



Be Good or Beware:

IT IS EASY TO RUN AFOUL WHEN SERVING AS A FIDUCIARY, but as this article fleshes out, ethical breaches can be very costly and damaging. Paying close attention to fiduciary duties and keeping the interests of the trust in the forefront will help avoid punitive damages.

While some authorities argue that the fiduciary duty of loyalty should be relaxed in light of the market efficiencies derived from self-dealing financial transactions, courts remain adamant that breaches of duty will be met with removal, damages, disgorgement, deterrence, and punitive damages.

Duty of Loyalty

Trust beneficiaries are particularly vulnerable to self-dealing and other abuses by trustees. Beneficiaries typically lack the financial sophistication necessary to monitor the trustee's investment decisions and discover abuses. The confidentiality of trust management decisions and lack of public information concerning the trust's performance shield trustees from market forces and other external pressures that can curb the abuses of fiduciaries in other contexts. Moreover, the cost and difficulty of ending the trust relationship, which ordinarily requires litigation to remove a trustee for cause, distinguish trusts from other confidential relationships that can be terminated more readily. (Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein* (2005) 47 *Wm. & M. L.Rev.* 541, 558–563; Rest.3d Trusts, § 78, com. b, p. 96.)

—*Uzuel v Kadisha* (Cal. App. 2010), 188 Cal. App. 4th 866, 878, *reh. den.*(Oct. 22, 2010), *rev. den.* (Dec. 15, 2010)

Ethical Violations by Fiduciaries

BY DOMINIC J. CAMPISI

The duty of loyalty, requiring a trustee to administer the trust solely in the interest of the beneficiaries ... is the most fundamental duty of a trustee ... Its purpose is to protect the best interests of the beneficiaries.

In *Uzyel*, the court of appeals reviewed a 191-page statement of decision dealing with two *inter vivos* trusts: “Neil Kadisha served as the trustee of two trusts. The beneficiaries, Dafna Uzyel and her children Izzet and Joelle Uzyel ... filed petitions for breach of trust against Kadisha and terminated the trusts. After a nonjury trial, the trial court awarded the Uzyels over \$59 million in compensatory damages and disgorgement of profits, plus \$5 million in punitive damages and over \$13 million in attorney fees” (*Ibid.* at 877).

On appeal, the court affirmed the bulk of the damages, remanded certain issues for correction of prejudgment interest, and affirmed the punitive damage award. The court reversed the \$13 million in attorney’s fees because the trustee successfully defended a number of claims and reduced the amount of damages awarded. The appellate court held as follows: “We conclude that Kadisha had reasonable cause to defend against the Uzyels’ claims in this proceeding and that they are not entitled to an award of attorney fees ...” (*Ibid.* at 928).

In affirming the damages awarded on five separate transactions, the appellate court explained the liability of a trustee for breaches of loyalty:

The duty of loyalty, requiring a trustee to administer the trust solely in the interest of the beneficiaries ... is the most fundamental duty of a trustee ... Its purpose is to protect the best interests of the beneficiaries. The

duty of loyalty requires a trustee to subordinate his or her interests to those of the beneficiaries in every regard ... A trustee’s motive in administering the trust is of paramount importance, and ensuring that the trustee will act in the sole interests of the beneficiaries rather than with some other motive is the principal object of the duty of loyalty...

—*Ibid.* at 905

No Further Inquiry Rule

The court adopted the “no further inquiry” rule, holding that once the existence of a conflict has been found, the beneficiaries are entitled to treat the transaction as void and seek appropriate damages:

A trustee is strictly prohibited from administering the trust with the motive or purpose of serving interests other than those of the beneficiaries. (Rest.3d Trusts, § 78(1) & com. f, p. 109; see also *id.*, § 87, com. c, p. 244 [“An abuse of discretion may result from the exercise of discretionary authority in bad faith or from improper motive”].) A trustee also is strictly prohibited from engaging in transactions in which the trustee’s personal interests may conflict with those of the beneficiaries without the express authorization of

either the trust instrument, the court, or the beneficiaries... **It is no defense that the trustee acted in good faith, that the terms of the transaction were fair, or that the trust suffered no loss or the trustee received no profit. This is known as the no further inquiry rule... Such a transaction is voidable at the election of the beneficiaries, and other remedies may be available, including an award of profits that the trust would have made if not for the breach of trust. ... This rule is prophylactic and is justified in part by its deterrent effect...** If the original purchase of an asset was a breach of the duty of prudent investing, the beneficiaries are entitled to affirm that transaction, waiving the breach, and enforce their remedies for a separate breach of the duty of loyalty in connection with the sale of the asset... (emphasis added).

