

Memorandum 84-23

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

This memorandum discusses the remedies for breach, the measure of a trustee's liability, and limitations on actions for breach of trust. When the trustee violates a duty owed to the beneficiary, the beneficiary may pursue any number of remedies against the trustee or the property for breach of the trust. In California, as in most jurisdictions, this area of the law is largely governed by case law and the Restatement rules. (See Exhibit 1 for a copy of the Restatement (Second) of Trusts rules on remedies for breach.) California statutory law relating to breach of trust is unsatisfactory; it is sketchy, scattered through the trust statutes and elsewhere, and awkwardly worded. (See Exhibit 2 for the text of various California statutes bearing on breach of trust.) A threshold question is the extent to which rules pertaining to breach of trust should be codified. This is probably the least codified area of trust law remaining in California. The staff proposes that the Commission recommend enactment of a statute providing the main remedies for breach of trust and the basic rules on liability. If the Commission does not approve this approach, the staff believes it would be better to rely on the common law than to continue most of the existing statutes in this area.

The gamut of general law and California law are discussed below; some specific suggestions are also made as to statutory language. The topics are arranged as follows:

Part I

A. Remedies for Breach of Trust

1. Compelling Performance of Duties
2. Enjoining Threatened Breaches
3. Setting Aside Wrongful Acts of Trustee
4. Appointment of a Receiver
5. Removal of Trustee
6. Requiring or Increasing Amount of Trustee's Bond
7. Reduction or Denial of Compensation
8. Lien on Proceeds of Wrongful Disposition

9. Tracing and Recovery of Trust Property or its Substitute
10. Liability for Damages
11. Miscellaneous Remedies

B. Statutory Formulation of Remedies for Breach of Trust

Part II

C. Measure of Damages

1. Improper Sale of Trust Property
2. Improper Failure to Sell Trust Property
3. Improper Investments and Purchases
4. Improper Failure to Purchase or Invest
5. Determination of Damages Upon Multiple Breaches
6. Balancing Losses Against Gains

D. Statutory Formulation of the Measure of Damages

Part III

E. Related Issues

1. Interest
2. Liability for Acts of Agents
3. Cotrustee Liability
4. Liability of Successor Trustee

Part IV

F. Limitation, Bar, and Exculpation

1. Consent of Beneficiary
2. Ratification by Beneficiary
3. Release by Beneficiary
4. Statute of Limitations and Discharge by Court Decree
5. Laches
6. Exculpation

G. Statutory Treatment of Limitation, Bar, and Exculpation

Part V

H. Conclusions

Part I

A. Remedies for Breach of Trust

1. Compelling Performance of Duties

The beneficiary may bring an action to compel the trustee to perform the duties under the trust. Restatement (Second) of Trusts § 199(a) (1959) [hereinafter cited as Restatement]. The trustee may be compelled to perform a particular act, such as selling trust property, distributing income or property, making an investment, or conveying property to a successor trustee. G. Bogert, The Law of Trusts and Trustees § 861, at 18-19 (rev.2d ed. 1982) [hereinafter cited as Bogert, Treatise]. The trustee may also be compelled to perform the trust in general. Id., at 18.

California statutes bear only obliquely on this remedy. Civil Code Section 863 provides that while the beneficiary of a trust in real property takes no title to the property, the beneficiary may "enforce the performance of the trust." Civil Code Section 2251 provides that the beneficiary may "take advantage [of the trust] at any time prior to its rescission." The staff has discovered no leading California cases on specific performance of private trusts. However, the cases do clearly recognize the authority of the Attorney General to sue to enforce charitable trusts. See People ex rel. Ellert v. Cogswell, 113 Cal. 129, 136, 45 P. 270 (1896). Cases have also recognized the right of a cotrustee to sue to enforce a charitable trust. Pratt v. Security Trust & Sav. Bank, 15 Cal. App.2d 630, 640-41, 59 P.2d 862 (1936); Holt v. College of Osteopathic Physicians & Surgeons, 61 Cal.2d 750, 755-57, 394 P.2d 932, 40 Cal. Rptr. 244 (1964).

2. Enjoining Threatened Breaches

The beneficiary may bring an action to enjoin the trustee from committing a breach of the trust. Restatement § 199(b). Examples of enjoined breaches include the making of an oil and gas lease that would constitute waste as to the remainder beneficiary, the transfer of property prohibited in the trust, the misappropriation of trust funds, and the voting of stock in a particular way. Bogert, Treatise § 861, at 11.

Civil Code Section 3422 provides that a "final injunction may be granted to prevent the breach of an obligation existing in favor of the applicant . . . [w]here the obligation arises from a trust." See also Code Civ. Proc. § 526(7). In St. James Church of Christ Holiness v.

Superior Court, 135 Cal. App.2d 352, 359-62, 287 P.2d 387 (1955), a trustee was enjoined from misrepresenting himself as authorized to act for others, interfering with rent collections, continuing in possession of trust property, and interfering with church operations.

