that "a trustee may engage in a self-interested course of action so long as the beneficiaries provide valid, informed consent" and that a Trustee, therefore, must be able to request such consent. Not to be overlooked is the Court's observation, in a footnote, that the language of the indemnification provision that purported to protect PNC "in its role as trustee and in its corporate capacity" would "not extend protection to other services provided to the Trust by PNC," such as broker's services.

Courts remain split as to whether a Trustee may condition distributions on the execution of a release provided all relevant information has been disclosed to the beneficiaries. In the absence of a statute addressing whether a Trustee could condition distributions on execution of a release, the Michigan Court of Appeals in *In re Stout Trust*, 2014 Mich. App. LEXIS 137 (2014), *affirmed in part, reversed and remanded on other grounds*, 2015 Mich. App. LEXIS 2386 (2015), held that the language of a trust instrument did not allow the Trustee to condition mandatory distributions on the execution of a release. The Michigan Trust Code permits a beneficiary to release the Trustee from liability for breaches of trust, but the statute could not be interpreted to "give the trustee the authority to require a release as a condition to a beneficiary's receipt of the distribution that he or she is entitled to pursuant to the terms of a trust." *See also, e.g.*, *Allen v. Ritter*, 35 A.3d 443 (Md. 2011) (holding that Maryland statutes provided executor the right to request a release before making a distribution that had already been court approved so long as the release was not a product of "fraud, material mistake or substantial irregularity" because without a release the executor could still be sued for claims related to the distribution and have no assets to fund a defense); *but see Bellows v. Bellows*, 196 Cal. App. 4th 505 (2011) (holding that a Trustee could not provide that cashing a check was acceptance of the terms of a receipt and release when California statutes do not permit the withholding of mandatory distributions and a previous court order required the distribution).

C. Court Rejects Modification of a Trust to Remove Trustee

In Re Trust Under Agreement of Taylor, 164 A.3d 1147 (Pa. 2017)

In 2013, three beneficiaries of a trust established several decades earlier by their grandfather petitioned the Orphans' Court to modify the trust instrument to add a provision giving themselves the authority, without court approval, to remove and appoint corporate Trustees at their discretion. The petition invoked 20 Pa.C.S.A. § 7740.1, which provides all beneficiaries, coming together, to petition the court to modify a trust as long as the modification does not violate a material purpose of the trust. Wells Fargo, the current Trustee, opposed the petition and moved for judgment on the pleadings, arguing that the Trustee must be removed, if at all, only in accordance with 20 Pa.C.S.A. § 7766, which is the provision of Pennsylvania's Uniform Trust Act dealing specifically with Trustee removal. 20 Pa.C.S.A. § 7766, very similar to UTC § 706, requires, among other things, court action to remove a Trustee.

The Orphans' Court found in favor of Wells Fargo. On appeal, the Superior Court reversed the decision of the Orphans' Court and ruled that the Orphans' Court could modify the trust to insert a provision allowing beneficiaries to remove and replace the Trustee.

The Supreme Court of Pennsylvania reversed the Superior Court and ruled against the beneficiaries' request to reform the trust. The Supreme Court concluded that Pennsylvania law does not permit the removal and replacement of a Trustee without Orphans' Court approval. In making its ruling, the Supreme Court concluded that, when reading 20 Pa.C.S.A. § 7740.1 in conjunction with 20 Pa.C.S.A. § 7766, ambiguities emerge. The Court noted that there are two plausible interpretations of the plain language of the two provisions. A Trustee may be removed, and replaced, only pursuant to 20 Pa.C.S.A. § 7766. A modification pursuant to 20 Pa.C.S.A. § 7740.1 to add a provision allowing replacement of a Trustee without court action would essentially circumvent the requirements for removal and replacement of the Trustee in 20 Pa.C.S.A. § 7766, thus rendering 20 Pa.C.S.A. § 7766 a dead letter. The Supreme Court determined that 20 Pa.C.S.A. § 7740.1 and 20 Pa.C.S.A. § 7766 must be construed in such a way that 20 Pa.C.S.A. § 7740.1 does not effectively nullify 20 Pa.C.S.A. § 7766. Here, permitting a court to modify a trust agreement pursuant to 20 Pa.C.S.A. § 7740.1 to allow Trustee replacement by the nonjudicial act of the beneficiaries would have precisely such effect, *i.e.*, to "nullify, exclude or cancel" the effectiveness of 20 Pa.C.S.A. § 7766.

