First Supplement to Memorandum 84-23

Subject: Study L-640 - Trusts (Comments on Breach of Trust)

This supplement reviews the comments we have received on the discussion in Memorandum 84-23 relating to breach of trust, and on the staff proposal to codify some basic rules in this area. Comments on this subject were received from the Executive Committee of the Probate and Trust Law Section of the Los Angeles County Bar Association (LABA Committee), the Executive Committee of the Estate Planning, Trust and Probate Law Section of the State Bar (State Bar Committee), and the California Bankers Association (CBA); these comments are included in the letters attached to Memorandum 84-58. Additional analysis by Melvin H. Wilson for the CBA is included in the letter attached to this supplement as Exhibit 1.

General Comments

The CBA "agrees in concept with the recommendations" of the staff. (See Memorandum 84-58, Exhibit 4, p. 6.) The State Bar Committee writes: "It makes sense to consolidate all rules concerning breaches of trust, and to bring more order to the rules." (See Memorandum 84-58, Exhibit 6, p. 2.) The State Bar Committee also writes that

> trust beneficiaries are not as powerless as the Memorandum may suggest and it should be realized that there are avenues already available to beneficiaries. For example, the Memorandum seems to ignore the process available through current Probate Code, Sections 1138 et seq.

The staff does not suggest that trust beneficiaries lack important remedies; however, the overview in Memorandum 84-23 does suggest that the law is unknown in some cases and that it is in a diffuse and disorganized state. As for Probate Code Section 1138 et seq., the basic memorandum does cite Section 1138.1(a)(7) relating to determining compensation. However, it was not the purpose of the memorandum to discuss procedural questions--this subject is discussed in Memorandum 84-29. Perhaps an argument could be made that broad authority to find remedies for breach are inherent in Section 1138.1(a)(2) which permits the court to pass upon the acts of the trustee and also in Section 1138.1(a)(4) which provides for instructing the trustee. Some sort of general authority is provided by Section 1138.2 which gives the court power to make "all

orders and decrees and take all other action necessary or proper to dispose of the matters presented by the petition." These vague, general provisions do not provide any guidance on the particular remedy that might be available for breach, but only general authority for dealing with problems brought before the court by way of petition.

The LABA Committee expresses a degree of uneasiness about codifying rules in this area since "to be too specific is to be too rigid." (See Memorandum 84-58, Exhibit 3, p. 4.)

Appointment of Receiver (Memorandum 84-23, p. 4)

Mr. Melvin H. Wilson, on behalf of the CBA, suggests clarification of the power of the court to appoint an interim trustee, in connection with the discussion in the memorandum of appointment of receivers. (See Exhibit 1, attached hereto.) This suggestion will be considered in the First Supplement to Memorandum 84-26 which relates to the office of trustee, including the appointment of successor trustees.

Draft Statute on Remedies for Breach of Trust (Memorandum 84-23, p. 10)

A proposed staff draft of a section listing important remedies for breach is set out on page 10 of the memorandum. The LABA Committee approved of the draft in general and made two suggestions for drafting improvements that the staff believes should be made. (See Memorandum 84-58, Exhibit 3, p. 4.) Because of grammatical difficulties in subdivision (b)(3), we would remove the specific mention of payment of damages, surcharge, and restitution from the subdivision and discuss these specifics in the comment to the section. Subdivision (b)(8) should be revised by adding the word "on" after "lien".

The State Bar Committee expresses concern about the references to the common law in subdivisions (c) and (d) of the draft section. (See Memorandum 84-58, Exhibit 6, p. 2.) The State Bar Committee asks several questions:

> Is the staff satisfied that common law rules do not conflict with rules of California law or does the staff mean for common law rules to override current California law? At the same time, it is possible that California law may not completely cover some areas of remedies contemplated.

References to the common law appear in two places. Subdivision (c) provides: "The availability and application of the remedies for breach of trust described in subdivision (b) are governed by the common law."

This provision is intended to lay to rest any idea that the remedies are new and can be applied without regard to precedent. It is not essential that this idea appear in the section; it could be relegated to the comment. However, to the staff it does not seem to create the doubts and uncertainties suggested by the State Bar Committee, so we would prefer to leave it in the section. Subdivision (d) merely makes clear that the statute is not intended to limit the availability of remedies that are not codified. This provision seems completely unobjectionable.