3. Setting Aside Wrongful Acts of Trustee

If it is too late to enjoin a breach but not yet so late that the rights of bona fide purchasers would be impaired, the beneficiary may seek to set aside wrongful acts of the trustee. See Bogert, Treatise § 861, at 16-17. This remedy has been used mainly to avoid conveyances. The staff has not found any California law on this remedy.

4. Appointment of a Receiver

The beneficiary may seek appointment of a receiver to take possession of trust property and administer the trust. Restatement § 199(d). This remedy would normally be used pending a decision on some other form of relief. See id. comment d; Bogert, Treatise § 861, at 13. In California, Code of Civil Procedure Section 564(1) provides for appointment of a receiver when there is a dispute between persons "jointly owning or interested in any property or fund . . . where it is shown that the property or fund is in danger of being lost, removed, or materially injured." Section 564(7) also provides authority for appointing receivers "[i]n all other cases where receivers have heretofore been appointed by the usages of the courts of equity."

5. Removal of Trustee

A trustee may be removed for a sufficiently serious breach or threatened breach of the trust. Restatement § 199(e) & comment e. If the trustee who is removed was a sole trustee, the court may also appoint a successor. Id. A related measure is the appointment of a new cotrustee without removing any other trustee. In re La Rocca's Trust Estate, 419 Pa. 176, 213 A.2d 666 (1965). Breaches that have provided grounds for removal include disobedience to court orders or the trust instrument, failure or refusal to act, comingling trust property, failure to account, acquisition of an adverse interest, accepting unauthorized compensation, appropriation of trust funds, and breaches resulting in large losses to the trust. See G. Bogert, Handbook of the Law of Trusts § 160, at 576 (5th ed. 1973) [hereinafter cited as Bogert, Handbook].

Civil Code Section 2283 provides that the court may remove a trustee "who has violated or is unfit to execute the trust," but this authority does not apply to removal of a trustee of a testamentary trust under a will probated in California. Probate Code Section 1123.5 provides a detailed procedure for removal of a testamentary trustee "who has violated or is unfit to execute the trust or has acquired any interest or become charged with any duty adverse to the interest of any beneficiary in the subject of the trust." This latter section also gives the court authority to remove any or all of the cotrustees of a testamentary trust where "hostility, ill feeling, or continued lack of cooperation among and between cotrustees has impaired the proper administration of the trust." (The subject of removal of trustees generally is discussed in Memorandum 84-26.)

6. Requiring or Increasing Amount of Trustee's Bond

If the trustee has provided a surety bond, it will provide a fund for the recovery of damages. Some courts may order the giving of a bond to secure faithful performance of the trust in the future if the trustee has breached the trust or threatens to do so. Bogert, Treatise § 861, at 11. The court may also order an increase in the amount of an existing bond or require new sureties. Id., at 11-12; see also Tex. Trust Code § 113.058(d).

The staff has not found any California case asserting the power of a court to require a bond. In Memorandum 84-26 the staff proposes that the statute give the court discretion to require a bond where necessary to protect the interests of beneficiaries.

7. Reduction or Denial of Compensation

A court has discretion to deny the trustee all compensation or reduce compensation for a breach of the trust. Restatement § 243; Bogert, Treatise § 861, at 23; see also Tex. Trust Code § 113.082. California law provides for the determination of compensation and the allowance of a greater compensation under appropriate circumstances, but does not provide for a reduction or denial of compensation in the event of breach. See Civil Code § 2274; Prob. Code §§ 1122, 1138.1(a)(7).

8. Lien on Proceeds of Wrongful Disposition

If the trustee acquires property as the product of a wrongful disposition of trust property, the beneficiary may have an equitable lien on the property in the hands of the trustee or may enforce a con-

structive trust as a method of securing a claim against the trustee for damages. Restatement § 202; Bogert, Handbook § 158, at 569-70. Under this theory the product is treated as the property of the trustee personally whereas under the tracing remedy the product is treated as a substitute for the trust property. Id., at 570. The advantage of the equitable lien is that the claim for damages may be asserted against the product with priority over general creditors of the trustee. Restatement § 202 comment a. The constructive trust results in securing the benefit of the wrongful transaction to the beneficiary if it is a profitable one. Id. Another advantage is that the usual exemptions from creditors' claims do not apply to enforcement of an equitable lien or constructive trust in this situation. Id., comment d.

Equitable liens and constructive trusts have long been recognized in California. See *Citizens' Bank v. Rucker*, 138 Cal. 606, 609-10, 72 P. 46 (1903); cases cited in 7 B. Witkin, *Summary of California Law Trusts* § 86, at 5446 (8th ed. 1974) [hereinafter cited as *Witkin, Trusts*]. The details of this type of equitable remedy, usually used in conjunction with some other remedy, are probably best left to case law.