—*Ibid.* at 905-6

More Expansive Damages than Available for Breaches of Prudence

The court rejected the claim that the Prudent Investor Act or common law investment duties could excuse the conflict. The court explained:

He breached his duty of loyalty regardless of whether a faithful trustee exercising reasonable care and acting in the best interests of the beneficiaries would have sold the shares at the same time. In our view, to allow a trustee to attempt to justify a breach of the duty of loyalty by showing that the transaction was consistent with, or even compelled by, the duty to invest prudently would seriously undermine the duty of loyalty and impair its deterrent value... **A court may excuse a trustee from liability for a breach of trust if the trustee acted reasonably and in good faith under the circumstances known to the trustee.** (§ 16440, subd. (b).) **But we are aware of no authority to excuse from the statutory measure of liability for a breach of trust (§ 16440, subd. (a)) a trustee who acted in bad faith by serving his own interests. Accordingly, we conclude that the fact that the sale might have been in the best interests of the trust, or even compelled by the duty to invest prudently, if true, does not excuse Kadisha from liability for his breach of the duty of loyalty.** (emphasis added)

—*Ibid.* at 906

Deterrence

The court held as follows:

The duty of loyalty, however, exists independently of the duty to invest prudently, and the damages resulting from a breach of the duty of loyalty are not necessarily the same as those resulting from a failure to invest prudently. Damages for a breach of the duty of loyalty should be based on what would have occurred if the trustee had complied with the duty of loyalty (i.e., but

for the breach of the duty of loyalty). Only then would the damages reflect the amount of profits lost as a result of the breach of the duty of loyalty. Accordingly, we reject Kadisha's argument that the damages for a breach of the duty of loyalty must be based on what a prudent investor would have done with the shares.

The remedy for a breach of trust should be adapted "to fit the nature and gravity of the breach and the consequences to the beneficiaries and trustee."^{***} The goals of the remedy are not only to compensate the beneficiaries for their loss, but also to deter the trustee in question and other trustees from committing similar acts. . . . Particularly with respect to the duty of loyalty, "the principal object of the administration of the rule is preventative, to make the disobedience of the trustee to the rule so prejudicial to him that he and all other trustees will be induced to avoid disloyal transactions in the future.

—*Ibid.* at 907-8

Tracing Rejected

Prior to becoming a trustee, the respondent had been involved in litigation with Qualcomm, which was settled in 1988, with Kadisha obtaining the right to acquire more than 660,000 shares of Qualcomm stock at \$1 per share, which he exercised with loan proceeds.

Qualcomm thrived, with its shares splitting four-for-one in late 1999, and the price of the post-split shares rising to \$179 in January 2000, before a precipitous fall later that year. The beneficiaries sought to force the trustee to disgorge the value of such shares purchased in 1988, claiming that "Kadisha's bank accounts in Union Bank and Wells Fargo Bank should be considered as one fund, like having cash in your right pocket and also your left pocket" (*Ibid.* at 891). The trial court rejected this claim: "The court finds [the Uzyels] have produced insufficient evidence (more likely to be not true) to trace Qualcomm stock (under Probate Code Section 16420(a)(9)) because Kadisha commingled his funds in a common fund and purchased the Qualcomm stock from the commingled fund. The common fund claim is not uninteresting but is as leaky as the New Orleans levee when hit by Katrina" (*Ibid.* at 891).

Unjust Enrichment

Damages for unjust enrichment were allowed for five other transactions found by the trial court to involve conflicts:

A plaintiff seeking a money judgment *in personam*, as distinguished from an equitable interest in a particular asset, as a remedy for unjust enrichment need only establish a causal connection between the wrongful conduct and the profits to be disgorged. The plaintiff need not trace the misappropriated funds to a particular asset as long as the plaintiff can establish a sufficient causal relationship between the wrongful conduct and the defendant's profits. . . .