The State Bar Committee has also objected to referring to the common law in connection with trustees' duties which were considered at the last meeting. (See Memorandum 84-21 considered at the June meeting and the State Bar Committee comments in Memorandum 84-58, Exhibit 2, p. 2.) At the June meeting, it was pointed out that California law adopts the common law generally. Civil Code Section 22.2 provides:

> 22.2. The common law of England, so far as it is not repugnant to or inconsistent with the Constitution of the United States, or the Constitution or laws of this State, is the rule of decision in all the courts of this State.

It was also noted that the power of appointment statute in Civil Code Section 1380.1 adopts the common law:

> 1380.1. Except to the extent that the common law rules governing powers of appointment are modified by statute, the common law as to powers of appointment is the law of this state.

The comment to this section reads in part:

> As used in this section, the "common law" does not refer to the common law as it existed in 1850 when the predecessor of Civil Code Section 22.2 was enacted; rather, the reference is to the contemporary and evolving rules of decisions developed by the courts in exercise of their power to adapt the law to new situations and to changing conditions. See, e.g., Fletcher v. Los Angeles Trust & Sav. Bank, 182 Cal. 177, 187 Pac. 425 (1920).

The court in Fletcher, a case involving termination of a trust at the request of the sole beneficiary, states that to ascertain the common law of England it is necessary to look to decisions of English courts and decisions of sister states that base their decisions on the common law. In light of these general principles, the staff does not think there is any danger in referring to the common law in the draft section.

The State Bar Committee suggests that "an explanation should be added to subsection (b)(9) stating what rights there are in trust property that has been traced." (See Memorandum 84-58, Exhibit 6, p. 2.) This

might be done by revising subdivision (b)(9) as follows: "To trace trust property that has been wrongfully disposed of <u>and recover the property or its proceeds</u>." Of course, it must be recognized that this statement is an oversimplification that ignores some restrictions on the right to recover property that is traceable. (See the discussion in the memorandum on pages 6-7.) Is should be said that the intention of the staff draft is to catalogue the remedies for breach of trust without codifying all of the qualifications and details. If the Commission is interested in proposing a more detailed statute, Section 30-4-3-11 of the Indiana Trust Code should be considered; it is set out on page 9 of the memorandum.

The State Bar Committee writes:

> [I]f the proposed statutory language is meant to encompass the exclusive procedures to be used, then the statute needs to go much farther than it does; it would be difficult to elaborate a satisfactory all-inclusive group of exclusive procedures.

(See Memorandum 84-58, Exhibit 6, p. 2.) The staff agrees that it would be difficult to codify a satisfactory set of exclusive remedies for breach of trust--that is why we did not try to do so. And that is why subdivision (d) of the draft section makes clear that the remedies are not exclusive. It is also the reason why subdivision (c) in effect incorporates the technicalities of the common law so that the statute need not attempt a statement of all this detail.

<u>Measure of Damages</u>

Mr. Melvin H. Wilson, on behalf of the CBA, characterizes the law on the measure of damages as "the most sensitive area covered" by the study. (See Exhibit 1, p. 1, attached hereto.) His concerns relate to the jurisdiction of the probate court to award both compensatory and punitive damages. This is a question that will be dealt with in the First Supplement to Memorandum 84-29 (Judicial Administration).

<u>Statutory Formulation of Measure of Damages (Memorandum 84-23, pp. 16-17)</u>

The staff has recommended a statute based on Section 205 of the Restatement (Second) of Trusts to state the basic rules governing the measure of damages. Melvin H. Wilson, on behalf of the CBA, approves of this approach. (See Exhibit 1, p. 4, attached hereto.) Mr. Wilson does not like the Texas statute offered as an example on page 16 of the memorandum because it adopts the substance of Section 203 of the Restatement which reads:

> The trustee is accountable for any profit made by him through or arising out of the administration of the trust, although the profit does not result from a breach of trust.