9. Tracing and Recovery of Trust Property or its Substitute

The beneficiary may follow the trust property or its substitute into the hands of persons other than bona fide purchasers and obtain the return of the property or its product to the trust. See Bogert, Handbook §§ 161-165; Witkin, *Trusts* §§ 86-88, at 5446-49; Restatement § 202. Many technical rules have been developed over the years to deal with the problems of tracing different forms of property and different mixtures of funds. For example, if the trustee has mingled trust funds with personal funds, it is presumed that withdrawals are of the personal funds, leaving the trust funds intact. Witkin, *Trusts* § 88, at 5447. The Restatement rule gives the beneficiary a proportionate share of the funds remaining on deposit and the funds withdrawn, but if the withdrawn funds are dissipated, the beneficiary is entitled to the funds remaining on deposit. Restatement § 202 comment i. If the trustee later deposits money in the account, the general rule is that the deposit does not restore the dissipated trust funds, and the beneficiary may reach only the lowest intermediate balance. Id. comment j. However, if the withdrawn funds were not dissipated after withdrawal, but were redeposited, it is as if the withdrawal had never been made. Id. comment 1. The funds deposited after withdrawal and dissipation replenish the trust if the

trustee manifests an intention to make restitution or if the deposit is made in an account in the name of the trustee as such and not as an individual. Id. comment m. Where two or more trust funds are mingled, the Restatement has rejected the first-in-first-out rule in favor of a rule entitling the beneficiaries to share proportionately in the products of the mingled funds. Id. comment n.

By and large and to the extent it is known, California law seems to be in accord with the basic principles of the Restatement. See Witkin, Trust §§ 86-88; Noble v. Noble, 198 Cal. 129, 135, 243 P. 439 (1926); Keeney v. Bank of Italy, 33 Cal. App. 515, 517, 165 P. 735 (1917); Carlin v. Masten, 118 Cal. App. 373, 376, 5 P.2d 65 (1931); People v. California Safe Deposit & Trust Co., 175 Cal. 756, 759, 167 P. 388 (1917). The bona fide purchaser rule is codified in a roundabout way in Civil Code Section 2243 which declares that "[e]very one to whom property is transferred in violation of a trust, holds the same as an involuntary trustee under such trust, unless he purchased it in good faith, and for a valuable consideration." In one respect, however, California law has rejected the Restatement rule, and that is where withdrawn funds have been dissipated and then restored. In Church v. Bailey, 90 Cal. App.2d 501, 504, 203 P.2d 547 (1949), the court held that the funds so deposited went to the trust and it was unnecessary to show an express intention on the part of the trustee to replace the trust funds.

Most cases involve tracing funds, but the beneficiary may trace the trust property into other forms. For example, in one case where trust funds were used to buy a drug store that was operated by the trustee in his own name for four years, the court found that the store and its stock were the identical property originally covered by the trust, i.e., the business, so that the proceeds of the sale of the business by the trustee's estate represented the trust fund. Byrne v. McGrath, 130 Cal. 316, 320-21, 62 P. 559 (1900).

The staff would continue California law but not codify its details.

10. Liability for Damages

The trustee is liable for damages arising out of a breach of the trust. See Restatement §§ 199(c), 205; Bogert, Treatise § 862, at 27-28. The trustee is personally liable in an action to recover damages or on an accounting where the trustee may be surcharged. Id. Liability for damages typically arises from breaches involving actions such as

unauthorized payments to beneficiaries, conversion of trust property, retention of property that should be sold or selling property that should be retained, negligence or misconduct in making or retaining investments, or mishandling duties such as recording instruments affecting trust property, obtaining security, or collecting trust property. Id., at 29-31.

It is elementary that California case law recognizes the trustee's liability for damages for breach of trust. See Witkin, Trusts § 85, at 5445. Several statutory provisions recognize this liability as well. See Civil Code §§ 2236-2238, 2262. The difficulty in this area involves the measure of damages for particular types of breach; this is discussed below. Naturally the staff proposes to recognize the action for damages as an appropriate remedy for breach of trust.

11. Miscellaneous Remedies

Several other remedies may be mentioned:

(1) The beneficiary has the right to obtain information necessary to secure performance of the trust or obtain a redress of breach. Hence, the beneficiary has a right to an accounting and may be permitted to inspect trust property. See Bogert, Treatise § 861, at 7-8. (The trustee's duty to account is discussed in Memorandum 84-21; proceedings to obtain an accounting are discussed in Memorandum 84-29.)

(2) A trustee who misappropriates trust property may be criminally liable for embezzlement. Penal Code § 506; *People v. Stanford*, 16 Cal.2d 247, 105 P.2d 969 (1940).

(3) Rescission is not a remedy for breach of a trust, although in a case where creation of a trust was induced by fraud, the trust may be set aside. See Bogert, Treatise § 861, at 23-24.

B. Statutory Formulation of Remedies for Breach of Trust

To what extent should remedies for breach of trust be codified? The staff's position is that a brief catalogue of the important remedies would be useful. It appears that few states have such a statute, but this is not surprising since trust law in general has been largely neglected in state statutes.

Consider the following provision from the Indiana Trust Code; it is the most detailed statute the staff has discovered:

§ 30-4-3-11.

(a) A beneficiary of a trust may maintain an action:
(1) to compel the trustee to perform his duties;
(2) to enjoin the trustee from committing an act which may be a breach of trust;
(3) to compel the trustee to redress a breach of trust; or
(4) to remove a trustee for cause and to appoint a successor trustee.