—*Ibid.* at 892

The court on appeal upheld the disgorgement, quoting the Tentative Draft of the Restatement Third of Restitution and Unjust Enrichment:

The general rule stated in the tentative draft of the Restatement, which we deem applicable under California law to a trustee who has committed a breach of trust, is that profits subject to disgorgement include any form of consequential gains or other secondary enrichment 'that is identifiable and measurable on the facts of the case and not unduly remote.' (Rest.3d Restitution and Unjust Enrichment (Tent. Draft No. 5, Mar. 12, 2007) § 51(4)(a).) The party seeking disgorgement 'has the burden of producing evidence permitting at least a reasonable approximation of the amount of the wrongful gain. Residual risk of uncertainty in calculating net profit is assigned to the wrongdoer.' (*Id.*, § 51(4)(d).)

—*Ibid.* at 894

Duty to Hedge or Collar

The beneficiaries had also sought damages for the trustee's failure to hedge the value of the sizable block of trust stock held at the time of the dot-com market crash:

The statement of decision stated that Kadisha breached his duty of prudent investing by failing to diversify Trust No. 1's assets and that he failed to sell the Qualcomm stock or take any measures to protect against a loss despite its precipitous decline in value in retaliation for the Uzyels' having sued him. The trial court found that Kadisha breached his duty to preserve the trust's assets by failing to take any action after the shares declined in value from \$179.31 at the market closing on January 3, 2000, to \$156.44 at the closing on January 5, 2000, and by failing to take any action thereafter. The court stated that Kadisha was a skilled investor who knew how to "collar" stock, employ a put option, place a stop-loss order, or take other measures to protect against a price decline.

—*Ibid.* at 912

In *Wilkins v. Wachovia* (E.D. N.C. 2011) ___ F. Supp.2d ___, 2011 WL 1134706 (March 24, 2011) the court dealt with the downside of such financial engineering. The plaintiff alleged breaches in the management of substantial shares of low-basis RBC stock. The court dealt with motions to dismiss, in which it did not consider the truth of the pleadings, but only whether the allegation is plausible on its face to state claims as a matter of law. Hence the allegations involved have not been tested by discovery or reviewed in an evidentiary hearing. The plaintiff allegedly discussed with bank personnel "how he could 'safely and conservatively' increase the income being generated by his RBC stock. . . ." *Wilkins v. Wachovia*, 2011 WL 902031 (Magistrate's Memorandum & Recommendation, filed Feb 28, 2011) at *1. The amended complaint alleged that the bank personnel "recommended that Wilkins implement a 'covered call' or 'call option' strategy . . . using his RBC stock through a Wachovia

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trust account, which they assured him was a conservative approach . . . Wilkins’s understanding from the information he received from [bank personnel] was that his RBC stock was not at risk, because the Wachovia option traders could manage his account so that the options sold would not be exercised” (*Ibid.*).

The amended complaint alleged that after an initial success, Wilkins doubled the amount of RBC stock included in the options strategy. Unfortunately, the price of the stock shot up, leading to losses of \$2 million. The suit alleged that he suffered losses of \$2.3 million plus \$110,051.28 in fees (*Ibid.* at 2).

The district court reviewed the recommendation of the magistrate and dismissed the negligence, fiduciary duty, and common law fraud allegations in the amended complaint, finding that North Carolina’s “economic loss doctrine” held that the investment agreement signed by the plaintiff precluded tort claims on the subject matter of the contract unless he could “allege a duty owed him by the defendant separate and distinct from any duty owed under a contract. . . .” (*Ibid.*).

Punitive Damages

The court in *Uzyl* upheld the award of \$5 million in punitive damages, rejecting the beneficiaries’ arguments that the amount was insufficient to serve the purposes of punishment and deterrence. The court also rejected the argument that if the amount of compensatory damages were increased on appeal, the punitive damage award would have to be increased:

If the reversal of part of a compensatory award renders the punitive damages excessive, the award of punitive damages should be reversed for a redetermination of punitive damages in light of the reduced compensatory award. . . . The reason for this is to ensure a reasonable relationship between the compensatory award and the amount of punitive damages. . . . If an appeal results in an increase in the compensatory award, however, the plaintiff is not entitled to a reversal of the punitive damages award to keep pace with that increase.

—*Ibid.* at 924

Punitive damages were also upheld in *Fullerton-Eichenlaub v. Rellamas*, (E.D. Ky 2011) ___F.Supp.3d___ 2011 WL 197833 and *Estate of Hoch* (ME 2011) 16 A.3d 137. In *Rellamas*, the court surcharged a self-dealing trustee who also held a power of attorney (POA). The court awarded punitive damages as well as well as \$567,829.37 in compensatory damages:

The outrageous actions of Petitioner/Counter-Defendant Trician M. Fullerton-Eichenlaub also warrant punitive damages: because they constitute oppression,

fraud or malice entitling Angela to punitive damages pursuant to KRS § 411.184; because Tricia acted with a wanton and reckless disregard for the property of Arthur and his beneficiaries; and in order to deter other from following her example. PUNITIVE DAMAGES are awarded in the amount of \$1,371,551.62.

