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TRUSTS AND ESTATES UPDATE

Expert Analysis

The Errant Fiduciary: Addressing Misconduct

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This month's article discusses recent opinions regarding fiduciary misconduct. Estate and trust litigators have long confronted fiduciaries who run afoul of their duties and responsibilities. Indeed, while most fiduciaries achieve the punctilio of honor, loyalty and good faith in the fulfillment of their stewardship, there are those who breach their trust and find themselves at the other end of litigation and a court order as a result.

Failure to Account

In *In re Brissett*, the executrix, who was previously held in contempt for failing to file her account, moved, by order to show cause, to extend her time to do so. The application was opposed by the respondents, co-administrators of the estate of the decedent's post-deceased spouse.

The record revealed that the decedent died in 2004 survived by her spouse, who post-deceased her. Her will was admitted to probate several years after her death, and letters testamentary issued to her niece, as the named fiduciary thereunder.

Following the issuance of letters testamentary, the fiduciaries of the estate of the post-deceased spouse petitioned for a compulsory accounting, which application was granted. The executrix was ordered to account within thirty days of service upon her of a certified copy of the court's order. When no account was filed, the fiduciaries moved to hold the executrix in contempt, which application was granted upon the default of the executrix, and the court authorized the issuance of a warrant of commitment without further notice in the event the executrix failed to purge herself of the contempt within 30 days of service upon her of the court's order with notice of entry.

Thereafter, a warrant of commitment was issued and the executrix was brought before the court by the Sheriff of the City of New York. At that time, counsel for the executrix stated that their client's failure to account was attributable to their law office failure rather than her willful disregard of the court's order. Based on counsel's representations, the court temporarily vacated the order of commitment, provided that in the event the executrix failed to account by a date certain, the warrant would once again issue. A warrant of commitment was again issued as a result of the executrix's failure to account, and yet another stay was granted until a date certain.

However, in lieu of filing her account, the executrix moved by order to show cause for an extension of time to file her account and for another stay of the warrant of commitment pending the outcome of the application. The court declined to grant the temporary relief.

In opposition to the relief requested by the executrix, the respondents maintained that she transferred to herself all estate assets, contrary to the provisions of the decedent's will, and requested that the court, inter alia, issue an order revoking the letters testamentary of the executrix, appointing one of them as the fiduciary of the estate, and imposing sanctions.

The court opined that although a warrant of commitment remained extant, the remedies afforded by the provisions of SCPA §2205 were likely to prove more fruitful than the imprisonment of the executrix for failure to comply with the court's directives. Accordingly, the court denied the request by the executrix for another extension of time to account, suspended the letters testamentary issued to her, directed that a hearing be held on the issue of whether the executrix's letters testamentary should be revoked and one of the respondents be appointed in her place and stead, and ordered that on the hearing date the parties be prepared to discuss a turnover of the books and records of the estate, and whether a trial date should be fixed for the successor fiduciary to take and state the account of the suspended executrix.

***In re Brissett*, NYLJ, July 26, 2010, at 26 (Sur. Ct. Bronx County).**

Removal of Fiduciary

Before the court in *In re Bernstein* was an application by the settlor to remove his son as trustee of the trust for self-dealing and alleged failure to cooperate with his co-trustee to such an extent that the proper administration of the trust was in jeopardy. Although the court noted preliminarily that the settler of a lifetime trust is not among the persons entitled to seek removal of a trustee under the applicable statutes, the settler based his claim of standing upon his status as a trust beneficiary. To this extent, the court considered the provisions of the trust, which authorized the trustee, in part, to make discretionary distributions of income to one or more individuals, other than the trustee, his spouse, descendants, or creditors, i.e. "almost every person in the world" as the trustee determined, and principal distributions to every person entitled to receive income.

The court found that as a member of the world population technically entitled to receive discretionary distributions of income and principal from the trust, the settler was a beneficiary. Nevertheless, the court concluded that this interest was not sufficient to grant him standing to seek removal of the trustee. Specifically, the court held that its determination was based not only

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on the de minimus nature of the settlor's interest, but also on constraints placed upon the settlor's control by tax laws that confer benefits for which the trust was expressly intended to qualify.

Notably, with respect to the former ground, the court opined that if the settler had standing to seek the trustee's removal, so too would virtually every individual in the world, given the breadth of the trust instrument. Inasmuch as the concept of standing derives from the requirement that the court have jurisdiction over an actual controversy, when the interest of an individual is negligible there effectively is no controversy to which jurisdiction may attach.