(b) If the trustee acquires property and wrongfully holds it outside the trust, a beneficiary is entitled at his option to either:

(1) require the property to be transferred to the trust or
(2) impose an equitable lien upon it to secure his claim for damages for breach of trust.

(c) If the trustee commingles the trust funds or property with his own funds or property or converts the trust fund or property into another form which is wrongfully held outside the trust: or

(1) if the fund or property can be traced and identified, the beneficiary is entitled to restoration of the fund or property to the trust;

(2) if the fund or property can not be traced and identified,

(A) In a case of commingling of funds or property, the beneficiary is entitled to a lien against the trustee's individual property from the date and in the amount of the fund or the value of the property at the time of the commingling.

(B) In a case of conversion of property, the beneficiary is entitled to a lien against the trustee's individual property from the date and according to the value of the property at the time of the conversion.

(d) If the trustee is also a beneficiary, the other beneficiaries will be entitled to a charge against the trustee's beneficial interest to secure their claims against him for a breach of trust.

(e) If a beneficiary successfully maintains an action under subsection (a) of this section or is entitled to a judgment under subsections (b), (c), or (d) of this section, he is entitled to a judgment for reasonable attorney's fees.

A simpler statute is Section 2221 of the Louisiana Trust Code which provides as follows:

A beneficiary of a trust may institute an action:

(1) to compel a trustee to perform his duties as trustee;
(2) to enjoin a trustee from committing a breach of trust;
(3) to compel a trustee to redress a breach of trust;
(4) to remove a trustee.

This provision is drawn from Restatement Section 199, but the Louisiana provision omits reference to appointment of a receiver. Is the Commission interested in proposing a statute like either of these?

A statute that lists important remedies for breach might read as follows:

(a) A violation by the trustee of any duty that the trustee owes the beneficiary is a breach of trust.

(b) Upon a breach of trust or a threatened breach, the beneficiary may commence an action or proceeding for any of the following purposes:

- (1) To compel the trustee to perform the trustee's duties.
- (2) To enjoin the trustee from committing a breach of trust.
- (3) To compel the trustee to redress a breach of trust by payment of damages, surcharging the trustee, or making restitution.
- (4) To appoint a receiver to take possession of the trust property and administer the trust.
- (5) To remove the trustee.
- (6) To set aside acts of the trustee.
- (7) To reduce or deny compensation of the trustee.
- (8) To impose an equitable lien or enforce a constructive trust of trust property remaining in the hands of the trustee.
- (9) To trace trust property that has been wrongfully disposed of.

(c) The availability and application of the remedies for breach of trust described in subdivision (b) are governed by the common law.

(d) Nothing in this section is intended to prevent resort to any other remedy for breach of trust available under any other statute or the common law.

Part II

C. Measure of Damages

The general rule is that the beneficiary injured by the breach of trust should be made whole by the damages, that is, the beneficiary should be restored to the same condition as if the wrong had not been committed. Bogert, Treatise § 701, at 198; Restatement § 199(c), § 205 comment a. Under the Restatement rule, the beneficiary generally has the option of seeking:

- (a) any loss or depreciation in value of the trust estate resulting from the breach of trust; or
- (b) any profit made by him through the breach of trust; or
- (c) any profit which would have accrued to the trust estate if there had been no breach of trust.

Restatement § 205. It is important to remember that equitable rules are at play here; comment g to Restatement Section 205 states that:

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 will be seen, California law makes allowance for trustees who have not committed a breach in bad faith. Professor Niles has noted the trend away from strict liability and toward "imposing liability for compensatory damages only when there is proof of fault and of a causal relation between fault and injury." Niles, A Contemporary View of Liability for Breach of Trust 18 (Mortimer H. Hess Memorial Lecture) (1974).

Refinements of the general principles of Restatement Section 205 are applicable depending upon the nature and seriousness of the breach. Categories of breach are frequently analyzed in terms of whether there was an improper sale or retention of property, an improper investment, or a failure to invest.

1. Improper Sale of Trust Property

Restatement Section 208 provides four alternative measures of liability where the trustee sells property that the trustee has a duty to retain: (1) value at the time of sale, plus interest; (2) value at the time of the decree plus income that would have accrued if it had not been sold; (3) specific reparation, if reasonable under the circumstances; and (4) accounting for the proceeds of the sale. The second of these measures of damages has been troublesome since the damages may be significant in a situation where property such as shares of stock or paintings has greatly appreciated between the time of sale and the time of the action against the trustee. Because of the sense that "appreciations damages" can be punitive, courts have on occasion reserved this measure for particularly culpable trustees, and applied a lesser measure where the trustee has been merely negligent or made a good faith mistake. See, e.g., *Estate of Rothko*, 84 Misc.2d 830, 379 N.Y.S.2d 923 (1975); *Estate of Talbot*, 141 Cal. App.2d 309, 296 P.2d 848 (1956).