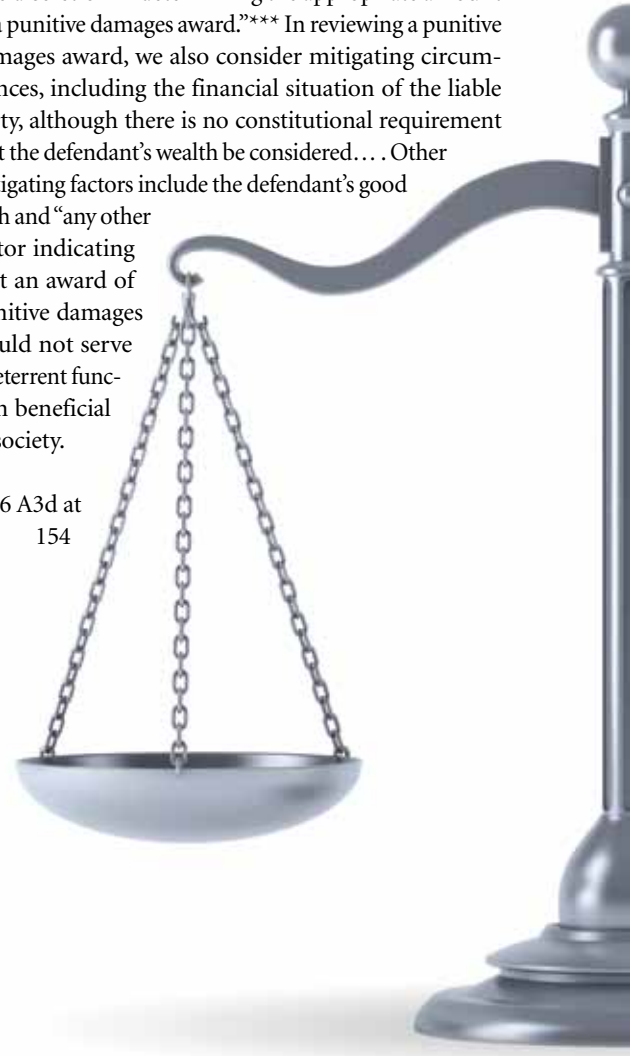
—*Ibid*

In *Hoch*, the Maine Supreme Court affirmed the award of \$3,746,753.50 of actual damages against caregivers who had utilized a POA from a vulnerable elderly person. Margarete Hoch had moved to Germany from Maine. She had given a durable power of attorney to the Chandlers, friends in Maine, and asked them to manage her funds. The Stifels operated a hotel and spa in Germany. Months after Hoch arrived at the Naturhotel, the Stifels obtained a power of attorney from Hoch that they used to obtain control of her assets and her person. The Chandlers filed an action in Maine against the Stifels seeking to obtain control of the assets and protective steps for the care of Hoch. The trial court imposed a constructive trust and \$3 million in punitive damages. “By virtue of the tortuous actions they took before Hoch’s death. . . , the Stifels proximately caused damage to Hoch before her death and to her estate after her death” (16 A.3d at 150).

The Supreme Court held:

Though not “open-ended,” the fact-finder has “considerable discretion in determining the appropriate amount of a punitive damages award.”*** In reviewing a punitive damages award, we also consider mitigating circumstances, including the financial situation of the liable party, although there is no constitutional requirement that the defendant’s wealth be considered. . . . Other mitigating factors include the defendant’s good faith and “any other factor indicating that an award of punitive damages would not serve a deterrent function beneficial to society.