Mr. Wilson reads this provision very broadly to apply to "totally innocent loans to purchasers of trust property and a variety of other normal banking transactions." (See Exhibit 1, p. 4, attached hereto.) The comment to Section 203 of the Restatement does not support this broad reading, but we need not confront the issue unless the Commission is interested in codifying Section 203.

The LABA Committee supports the adoption of Section 205 of the Restatement as proposed by the staff. (See Memorandum 84-58, Exhibit 3, p. 4.) The LABA Committee would also codify Section 204 of the Restatement which reads as follows:

> The trustee is not liable to the beneficiary for a loss or depreciation in value of the trust property, or for a failure to make a profit, not resulting from a breach of trust.

This is the corollary of Restatement Section 205 which relates to liability for a breach. As noted in the memorandum on pages 16 and 17, the trust codes of Indiana, Louisiana, and Texas all enact Restatement Section 204. The staff sees no problem in codifying this rule.

The LABA Committee also suggests that the statute codify the good faith exception of Restatement Section 205 comment g:

> In the absence of a statute, it would seem that a court of equity may have power to excuse the trustee in whole or in part from liability where he has acted honestly and reasonably and ought fairly to be excused.

As noted in the memorandum, a drawback of adopting basic Restatement rules is that crucial limitations are sometimes buried in the comments. The staff thinks it is a good idea to codify the good faith exception as suggested by the LABA Committee.

<u>Attorney's Fees</u>

The memorandum on page 17 suggests that the Commission consider making a statutory provision for attorneys' fees incurred by the beneficiary in bringing an action for breach, as is done in the Indiana statute. The LABA Committee's position on this suggestion is as follows:

> Since the codification of rules tends to automatically include the suggestion that perhaps the law is being changed, perhaps the statute should include liability for attorneys' fees incurred by

> the beneficiary in proceedings involving breach of trust. They are currently allowed if the beneficiary's actions have resulted in common benefit to the beneficiaries as a whole, a group of them, or the trust estate. The common benefit or common fund theory of attorneys' fees may perhaps advisably be codified. If the trust estate is liable, perhaps also the Court should be authorized to award attorneys' fees to beneficiaries from the trustee.

(See Memorandum 84-58, Exhibit 3, pp. 4-5.) The State Bar Committee takes the following position:

> In trust litigation (as with other litigation) there appear to be two conflicting policies of whether or not attorneys' fees should be allowed. This is especially true in breach of trust cases. Allowing attorneys' fees may encourage litigation in a field in which litigation is already burgeoning. On the other hand, without some provision for allowance of attorneys' fees, the access of a beneficiary to the Court process may be too restricted. If the trustee is allowed fees from the trust, the beneficiary pays all fees. Perhaps allowing the Court to order the trustee to pay the beneficiary's attorneys' fees would provide reciprocity. Punitive damages do not appear to be a reasonable solution to the attorneys' fee problem if the trustee acts in "good faith" but is found guilty of a breach. Perhaps the Court, in its discretion, should have authority to award or deny attorneys' fees.

(See Memorandum 84-58, Exhibit 6, pp. 2-3.)

Both Committees seem to favor legislating a liability of the trustee for attorney's fees in breach of trust actions or proceedings. What does the Commission want to do?

The LABA Committee also wonders whether the "common benefit or common fund theory of attorney's fees may perhaps advisably be codified." The staff sees no reason to codify these rather imprecise equitable exceptions to the normal limitation on the award of attorney's fees to cases where provided by contract or statute. See generally Code Civ. Proc. § 1021; California Attorney's Fees Award Practice §§ 3.1, 3.12, 3.13 (Cal. Cont. Ed. Bar 1982); 4 B. Witkin, California Procedure _Judgment_ §§ 129-34, at 3278-84 (2nd ed. 1971 & Supp. 1983). If a trustee liability for attorney's fees is provided, it might be a good idea to refer to the general law on the common fund and substantial benefit rules in a comment.

Punitive Damages and Fraud

The State Bar Committee suggests:

> The punitive damages question should also be studied. The rules for punitive damages should be more specifically set forth than at present, and fraud which would justify an award of punitive damages should be fraud as generally understood, and not fraud as defined in Civil Code § 2234.