The leading California authority in this area is *Estate of Talbot*. In *Talbot* the trustee had discretion to sell property but was found to have committed a breach of trust by relying on advice of one of the beneficiaries and failing to exercise an independent judgment. This case was thus distinguished from cases where the trust imposes a specific duty to hold specific property. Among other things, to support this distinction the court pointed to language in comment b to Restatement Section 208 to the effect that the section "does not include the situation

where the trustee is authorized to sell, but commits a breach of trust by selling at an improper price or otherwise." The Talbot court also had to attempt to make sense out of Civil Code Sections 2237 and 2238 which then read as follows:

2237. A trustee who uses or disposes of the trust property contrary to Section 2229 [dealing with property for a purpose unconnected with trust], may, at the option of the beneficiary, be required to account for all profits so made, or to pay the value of its use, and, if he has disposed thereof, to replace it, with its fruits, or to account for its proceeds, with interest.

2238. A trustee who uses or disposes of the trust property in any manner not authorized by the trust, but in good faith, and with intent to serve the interests of the beneficiary, is liable only to make good whatever is lost to the beneficiary by his error.

The court determined that the trustee was in good faith and so made only a technical breach of the duty to exercise discretion, since the trustee had no duty to retain the property. Since the beneficiaries could not have compelled retention of the stock in this case, the proper measure of damages was the loss to the corpus (capital gains taxes and expenses of sale), plus interest. The court, in effect, moved from the Field Code toward the Restatement; hence the statutory the measure of damages, in this light needs to be put on a more rational basis.

2. Improper Failure to Sell Trust Property

If the trustee fails to sell property that the trustee has a duty to sell, the measure of damages under Restatement Section 209 is the amount that would have been received if the property had been sold, with interest thereon. The comment to this section does not limit its application to cases where a specific duty to sell is stated in the trust, although the illustrations in the comment involve stock which the trustee is directed to sell within six months. Compare Restatement § 208 & comment b, discussed supra. By its terms, Restatement Section 209 would apply to a situation where the trustee committed a breach of trust by failing to sell unproductive or underproductive property. Thus, a situation similar to that in Estate of Talbot, supra, could arise where the trustee breached the trust by failing to exercise an independent judgment so that property that should have been sold was retained. If the property has greatly depreciated in value (the opposite direction from the facts in Talbot), the damages for an "innocent" breach would be the same as in Talbot. Presumably the court would find the same objections

to this rule, but it would be more difficult to reach the desired result because of the difference in language of the Restatement comments.

There is some thought that the trustee should not be held liable for the full amount of the loss under Restatement Section 209 if the market has been in a general decline and the breach was not in bad faith. See Restatement § 211 comment d, § 212 comment e; Bogert, Treatise § 701, at 208.

In California, Civil Code Section 2261(2) permits a trustee to retain trust property, unless otherwise directed by the trust, if it is prudent to do so. Civil Code Section 2262 provides that if the trustee "omits to invest the trust moneys according to [Section 2261], he must pay simple interest thereon, if such omission is negligent merely, and compound interest if it is willful." These provisions give little guidance.

3. Improper Investments and Purchases

Under Restatement Section 210, a trustee who purchases property that the trustee has a duty not to purchase may be charged with the amount expended, plus interest, or required to account for the property purchased. The application of this section is limited to situations where the trustee is under a duty not to purchase certain property and does not include situations where the trustee has authority to purchase the property but breaches some duty in doing so. Restatement § 210 comment a. The illustrations to Section 210 indicate that this section deals with situations such as where the trustee is directed to invest only in bonds, and instead buys stock. If the improper investment is profitable, the beneficiary will surely choose to make the trustee accountable for the profit.

Where the trustee breaches the trust by making an improper investment in a manner not covered by Restatement Section 210, the general rules set out in Restatement Section 205 (discussed supra) would apply. This is also the case where the trustee breaches the duty of loyalty by buying property from himself with trust funds. See Restatement § 206. It is not clear, however, in what respects the application of the rules in Section 205 would differ from Section 210.

In California, Civil Code Section 2238 makes the trustee liable "to make good whatever is lost" where an improper investment is made in good faith. This standard would seem to afford the court a broad discretion to fix damages. "To make good whatever is lost" is a fair summary of

the general rule of damages set out in Restatement Section 205. The California statute omits to make clear that the trustee is also liable for any profit made through a good faith breach. Civil Code Section 2237, applicable to breaches involving the use of property for the trustee's own purposes or for a purpose unconnected with the trust, does provide for an accounting for profits made. Restatement Section 205, while not answering all questions, is preferable to the California statutes in this regard.

4. Improper Failure to Purchase or Invest

If the trustee fails to purchase specific property the trustee had a duty to purchase, under Restatement Section 211 the trustee may be (1) charged with its value at the time of the court decree, plus income that would have accrued or (2) required to purchase the property if reasonable to do so and then charged with the difference between the original and current price, plus income that would have accrued. These rules apply to specific property required to be purchased; if the trustee has a choice among several securities, for example, and does not invest in any of them, the least profitable security is the measure of damages. Restatement § 211 comment e. If the trustee violates the general duty to make trust property productive, the trustee is chargeable with the income that normally would accrue from proper investments, but not with the loss of profit that might have resulted because of a general rise in the values in the securities market. Id. comment f.