—16 A3d at 154



In *Siegel v. JPMorgan Chase Bank*, ___ So. 3d ___, 2011 WL 519899 (February 16, 2011) the court dealt with a trust that authorized the trustee to follow directions of a holder of a POA to make gifts, “provided that such gift either (i) shall be reasonably consistent with any pattern of my giving or with my estate plan or (ii) shall not exceed the annual exclusion available from time to time for federal gift tax purpose” (2011 WL 519899 at *1). The trustee had sole discretion to pay so much of the income or principal for the “support, maintenance, health, comfort or general welfare” of the settlor. The beneficiaries objected to multiple gifts directed by the POA holder and approved by the trustee, including gifts to employees of the POA holder and the JPMorgan employee administering the trust and gifts which resulted in gift tax liability. They also objected to the early funding of a subtrust that was to be established on the death of the settlor, “causing a substantial gift tax liability,” as well as allegedly excessive expenditures for the “welfare” of the settlor (2011 WL 519899 at *3). The court held that the power of attorney limited the holder’s powers; moreover, “the power of attorney also prohibited the attorney-in-fact from invading the principal of the trust ...” (*Ibid*). “Despite the lack of power of the trustee to make gifts and the specific prohibition of the attorney-in-fact to withdraw principal of the trust, the trustee made gifts and permitted Novak to withdraw principal to pay other gifts. The trustee had no authority to do so, and we can find no legal support which holds that gifts to others can constitute payments for the ‘comfort or general welfare’ of the beneficiary of a trust” (2011 WL 519899 at *6). The court concluded that “Permitting the trustee to deplete the trust principal by lavishing gifts on others does not provide for the support or welfare

of the settlor and disregards the duty to the remainderman. Thus, the trustee had no authority to make gifts of the trust to others” (2011 WL 519899 at *7).

The court held that “an attorney-in-fact must act in the best interests of the principal, which is consistent with the fiduciary duties

that the courts have imposed on the attorney-in-fact” (*Ibid*). It ruled: “Because [t]he relationship of an attorney-in-fact to his principal is that of agent and principal..., the attorney-in-fact must act in the utmost good faith and undivided loyalty toward the principal, and must act in accordance with the highest principles of morality, fidelity, loyalty and fair dealing... .”

While it did not appear that the attorney-in-fact had benefitted herself with any substantial gifts, “However, the fact that substantial gifts were given to so many people suggested that the power to gift was not exercised with Mrs. Rautbord’s best interests in mind. Whether the gifts that she made as attorney-in-fact were in the best interest of Mrs. Rautbord is an issue of fact for determination by the court. Nevertheless, where the gifts were made from substantial invasion of principal, which the attorney-in-fact was not permitted under the terms of her appointment, that alone suggests that she breached her fiduciary duty and did not act in the best interest of her principal” (2011 WL 519899 at *8).

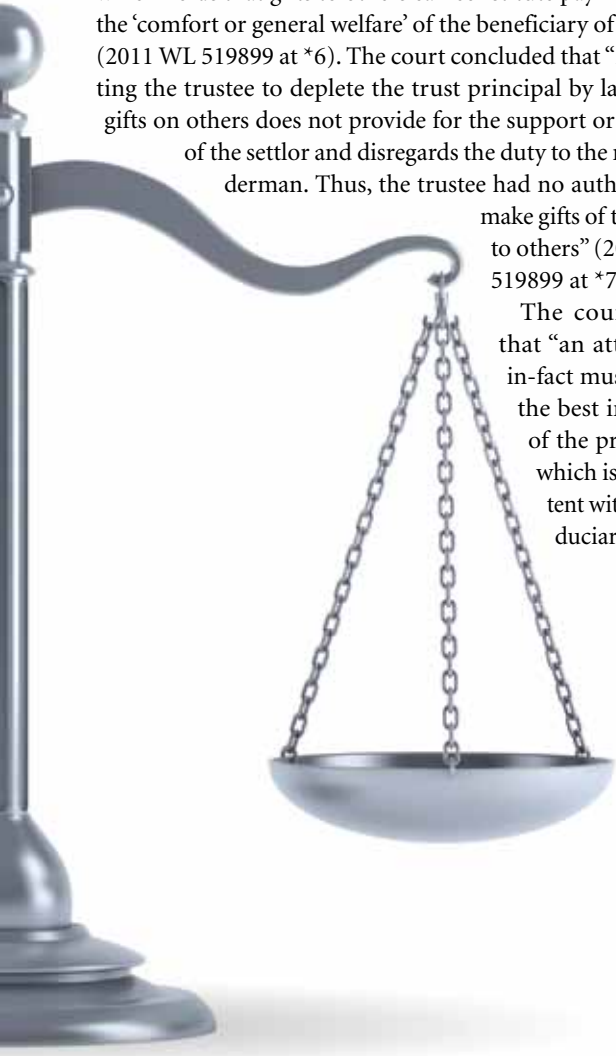
The court held that “The settlor unmistakably directed the creation of the trust on her death. The trustee breached its fiduciary duty by prematurely funding it, causing unnecessary expense to the trust.”