(See Memorandum 84-58, Exhibit 6, p.3.) Civil Code Section 2234 reads: "Every violation of the provisions of the preceding sections of this Article is a fraud against the beneficiary of a trust." The Commission decided not to continue Section 2234 when the matter was considered in June 1983, so the State Bar Committee's objection has been met.

As for the State Bar Committee's suggestion that punitive damages rules should be "more specifically set forth", the staff is uncertain of what is intended. If the problem involves the jurisdictional issues that arose in the recent case of Burton v. Security Pacific National Bank, 155 Cal. App.3d 967 (1984), that question will be dealt with in the First Supplement to Memorandum 84-29 (Judicial Administration). If the State Bar Committee is suggesting that we attempt to codify the law relating to punitive damages, the staff would resist the suggestion.

Interest (Memorandum 84-23, p. 18)

The staff proposed a new provision for interest based on Restatement Section 207. (The Restatement section is set out on page 3 of Exhibit 1 attached to Memorandum 84-23.) The LABA Committee approves of this proposal in general but has some additional suggestions:

> [W]e believe that the "such other rate as the court . . . may determine" portion of subsection (1) [of Restatement Section 207] should be limited so that it is either the legal rate or "the interest actually received by the trustee or which the trustee should have received." Subsection (2) on the compounding of interest is generally sound. Our reasons for concern about subsection (1) are that the legal rates should be a floor to the interest rate and "other rates" should not be higher unless the circumstances are such that the trustee actually did receive higher amounts of interest or should have received higher amounts given the circumstances at the time.

(See Memorandum 84-58, Exhibit 3, p. 5.) The Restatement affords a significant degree of discretion to the court in setting the rate of interest depending on the circumstances, as delineated in the comment to Section 207(1):

> a. Interest received. The trustee is chargeable with any interest actually received by him on trust funds, although the amount received is greater than the legal rate or the current rate of return on trust investments.
>
> b. Interest which should have been received. If it was the duty of the trustee to invest trust funds in securities paying interest at a certain rate and in breach of trust he neglects to do so, he is chargeable with that rate of interest, even though it is higher than the legal rate or the current rate of return on trust investments.

c. Interest at legal or other rate. Except under the circumstances mentioned in Comments a and b, the beneficiary is entitled to interest at the legal rate, or at the current rate on trust investments, or at some other rate, as the court may in its sound discretion determine.

In determining the rate of interest with which the trustee is chargeable, the following circumstances may be relevant: (1) whether the breach of trust was committed in bad faith, was intentional although not committed in bad faith, was committed negligently or as a result of a mistake in the interpretation of the trust instrument; (2) whether the breach of trust consisted in action by the trustee or in his failure to act.

Ordinarily if a breach of trust consists only in the failure of the trustee to invest trust money, or in the failure to sell trust property and to invest the proceeds, the trustee is chargeable with interest at the current rate of return on trust investments and not with interest at the legal rate.

If breach of trust consists in an improper sale of trust property or an improper purchase of property for the trust, the trustee is chargeable with interest at the current rate of return on trust investments, unless the breach of trust was intentionally committed, in which case he is ordinarily chargeable with interest at the legal rate.

If the breach of trust consists in the failure to pay to the beneficiary trust funds to which he is entitled, the trustee is ordinarily chargeable with interest at the legal rate if he intentionally violated his duty to the beneficiary in withholding payment. If, however, his failure to pay was due to a reasonable doubt as to his duty to make payment, he is not liable, during the period while the question of his duty is being litigated, for any interest except such as he has actually received or should have received during that period. In such a case the trustee should ordinarily not invest the money but should deposit it in a bank in order that he may be in a position to pay it over immediately if the court should so decree.

Under the Restatement rule, as indicated in comment c, the court could award interest at a rate lower than the legal rate (currently 10% in California) if the breach involved only a failure to invest or sell and if the current rate of return on trust investments generally is lower than the legal rate. The LABA Committe apparently disagrees with this view and would make the trustee liable at the 10% rate as a minimum. The LABA Committee also seems to be arguing that the legal rate should be a ceiling unless the trustee actually received or should have received a higher amount. Under the Restatement, the legal rate appears to be a ceiling in cases involving an intentional breach if the other rates are lower. In summary, there appears to be agreement on the legal rate as a ceiling. However, the LABA Committee would also make it a floor, whereas the Restatement permits a lower rate. What does the Commission wish to do?