To obtain a modification under 20 Pa.C.S.A. § 7740.1, beneficiaries need only show that the modification would not be inconsistent with a material purpose of the trust. On the other hand, to remove and replace a Trustee pursuant to 20 Pa.C.S.A. § 7766, beneficiaries must satisfy substantial evidentiary requirements, and the court must make numerous findings of fact and conclusions of law. The Supreme Court held that the scope of 20 Pa.C.S.A. § 7740.1 does not extend to modification of trust agreements to permit the removal and replacement of Trustees.

IV. Heightened Standards of Performance for Professional Fiduciaries

Restatement Third § 77(3) states that "[i]f the trustee possesses, or procured appointment by purporting to possess, special facilities or greater skill than that of a person of ordinary prudence, the trustee has a duty to use such facilities or skill." *See also* Restatement Second § 174. The Comment to Restatement Third § 77(3) adds that "[e]ven a trustee with special skills and facilities may, as a matter of reasonable care in some circumstances, have a duty to obtain guidance or assistance in carrying out responsibilities appropriate to the plan for administration of the particular trust."

Similarly, Section 2(f) of the Uniform Prudent Investor Act states that "[a] trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise." *See also* UTC § 806, which contains virtually identical language.

Numerous courts have applied these rules to lawsuits against professional Trustees. *See, e.g.*, Rigelhaupt, "Standard of Care Required of Trustee Representing Itself to have Expert Knowledge or Skill," 91 A.L.R.3d 904.

In *In re Scheidmantel*, 868 A.2d 464 (Pa. Super. 2005), the grantor established a revocable trust (the "Trust") in 1998 and designated a corporate Trustee. The grantor's husband was the sole beneficiary during his lifetime. After the grantor husband's death, the Trust assets were to be distributed outright to the grantor's descendants.

The Trustee did not conduct a review of the Trust's investments until a week after the grantor's death, which was over seven months after the Trust was established. A few months after the grantor's death, the Grantor's husband became incapacitated. The Trustee never consulted with his children (the remainder beneficiaries) regarding the grantor husband's health. In June of 2000, despite the grantor husband's health concerns, the Trustee changed the investment goal of the Trust to a more aggressive objective and adopted an assumption, for investment purposes, that the Trust's duration would be extended. In September of 2000, as part of the Trustee's diversification of the Trust assets, the Trustee sold a portion of the Trust's assets and purchased other assets, which resulted in a loss of income generated by Trust property. Shortly thereafter, a stock dividend was announced for one of the Trust's primary holdings, but the Trustee had sold a block of the stock before the ex-dividend date and therefore lost the stock dividend with respect to the stock that had been sold.

After the grantor's husband died in December of 2000, triggering a distribution of all of the Trust assets to the remainder beneficiaries, the Trustee continued to purchase mutual funds focused on capital appreciation. The Trustee did not submit an accounting documenting termination of the Trust and outright distribution of its assets until May of 2002.

The Trustee had circulated advertising material describing the Trustee's employees as "capable specialists." The court stated that the Trustee "held itself out as having special expertise in managing living trusts." The court explained that, "[w]hen challenged, the administration of every corporate fiduciary must be 'carefully scrutinized' to determine whether it has 'performed according to the higher standards required of it'" (quoting *Estate of Knipp*, 414 A.2d 1007 (Pa. 1980).

The court found that one of the primary purposes of the Trust was to provide income to grantor and grantor's husband. The court concluded that the Trustee's conduct was unjustified under the specific circumstances of the Trust and constituted "gross negligence" under Pennsylvania law, despite the broad authority granted to the Trustee in the Trust instrument.

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