The court noted that while the trustee had “sole discretion” to distribute principal or income of the trust under the trust standard, “Under New York law, even though the trustee has sole discretion to determine the appropriateness of expenditures, it does not foreclose all inquiry by a court of the proper use of such discretion. ... ‘[T]he court has the responsibility to ensure that the trustees do not abuse their discretion. Accordingly, the court has the authority to correct abuses in the exercise of absolute discretion that are arbitrary or the result of bad faith.’ ... Where distributions fall within a class of expenditures authorized by the trust, a trustee must still act reasonably and with good faith in carrying out the terms of the trust.” The court concluded “we cannot determine whether some of the expenses would even fall within the trustee’s duty to provide for Mrs. Rautbord’s support, care, comfort, and general welfare. We likewise remand for a hearing to make this determination” (2011 WL 519899 at *9).

Breaches and Aiding and Abetting Breaches

In *Paradee v. Paradee* (Del. Ch. 2010) 2010 WL 3959604 Charles Paradee had created an irrevocable life insurance trust (ILIT) for his grandson, Trey. The trust provided that when Trey turned age 30 he could become trustee. The trust was funded with a combination of whole life and term life designed to pay a death benefit of \$1,150,700. This was a second-to-die policy based on his life and that of his second wife, Eleanor. Charles had married Eleanor shortly before the establishment of the ILIT. She began to assume responsibility for managing the family company.

When faced with an unexpected levy of back taxes in the amount of \$200,000 for the family company, Eleanor sought some way to pay the bill. The Chancery Court concluded that “Eleanor simply preferred for selfish reasons to shift



the cost of their tax bill to someone else. Although there is no such thing as a free lunch, it is always nice (all else equal) if someone else pays. Eleanor wanted someone else to pay” (2010 WL 3959604 at *3).

She contacted the trustee and asked if they could revoke the ILIT in order to use the value of the policies to provide the money she needed. The family attorney advised Eleanor that “irrevocable” meant “irrevocable,” and that the Paradees could not access the Policy’s cash value by revoking the Trust.” (*Ibid*). Eleanor asked the trustee to see whether the trust could loan the \$200,000, despite having been warned that a policy loan would be deducted from the benefit paid on the policy and that if loan payments were not made, the policy might lapse. Having been rejected by the family attorney, the trustee then contacted another attorney who recommended that “in no case should the trustee make a loan unless the loan payments will be adequate to cover debt service on the policy loan plus the amount required to keep premiums current” (2010 WL 3959604 at *4). The trustee then obtained a policy loan and lent the loan amount to the family company, but failed to obtain a secured loan from the family company or policy terms such that the payments would be sufficient to service the policy loan.

After the death of the trustee, Eleanor appointed herself trustee of the ILIT. In that year the family company failed to pay the interest on its loan with the trust, with the consequence that the value of the policy was reduced and the loan

balance increased. The court found that “Eleanor consciously, intentionally, and vengefully refused to take any action to protect or preserve the Policy because she did not want Trey to benefit” (at *8). After continued failure to make loan payments, the policy lapsed (*Ibid*). At the time of the lapse, the ILIT held approximately \$300,000 of other assets.

Eleanor then appointed her handyman as the trustee of the trust. Eleanor adopted the handyman, although the court notes that this was for “estate planning reasons” (2010 WL 3959604 at *8).

Trey did not know about the ILIT until after the lapse of the policy. He brought an action

to recover damages. The court found that the first trustee, Eugene N. Sterling, had breached his duties. “When deciding whether the Trust should loan money to the Paradees, Sterling breached his duty of loyalty. Instead of evaluating what was in the best interests of the Trust, he evaluated whether he could please his long-time clients, the Paradees” (2010 WL 3959604 at *10). The court held that “As part of the duty of loyalty, a trustee ‘must exclude all selfish interest and all consideration of the interests of third persons.’”

The court concluded that Eleanor knowingly participated in the trustee’s breach. “[I]t is bedrock law that the conduct of one who knowingly joins with a fiduciary ... in breaching a fiduciary obligation, is equally culpable.”** (“[P]ersons who knowingly join a fiduciary in an enterprise which constitutes a breach of his fiduciary duty of trust are jointly and severally liable for any injury which results.”) (2010 WL 3959604 at *12).