Cotrustee Liability (Memorandum 84-23, pp. 19-20)

The staff suggested in the memorandum that the Restatement rule on cotrustee liability be enacted. (See Restatement § 224(2) in Memorandum 84-23, Exhibit 1, p. 9.) The LABA Committee is concerned about Restatement Section 224(2)(e) which makes a trustee liable if the trustee "neglects to take proper steps to compel his cotrustee to redress a breach of trust." The LABA Committee asks:

> Just how far must a co-trustee go "to compel a co-trustee to redress a breach of trust?" Is the non-breaching trustee obligated to file suit against this co-trustee? Is he supposed to independently determine whether an act by his co-trustee constitutes a breach? Can the non-breaching trustee wait until the court determines that a breach has occurred? We believe that perhaps that particular subsection should be dropped. We are reluctant to see a co-trustee's liability for the acts of his co-trustee increase too greatly in situations where there was no affirmative consent to or participation in the acts later determined to be improper.

(See Memorandum 84-58, Exhibit 3, p. 5.) As noted in the memorandum, existing Civil Code Section 2239 appears to provide a more limited liability. (See the discussion on page 19 of Memorandum 84-23.) The comment to the Restatement provision does not answer all the questions posed by the LABA Committee; it gives the following illustration:

> A and B are co-trustees. A knows that B has embezzled a part of the trust property but makes no effort to compel him to make restitution. A is liable for breach of trust.

It seems clear that under these circumstances, the co-trustee is obliged to file suit, if no other steps can obtain the proper restitution. It also appears to the staff that as a general proposition, the Restatement provision is a reasonable statement of the law and that it is merely a consequence of the basic fiduciary principle.

The LABA Committee is also concerned with the situation where one cotrustee has a greater expertise than the others. (See Memorandum 84-58, Exhibit 3, pp. 5-6.) The Committee suggests that it is undesirable to make a widow-cotrustee liable for allowing investment decisions to be made by the cotrustee who is an investment advisor. The staff does not think this example falls within the scope of the liability in Restatement Section 224(2)(e). We also doubt that it would be an improper delegation under Restatement Section 224(2)(b), particularly in light of the broader powers of delegation proposed in the draft statute attached to Memorandum 84-22.

Limitations (Memorandum 84-23, pp. 21-22)

The LABA Committee expresses doubt about what statute of limitations rule the staff is proposing. (See Memorandum 84-58, Exhibit 3, p. 6.) The proposed statute of limitations is discussed in the last paragraph on page 22 of Memorandum 84-23, although through an omission the draft statute was not set out. As approved by the Commission in June 1983, this provision reads as follows:

§ ____ . Limitations on proceedings against trustees after final account

____ . (a) Unless previously barred by adjudication, consent, or limitation:

(1) If a beneficiary has received an interim or final account in writing that fully discloses the subject of a claim, a claim against the trustee for breach of trust is barred as to that beneficiary unless a proceeding to assert the claim is commenced within one year after receipt of the account.

(2) If an interim or final account does not fully disclose the subject of a claim, a claim against the trustee for breach of trust is barred as to that beneficiary unless a proceeding to assert the claim is commenced within one year after the beneficiary discovered, or reasonably should have discovered, the subject of the claim.

(b) For the purpose of subdivision (a), a beneficiary is deemed to have received an account if, in the case of an adult, it is received by the adult personally or in the case of a minor or person under legal disability, it is received by the person's representative.

Comment. Section ____ is a new provision and is drawn in part from Uniform Probate Code Section 7-307. Under prior law, the four-year limitations period provided in Code of Civil Procedure Section 343 was applied to actions for breach of express trusts. See Cortelyou v. Imperial Land Co., 166 Cal. 14, 20, 134 P. 981 (1913); Oeth v. Mason, 247 Cal. App.2d 805, 811-12, 56 Cal. Rptr. 69 (1967). This provision does not displace the statute of limitations applicable to actions for relief on the ground of fraud. See Code Civ. Proc. § 338(4).