In California, Civil Code Section 2262 simply provides a liability for simple or compound interest for failing to invest under the prudent man standard set forth in Section 2261. See, e.g., Estate of Prior, 111 Cal. App.2d 464, 471, 244 P.2d 697 (1952) (executor-trustee liable for 7% interest where money deposited in no interest commercial bank account); Lynch v. John M. Redfield Found., 9 Cal. App.3d 293, 302-03, 88 Cal. Rptr. 86 (1970) (trustees of charitable foundation liable for 7% interest on income accumulated in no interest account for 5 years).

5. Determination of Damages Upon Multiple Breaches

Restatement Section 212 provides special rules where a trustee breaches in more than one of the four ways just discussed. For example, if the trustee sells property that was to be retained and buys other property with its proceeds, the beneficiary can pursue one of the remedies for an improper sale under Restatement Section 208 or for an improper purchase under Restatement Section 210. Comment b gives the following as an example:

A is trustee for B of shares of the X Company. By the terms of the trust A is directed to retain the shares. In breach of trust, A sells the shares and with the proceeds purchases shares of the Y Company.

(1) If the shares of the X Company rise in value, A is liable for their value at the time of the decree, less the value of the shares of the Y Company.

(2) If the shares of the Y Company rise in value, A is accountable for their value at the time of the decree.

(3) If the shares of the Y Company fall in value, A is chargeable with the loss, less any loss in value of the shares of the X Company at the time of the decree.

These special rules are subject to the qualification that if the trustee has acted in good faith and incurred a loss, the trustee has a defense if the loss would have occurred anyway. Restatement § 212(4).

These rules appear to be specific cases of the general rule that the beneficiary is to be made whole. Hence, where the trustee wrongfully purchases property and fails to purchase property as required, the trustee is permitted to offset the rise in the value of the property wrongfully purchased against the liability from the failure to purchase other property that rose in value. Restatement § 212(2) & comment c. Losses may be similarly offset; hence, if the improperly purchased property falls in value, the liability for that loss is offset by any loss that has occurred in the value of the property that should have been purchased. Id.

6. Balancing Losses Against Gains

A related problem involves the determination of when it is permissible to offset a gain from one breach of trust against a loss incurred by another breach. The rule of Restatement Section 213 is that the trustee can not balance liability if the breaches are "distinct." Breaches may be distinct if they involve different parts of the trust property. Restatement § 213 comments a & b. A distinct breach with regard to one part of trust property may occur when the trustee has dealings with two different parties regarding the property, or when the string of improper dealings is longer than the transactions described in Restatement Section 212. See Restatement § 213 comment c. Other factors include whether there has been an accounting between breaches, how the property is dealt with between breaches, whether the trustee was acting in good faith, and whether the breaches are the result of a single policy of the trustee. See id. comment e. One authority characterizes the Restatement discussion of what is a distinct breach of trust as "rather vague" and overly

favorable to trustees. Bogert, Treatise § 708, at 253. The complexity of determining damages in this area is bound to lead to some disagreement. The Restatement recognizes that the determination of what is a distinct breach is likely to involve the weighing of several factors and that no positive rule can be laid down to determine the proper weight of the factors in all cases. Restatement § 213 comment e. This is obviously an area that does not lend itself to detailed statutory treatment.

A bill pending before the California Legislature relates to this subject. Assembly Bill 630 would alter the prudent investor rule of Civil Code Section 2261 in part to consider individual investments as part of an overall investment strategy. This would have the effect of permitting a balancing of losses and gains under the umbrella of an "overall investment strategy." It is not clear how this standard would interact with the distinct breach concept in the Restatement.

D. Statutory Formulation of the Measure of Damages

Modern codifications of the liability of a trustee for a breach of trust have been influenced by the Restatement. Section 114.001 of the Texas Trust Code provides as follows:

(a) The trustee is accountable to a beneficiary for the trust property and, except for the trustee's compensation as provided by this chapter or by the terms of the trust instrument, for any profit made by the trustee through or arising out of the administration of the trust, even though the profit does not result from a breach of trust.

(b) 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 that does not result from a failure to perform the duties set forth in Section 113.056 or for any other breach of trust.

(c) A trustee who commits a breach of trust is chargeable with any damages resulting from such breach of trust, including but not limited to:

(1) any loss or depreciation in value of the trust estate as a result of the breach of trust;

(2) any profit made by the trustee through the breach of trust; or

(3) any profit that would have accrued to the trust estate if there had been no breach of trust.

The reference to Section 113.056 in subdivision (b) picks up the prudent investor standard. Subdivision (b) is drawn from Restatement Section 204 and subdivision (c) is nearly the same as Restatement Section 205. Texas law does not go into further detail along the lines of Restatement Sections 208-212 that were discussed supra.

Section 30-4-3-11 of the Indiana Trust Code in relevant part provides:

(a) The trustee is accountable to the beneficiary for the trust estate.

(b) If the trustee commits a breach of trust, he is liable to the beneficiary for:

(1) any loss or depreciation in the value of the trust property as a result of the breach;

(2) any profit made by the trustee through the breach;

(3) any reasonable profit which would have accrued on the trust property in the absence of a breach; and

(4) reasonable attorney's fees incurred by the beneficiary in bringing an action on the breach.