The court also found: “Eleanor should have informed Trey about the Trust, should have paid Trey the net income from the Trust, and should have used trust assets to maintain the Policy.” (*Ibid*).

The court awarded Trey \$1,150,700, which represented “the death benefit that the Policy was designed to achieve under the most likely range of future states of the world at the time the Policy was purchased” (2010 WL 3959604 at *13). The court made this award despite the fact that Eleanor was still living. “I reject as inequitable the respondents’ contention that any award of damages should be withheld until Eleanor’s actual death” (*Ibid*).

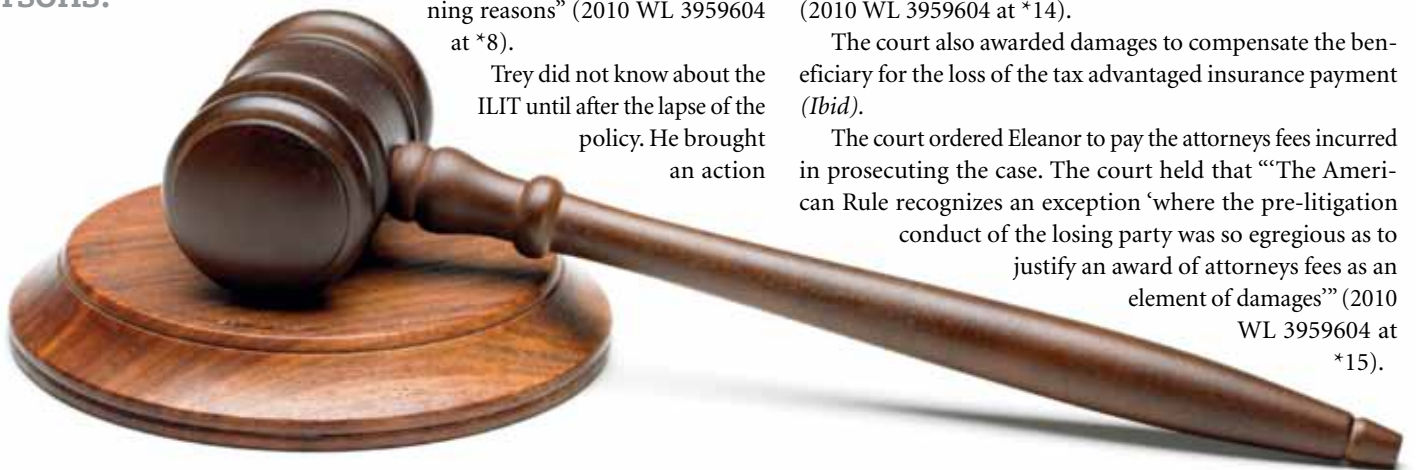
Because of the policy loans, the number of insurance company shares the trust received upon demutualization were reduced. “Where a party has wrongfully deprived another of the ability to sell shares, damages are measured using the **highest intermediate value of the shares less the value at the time of judgment.** See *Duncan v. Theratyx, Inc.*, 775 A.2d 1019, 1023 (Del. 2000)” *Ibid*. (emphasis added)

The court held that “Although it would be improbable (bordering on impossible) for the Trust to have sold precisely at the top of the market, the faithless fiduciary must bear that risk, not the innocent beneficiary” (*Ibid*). Damages for the sale of stock totaled \$559,766.96 plus prejudgment interest (2010 WL 3959604 at *14).

The court also awarded damages to compensate the beneficiary for the loss of the tax advantaged insurance payment (*Ibid*).

The court ordered Eleanor to pay the attorneys fees incurred in prosecuting the case. The court held that “The American Rule recognizes an exception ‘where the pre-litigation conduct of the losing party was so egregious as to justify an award of attorneys fees as an element of damages’” (2010 WL 3959604 at *15).

The court held that “As part of the duty of loyalty, a trustee ‘must exclude all selfish interest and all consideration of the interests of third persons.’”



Improper Delegation of Investment Duties

Matter of the Trust of Rivas, (N.Y. Sur.2011) 2011 WL 32792 (January 5, 2011) dealt with a proposal to modify management of a charitable trust created to support the psychiatry department at the University of Rochester. The trust had a corporate trustee as well as an investment advisory committee composed of the two members appointed by the university and one by the trustee.