The LABA Committee argues for a six-month period as allowed under Code of Civil Procedure Section 473 (relief from judgment). The staff suspects we may be dealing with two separate issues here. The above draft section deals with the statute of limitations running from a written accounting or from the time the beneficiary learns or should have learned of the facts. This is a different question from the finality of court decree approving an accounting. We have not proposed to reexamine or alter the normal rules of civil procedure on finality, and so we have nothing to say about Code of Civil Procedure Section 473. The draft section covers all cases, with the exception of fraud, where the traditional

three-year period would apply. If the trustee makes a full disclosure of the subject of a claim in a written accounting, the statute of limitations runs one year from the date of the accounting. In any other situation (other than fraud), the same period of limitations applies, but it runs from the date the beneficiary discovered, or should have discovered, the facts. This scheme covers all bases; there is no room for applying the general four-year statute.

The CBA has suggested a one-year statute as applied to an accounting and a four-year statute if there is no accounting filed. (See Memorandum 84-58, Exhibit 4, p. 4.) The CBA argues in support of this suggestion:

> This provision would be consistent with the statute of limitation provisions under ERISA and should be included in order to give a reasonable period of time within which a beneficiary may complain of a trustee's actions absent fraud.

Does the Commission wish to reconsider the policy on limitations in light of these comments?

Laches (Memorandum 84-23, p. 23)

The LABA Committee agrees that there is no reason to "legislate on the issue of laches." (See Memorandum 84-58, Exhibit 3, p. 7.)

Exculpation (Memorandum 84-23, p. 23)

The staff questioned the wisdom of codifying any recognition of the power of a trustor to exculpate the trustee from liability for breach. The LABA Commitee reads "Civil Code Section 2258 as giving a fairly broad mandate to the trustee to follow all the directions of the trustor, including those which may be contrary to the usual rules of trust law." (See Memorandum 84-58, Exhibit 3, p. 6.) The staff considers Section 2258 to be an overstatement where it says that the trustee must follow all the directions of the trustor given at the time of its creation. This appears to be an oral modification rule, more than an exculpation statute. Subdivision (b) of Section 2258 does provide that the trustee "shall incur no liability to any person having a vested or contingent interest in the trust and may follow such instructions regardless of any fiduciary obligations to which the directing party may also be subject." But this relates strictly to revocable trusts, and so it is not a general statutory adoption of an exculpation rule. The staff's viewpoint is simply that for a relationship to be properly characterized as a trust and treated as such by the state, it must conform to certain broad

standards. Just as a trustee can not exercise totally unbridled discretion, the trustee can not operate free of all liability to the beneficiaries. Of course, Restatement Section 222 does not suggest that the trustee is to be held harmless against all liabilities. The issue for the Commission's decision is whether a limited recognition of the power of the trustor to exculpate the trustee for innocent breaches should be codified. The Commission should read the arguments of the LABA Committee in full as set out on pages 6 and 7 of Exhibit 3 to Memorandum 84-58.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

MEMORANDUM NO. 6

CLRC Study L-640, Memorandum 84-23

To: Paulette Leahy

From: Melvin H. Wilson

Date: June 13, 1984

Subj: Breach of Trust

Part I, A 4 of the Memorandum relates to "Appointment of a Receiver. The comment does not cite any California cases and it is presumed that the staff found none. I direct your attention to Estate of Joslyn (1967) 256 Cal. App. 2d 671, 64 Cal. Rptr. 386, in which a corporate fiduciary was appointed "interim trustee" pending resolution of objections to the appointment of an individual successor trustee. A beneficiary made a successful collateral attack on that order by appealing a subsequent order instructing the "interim trustee." The basis for the appeal was that the court lacked jurisdiction to appoint an "interim trustee" because the proceeding in which the interim trustee was appointed was not noticed as one for appointment of an interim trustee. There is considerable case law which refutes the appellate court's conclusion as to the lack of jurisdiction.