(c) In the absence of a breach of trust the trustee has no liability to the beneficiary either for any loss or depreciation in value of the trust property or for a failure to make a profit.

. . .

Subdivision (b) is Restatement Section 205 with the addition of the liability for attorney's fees. Is the Commission interested in proposing a liability for attorney's fees?

The most detailed provisions on the measure of damages for a trustee's breach of trust are contained in the Louisiana Trust Code. As a general rule, Section 2201 follows Restatement Section 205. Section 2202 enacts Restatement Section 204 relating to nonliability in the absence of a breach. Section 2203 enacts Restatement Section 213 relating to balancing losses against gains.

If California follows the pattern of these other states, the special rules relating to liability for selling, purchasing, failing to sell, and failing to purchase in Restatement Sections 208-211, and the rules on multiple breaches provided in Restatement Section 212 would not be codified. This middle ground appeals to the staff. As suggested supra, Restatement Section 205 provides some more detail than and is preferable to Civil Code Sections 2237 and 2238. Replacing these provisions with the Restatement language would make California law consistent with most jurisdictions where the Restatement is presumed to be influential, if not governing.

The drawback of enacting the Restatement language is that it is still rather general. For example, one must read the comment to the Restatement to find out that the good faith breach or the technical breach do not make the trustee liable for appreciations damages.

Part III

E. Related Issues

1. Interest

The liability for interest has been touched upon in the preceding discussion. California Civil Code Section 2262 has been noted as providing for simple interest upon negligent failure to invest and compound interest upon willful failure to invest. Restatement Section 207 provides for interest at the legal rate or at some other rate in the court's discretion when the trustee incurs a liability for an amount of money with interest thereon. Of course, if the trustee receives a greater amount as interest, the trustee is liable for that amount. The trustee is chargeable with simple interest generally, but may be charged compound interest (1) where compound interest has been received, (2) where the profit cannot be ascertained but may be presumed to be at least equal to compound interest, or (3) where the trustee had a duty to accumulate income. Id.

It is said that the award of compound interest is not made to punish a trustee, but only to prevent the trustee from profitting from wrongdoing. *Miller v. Lux*, 100 Cal. 609, 616, 35 P. 345 (1893). In this case, interest at the legal rate was compounded to compensate for the fact that the market rate exceeded the legal rate.

It appears that liability for interest is not frequently made a subject of trust statutes. Indiana, Louisiana, and Texas do not provide for the recovery of interest. The staff finds the California provision to be too limited since it applies by its terms only to the failure to invest. The staff recommends that Civil Code Section 2262 be replaced with a more general interest provision based on Restatement Section 207.

2. Liability for Acts of Agents

The general rule in Restatement Section 225 is that a trustee is not liable to the beneficiary for acts of agents employed in the administration of the trust. This rule does not shield a corporate trustee from liability for breach by its own officers and employees within the course of administration of the trust. Restatement § 225 comment b. The general rule of nonliability does not apply in situations where the trustee directed the agent's acts, improperly delegated authority to the agent, was negligent selecting or supervising the agent, approved the agent's acts, or fails to take steps to redress the wrong.

Indiana Trust Code Section 30-4-3-11 codifies Restatement Section 225(2) in the following terms:

(d) The trustee is liable to the beneficiary for acts of an agent which, if committed by the trustee, would be a breach of the trust if he:

- (1) directs or permits the act of the agent;
 - (2) delegates the authority to perform an act to the agent which he is under a duty not to delegate;
 - (3) fails to use reasonable care in the selection or retention of the agent;
 - (4) approves, acquiesces in or conceals the act of the agent;
- or
- (5) fails to use reasonable effort to compel the agent to reimburse the trust estate for any loss or to account to the trust estate for any profit.

The staff recommends such a provision for California law.

3. Cotrustee Liability

Under Restatement Section 224 a trustee is not liable for a breach of trust committed by a cotrustee unless the trustee participates in the breach, improperly delegates administration of the trust, approves or acquiesces in a breach, enables the cotrustee to commit a breach by failure to exercise reasonable care, or neglects to compel a redress of the breach. A comparison with Restatement Section 225 shows that the rules are quite similar for agents and cotrustees.

California Civil Code Section 2239 provides that a "trustee is responsible for the wrongful acts of a cotrustee to which he consented, or which, by his negligence, he enabled the latter to commit, but for no others." This appears to provide a more limited liability than that imposed under Restatement Section 224. Civil Code Section 2239 does not seem to impose liability for failure to compel a redress of the breach, although this might fall within the concept of consent, if read broadly. It is also not clear whether mere acquiescence in acts of a cotrustee will lead to liability under Section 2239. In one case the court raised the question of whether Section 2239 should be read literally, but did not answer it. *Gbur v. Cohen*, 93 Cal. App.3d 296, 302, 155 Cal. Rptr. 507 (1979). There is some indication that California courts will not be held to a literal interpretation of Section 2239. In *Blackmon v. Hale*, 1 Cal.3d 548, 559, 463 P.2d 418, 83 Cal. Rptr. 194 (1970), the court quoted *In re Estate of Whitney*, 124 Cal. App. 109, 118, 11 P.2d 1107 (1932), to the effect that a trustee may be liable "by negligent

inattention to his duties, by delinquency therein far short of active participation in the conversion of trust funds by a co-guardian." (The court in Whitney was quoting language from a Minnesota case.)