In 2009, a majority of the advisory committee voted to delegate management of the trust's \$28 million portfolio to the University's long-term investment pool (LTIP) (2011 WL 32792 at *1).

The court held that such a delegation would be improper because of potential conflicts of interest.

The court noted that the advisory committee of the trust "is conferred the status of a co-trustee and fiduciary obligations attach.... If there is reason to suspect the advisor is violating its fiduciary duty, the trustee is not under a duty to abide by the advisor and may be liable if it does" (2011 WL 32792 at *3).

The court looked to the intent of the settlor, not those pesky actual terms set forth in the document relied upon by the University. "Stated differently, the substance of the Agreement must not be destroyed in deference to the naked word [*In re Herzog*, 301 N.Y. 127 (1950)]. If the Court were to allow for the University's argument that Articles Seventh and Eighth are dispositive and control the entire Agreement, there would be little sense in having Bank of America serve as trustee, only [to] be subservient to an Advisory Board dominated by representatives named and employed by the University and directed to invest the entire corpus in an investment vehicle controlled by the University" (2011 WL 32792 at *4).

The court noted that the LTIP's 85 investment managers would be "overseen not by any party to the Agreement, but rather by a subcommittee of the University's Board of Trustees who would have unfettered control and discretion as to the investment of the Trust corpus" (2011 WL 32792 at *5).

Many universities have sought to convince trustees of charitable trusts of which they were the remainderman to fold the portfolios into that of the University itself (See 2003 TNT 248-20, LTR 200352017).

The surrogate court focused on potential conflicts:

As two of three members of the Advisory Committee are employed by the University of Rochester, there may be an occasion whereupon the loyalties to the University's Department of Psychiatry, as the beneficiary, and to the University are conflicted, or at the very least divided. The members of the Advisory Committee, with a conferred fiduciary status, owe a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect. "This rule is sensitive and inflexible."... However, those two members of the Advisory Committee also have a duty of loyalty to their employer, the University.

However, if the proposed investment in the LTIP were allowed, the majority of the Advisory Committee would

be placed in a tenuous position should they ever question the handling of the funds by the LTIP or discover that the needs of the Rivas Trust are being subsumed by the larger purpose of the LTIP. "The fundamental rule of undivided loyalty to a trust nor of the rule that a trustee shall not *place itself* in a position where its interest *may be* in conflict with its duty."*** Otherwise, any circumstance where even a scintilla of divided loyalties among the majority of the Advisory Committee is evident will result in voiding any transactions in which they may appear...

—2011 WL 32792 at *5

Since one goal of consolidating charitable trusts in a LTIP is the desire of institutions to minimize their overhead and use the size of the endowment to allow them to obtain economies of scale to save expenses and to be able to engage better or more diverse fund managers, there clearly are potential conflicts.

The court objected to the shift from the Uniform Prudent Investor Act (UPIA) to the new Institutional Funds Act, governing the LTIP (2011 WL 32792 at *6). The court may have been considering the sad and very public travails of the endowments which suffered both large losses in the Great Recession and serious liquidity problems. It is not clear why the standards of the UPIA would better serve the Rivas Trust and the court does not delve into the actual terms of the Institutional Act adopted in New York to explain what harm might result.

The court did look to the problems which would be faced by the advisory committee in monitoring the multiple sub-managers and institutional custodian of the LTIP:

In handing over the entire corpus of the Trust to a different custodian, to be managed by 85 different investment firms taking directives from another governing body, the Trustee and the Advisory Committee would be breaching their duties imposed by the Prudent Investor Act inasmuch as upon their delegation, they would be unable to monitor the managers of the LTIP. *In re Petition for Judicial Settlement of Intermediate Account of Proceedings by Bankers Trust Co. of New York*, 2 Misc. 3d 1004(A) (Surr. Ct. New York Co. 2004).

—2011 WL 32792 at *6 Because

After examining recent litigation, it's clear that the courts are holding fiduciaries to their promises as trustees. The message is simple and clear: Keep the trust's interests above all else and learn from others' mistakes. By doing so, you can avoid ethical and legal troubles, especially costly punitive damages. ■

ABOUT THE AUTHOR

DOMINIC J. CAMPISI, co-founder and partner at San Francisco-based Evans, Latham & Campisi, specializes in fiduciary litigation and is nationally known as an expert in this field. Reach him by telephone at (415) 421-0288 or via e-mail domcampisi@aol.com.