The Joslyn case, coupled with the comment under I, A, 5, Removal of Trustee, indicates there is a need for some clear rules for the court's authority to appoint a "temporary trustee" pending resolution of a contested or appealed removal or successorship proceeding. Probate Code §2250 et seq might serve as a model for such provisions.

I, A, 9, Tracing and Recovery of Trust Property or its Substitute. Clapp v. Vatcher (1909) 9 Cal. App. 462, 99 P. 549, deals with the measure of

damages in a civil action to recover the value of real property converted by the defendant.

II, C, Measure of Damages, is the most sensitive area covered by the LRC Study. The most significant issues are whether an equity court can award either or both consequential compensatory and punitive damages to beneficiaries (as contrasted with the trust corpus) in a breach of trust case. Although a number of recent appellate and trial court decisions seem to recognize that an equity court has jurisdiction to award consequential and punitive damages to the beneficiaries, a statement in Pitzer v. Security Pacific National Bank (May 16, 1984) Court of Appeal, Second District, Division 5, 2d Civ. No. 67448 (Certified for Publication), is contrary. On page 15, Footnote 11, the court stated: "Since the matter at bench for adjudication is exclusively within the jurisdiction of the probate court, respondents' inclusion of a claim for damages erroneously sought to expand those remedies presently available for breach of a testamentary trust. The remedies which were sought, those being an award of compensatory and punitive damages, are beyond the jurisdiction of the probate court to award." (Emphasis supplied)

Simply stated, the policy question which must be resolved is are beneficiaries entitled to compensatory or punitive damages for breaches of trust by a trustee in an exclusive jurisdiction equity case proceeding involving the internal affairs of a trust?

If the policy decision is that they are not entitled to an award by the court of such damages in an exclusive equity jurisdiction case involving the internal affairs of the trust under proposed §4601(a) (Memorandum 84-29), then the Pitzer decision comment is valid on that point and does not create the obvious paradox of it being necessary to try an equity case and a civil case

concurrently under proposed §4601(b) because the factual issues are essentially the same.

On the other hand, if, under the law of this state (which a number of trial courts and some appellate courts seem to believe is the case), beneficiaries are entitled to compensatory and punitive damages arising from a breach of trust, and if, as the Pitzer decision states, they may not recover such damages in an exclusive jurisdiction equity proceeding under proposed §4601(a), then they must be entitled to recover such damages in a civil action. That, of course, is consistent with the policy reflected in §4601(b) which in turn reflects the general policy of this state to expedite trials by consolidating proceedings where there are common issues of fact.

The concurrent jurisdiction environment is one in which a trustee can be exposed to the risk of a jury awarding outrageous damages for simple negligence. An example is the Pitzer case. The beneficiaries were able to convince a jury that the trustee committed a variety of heinous wrongs in selling real property and as a consequence, the jury awarded the three beneficiaries an aggregate of $24,500 in emotional distress and $2,000,000 in punitive damages, while the court awarded slightly less than $25,000 in the surcharge proceeding. In a separate civil cause of action, which the appellate court held was the only cause of action properly triable by the jury, the award was $3,000 compensatory damages for alleged interference with the plaintiff's irrevocable license to use water from a well on the trust property.

A collateral concern with the concurrent jurisdiction issue is that unless the trial judge clearly understands the scope of his jurisdiction, he can very easily lose control of the case. All too often, the judge, being used to conducting civil cases in which the jury is the sole trier of fact,

will abdicate his responsibility to try the equity case by allowing the jury to try the whole case.

The appellant's brief in both Estate of Pitzer (the surcharge portion of the consolidated case) and Pitzer v. Security Pacific National Bank (the civil action) cite numerous errors on the part of the trial court which resulted in the jury hearing all of the plaintiff's evidence but not all of the defendant's rebutting evidence because that related to the probate case.

A comparable situation occurred in Edgar v. Bank of America (1942) 50 Cal. App. 2d 827, 123 P.2d 885. Edgar involved a title holding trust for 80 acre tract on west side of Central Valley acquired by 30 owners in 1921. The bank was expressly precluded from selling the property. The land was arid, leased for grazing, and the income barely covered taxes. In 1936, the bank was approached by Scott and Stahl who believed the property would arable if water could be developed. They offered to purchase property for $800. The bank mistakenly believed it owned property in fee and agreed to sell for $200 down, $600 balance in installments and reserved mineral rights. Scott & Stahl drilled two wells on the property at a cost of $4,500 and leased 900 acres adjoining the property and began to farm all of the 980 acres.