With respect to the second ground, the court recognized that the ability of the settler to remove the trustee would effectively subject the trust to estate tax, an outcome that the settler clearly intended to avoid.

Accordingly, the petition for removal was dismissed.

***In re Bernstein*, NYLJ, April 26, 2010, at 32.**

Surcharge

In a contested intermediate accounting proceeding of an irrevocable trust created by the decedent for the benefit of his grandchildren, the objectants requested that the fiduciaries be surcharged and/or denied commissions.

The subject trust was created by the decedent as an estate planning device in 1976. The original trustees were an attorney and a banking institution. Upon the death of the attorney, another member of his law firm succeeded him. The accounting before the court covered the stewardship of the current trustees, as well as the account of the deceased trustee.

In opposition to the judicial settlement of that account, the objectants, who were seven adult grandchildren and the guardian ad litem, alleged, inter alia, that the fiduciaries abused their discretion with respect to trust distributions and breached their fiduciary duty to the trust. In addition, the objectants requested that the fiduciaries be surcharged for retaining annual commissions without furnishing annual statements required by SCPA §§2309(4) and 2312(6), and that the corporate fiduciary be surcharged for retaining commissions in excess of the compensation afforded by the provisions of SCPA §2312. Finally, while not pled, the objectants alleged that the corporate fiduciary should be removed and/or surcharged, due to its failure to inform them of its felony conviction in 1999, which disqualified them from serving in a fiduciary capacity.

On the issue of the corporate fiduciary's felony conviction, the court noted that the bank was named in a federal felony information and pled guilty to unlawful diversion of unclaimed funds. The court held that although it could remove the bank on the basis of its felony convictions, the decision to do so was discretionary, and based upon an assessment of whether the conduct for which the fiduciary was convicted was deemed to endanger the estate or trust or seriously impede its administration. Within this context, the court found that the bank was not considered a convicted felon until its sentencing in July 1999, the final date of the accounting period. Further, the court found it relevant that less than six months after its conviction, New York State issued a certificate of relief of disabilities, specifically relieving the bank. Finally, the Supreme Court, New York County granted the bank's application to substitute its affiliate in its place to administer its fiduciary accounts.

Accordingly, the court found that a surcharge and/or denial of commissions was unwarranted.

As to the allegations regarding abuse of discretion, the court concluded that the record was devoid of any evidence that the trustees acted dishonestly, or with an improper motive, or beyond the bounds of reasonable judgment, or in a manner in which they failed to use their judgment in any respect in administering the trust during the accounting period.

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Similarly, the court found no evidence in the record that the trustees breached their fiduciary duty of loyalty to the trust by self-dealing. More particularly, the court found the objectants' contentions that the trustees generated Federal and New York state fiduciary income taxes unnecessarily by failing to make income distributions to the beneficiaries wholly unsupported by the record. The taxes incurred were shown to be the result of capital gains generated from the sale of successful investments, as well as a result of the trustees' compliance with the provisions of the trust instrument to retain undistributed income. Finally, the court found no evidence in the record supporting objectants' allegations that the trustees gave preferential treatment to some beneficiaries over others.

Further, on the issue of the corporate fiduciary's commissions, the court opined that, pursuant to the provisions of SCPA §2312(4), absent a surcharge, a corporate trustee is entitled, at a minimum, to compensation allowed an individual trustee under SCPA §2309. However, the court noted that when a matter is contested, the reasonableness of a corporate fiduciary's commissions pursuant to SCPA §2312 should be analyzed in accordance with certain enumerated criteria, including the size of the trust, the character of the work involved, the knowledge, skill and judgment required and used in the administration of the trust, and the amount of risk involved, as well as the trustee's published fee schedule. Based on this criteria, and the proof presented, the court held that the corporate fiduciary was entitled to reasonable compensation in accordance with the provisions of SCPA §2312.

Nevertheless, the court found that the trustees violated the provisions of SCPA §§2309(4) and 2312(6) by failing to provide the beneficiaries with annual statements for a twenty-year period in compliance with the provisions of SCPA §2309(4) and §2312(6). The court held that although it had the discretion to relieve the fiduciaries of minor deviations from the statutory requirements, the complete failure by the trustees to fulfill their statutory duty for a twenty-year period could not be considered minor.

Accordingly, the trustees were surcharged at the rate of 9 percent per annum on the commissions improperly taken, from the date the commissions were paid to the date the account was filed.

***In re Manny*, NYLJ, June 4, 2010, at 31 (Sur. Ct. Westchester County).**