In 1937, a beneficiary discovered th farm operation and reported this to the bank. The bank investigated and, upon discovering its error, repurchased the property for $5,000 and forgiveness of balance of purchase price of $500. Scott & Stahl reserved right to possession for 4 years at $400 per year, and agreed to surrender the wells intact at end of term.

The beneficiaries sued for loss of use and occupancy and rents during the term of the reservation. Over the bank's objection, the action was tried before a jury. At the conclusion of their case, plaintiffs stated that they were uncertain whether the case was one at law or equity and would have no

objection if the jury were either dismissed or retained as an advisory jury. The court retained the jury in an advisory capacity. The jury returned an advisory verdict of $25,000 against bank. The trial court made findings that the award of $25,000 was for loss of use and occupancy, rents, issues and profits, "and loss of rents for use of water applied to the adjacent lands", without stating the breakdown.

The appellate court, page 832, said "[to] apply the rules claimed by respondents alone to this case would work an injustice and not only give to them the pound of flesh they claim but also innocent blood to which they are not entitled. While appellant bank should be held liable for the result of its negligence in accordance with the rules of law applicable, it cannot be said that respondents may benefit by any judgment that indicates an award of punitive damages."

The court analyzed CC §§2229 and 2237 to determine whether the evidence was responsive to the election of remedies required by those sections and thus whether it was competent to support the findings. The court concluded that the evidence was not responsive and thus not competent. It summarized the rules, page 833, as follows: "Under no theory of law would the plaintiffs be entitled to recover both the value of the use and occupation <u>and</u> the rents, issues and profits. If they elected to charge the bank for the value of the use and occupation, the bank would be entitled to retain the rents, issues and profits. They cannot have both. Whether the judgment is for any one or more of these items cannot be determined from the findings. The findings are not definite and furnish no reasonable basis for damages in the sum mentioned in the judgment. (Cases cited) The complaint should have charged definitely and specifically the theory under which recovery was sought."

Judith I. Bloom, in The Right to a Non-Jury Trial For Trust and Probate Issues, Los Angeles Lawyer, June 1984, Page 34, summarizes by stating: "Case law development suggests that juries can be ineffectual, even counterproductive, in supervising fiduciaries." I might add that juries may be downright dangerous to a fiduciary's health and if the Pitzer conclusion accurately states the law, the consumer public which is increasingly utilizing the services of fiduciaries, particularly those provided by "target defendants", the banks, may soon find those services are no longer available. The reason is simply that the uncontrollable (everyone makes mistakes now and then) negative impact on the "bottom line" of just a few exorbitant jury awards will make unacceptable the risks of continuing to provide those services. As a rough rule, considering the average fees charged by corporate fiduciaries and assuming a 5% post-tax profit margin for trust departments, for every dollar of jury award, a trustee would have to add $2,000 in assets managed to offset the loss. In other words, for a $100,000 punitive damage award, the trustee would have to book 500 new $400,000,000 trust accounts to offset the loss for that year. Even if some amortization theory applied, the bottom line pressure would still exceed the risk tolerance of contemporary managers.

II, D, Statutory Formulation of the Measure of Damages. I note that the staff does not appear to focus on §203 of the Restatement. If this is an indication that they do not embrace it, I heartily agree. See my Memorandum 3 dealing with loans to purchasers of trust property. Incorporation of Restatement §203, which is incorporated in the Texas statute [§114.001(a)], would prevent totally innocent loans to purchasers of trust property and a variety of other normal banking transactions. However, I still believe we

should have some statutory clarification, such as my suggestion in my Memorandum 3 on loans, that the holding in Pitzer be codified.

I believe that the staff recommendation at the bottom of page 17 that replacing CC §§2237 and 2238 with Restatement §205 [when coupled with proposed §4601(a)] will accomplish about all we can reasonably expect.

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