Both Indiana and Louisiana have codified Restatement Section 224(2). See Ind. Code Ann. § 30-4-3-12 (West 1979); La. Rev. Stat. Ann. § 9:2205 (West 1965). The staff recommends a provision on the same pattern to replace Civil Code Section 2239.

4. Liability of Successor Trustee

A successor trustee is not liable for a breach of a predecessor trustee, but the successor may be liable if the situation is allowed to continue, if steps are not taken to compel the predecessor trustee to deliver property to the successor, or if steps are not taken to redress the breach of the predecessor. Restatement § 223. We have found no California law on this subject.

Louisiana and Texas have provisions essentially the same as Restatement Section 223. La. Rev. Stat. Ann. § 2204 (West 1965); Tex. Trust Code § 114.002. Section 30-4-3-13 of the Indiana Trust Code omits the Restatement provision relating to permitting a breach situation to continue. Judging by the lack of cases in California, this has not been a very active area. However, the staff thinks that a section based on Restatement Section 223 would be a useful provision.

F. Limitation, Bar, and Exculpation

1. Consent of Beneficiary

The beneficiary may be barred from pursuing the trustee for a breach of trust if the beneficiary consented to the breach in advance, requested that the breaching acts be done, or joined with the trustee in the breach. See Bogert, Handbook § 168, at 628; Restatement § 216(1); see also UPC § 7-307. Of course, the consent of the beneficiary is not effective if the beneficiary was under an incapacity, did not have the material facts, or was induced to consent by improper conduct of the trustee. Restatement § 216(2). Silence or failure to object should not be held to be consent. See *Ferro v. Citizens Nat'l Trust & Sav. Bank*, 44 Cal.2d 401, 414, 282 P.2d 849 (1955) (citing Restatement § 216(1) & comment a).

2. Ratification by Beneficiary

The beneficiary may be barred where the breach of trust is ratified by the beneficiary after the breach. Bogert, Handbook § 168, at 629; Restatement § 218(1). Ratification or affirmance is subject to the same qualifications as consent, as discussed above. See Restatement § 218(2). An early California case held that a beneficiary who has approved the trustee's bringing an action may not sue for a breach on the grounds of neglect in delaying to bring the suit. *Ellig v. Naglee*, 9 Cal. 683, 696 (1858).

3. Release by Beneficiary

The beneficiary may also release the cause of action against the trustee for breach of trust. Bogert, Handbook § 168, at 630; Restatement § 217(1). Like consent and ratification, release is subject to some qualifications concerning the capacity and knowledge of the beneficiary. Restatement § 217(2).

4. Statute of Limitations and Discharge by Court Decree

A trustee may be discharged by a court decree approving an accounting or in bankruptcy. Restatement §§ 220, 221; Bogert, Handbook § 170, at 639-40. Under general law the applicable statute of limitations does not run as between the beneficiary and trustee until the beneficiary knows or should reasonably know of the breach. *Id.*, at 642; Witkin, Trusts § 84, at 5444.

Uniform Probate Code Section 7-307 bars actions against the trustee for breach of trust brought later than six months after a final account making full disclosure and showing termination of the trust relationship. The accounting may be a formal account made pursuant to court proceedings or an informal accounting made directly to the beneficiary under the provisions of UPC Section 7-303. If the final account does not make full disclosure, a three-year limitations period applies if the beneficiary has received a final account and been informed of the location and availability of the trustee's records. Apparently claims based on interim accounts are barred only by adjudication or consent, unless some general statute is applicable. It also appears that the six-month and three-year provisions do not apply in cases of the trustee's fraud. See UPC § 1-106 (two-year period running from time of discovery of fraud).

California law has been summarized as follows:

In California, absent fraud, the four-year general statute of limitations applies to trusts not subject to court supervision and to court supervised trusts when no accounting is rendered. Under California law, an accounting settled by the court is final once

the period for appeal expires unless the decree of approval is set aside within six months by reason of mistake, inadvertence or neglect.

State Bar of California, the Uniform Probate Code: Analysis and Critique 206-07 (1973). The four-year catch-all statute of limitations provided in Code of Civil Procedure Section 343 has generally been applied to actions for breaches 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); but cf. *Estate of McCabe*, 80 Cal. App.2d 823, 183 P.2d 72 (1947) (termination of trust did not start statute running since Prob. Code § 1121 gives beneficiary absolute right to account if not rendered to court in preceding six months, court not deciding whether statute of limitations applied). The statute of limitations applicable to actions for relief on the ground of fraud is three years from the discovery of the facts. Code Civ. Proc. § 338(4).

The Uniform Probate Code is more protective of trustees than California law. The effect of court-approved accounts appears to be the same, but the six-month period applicable to nonapproved accounts, including informal accounts to the beneficiary, would be a significant change in California law. Under the UPC scheme, the important factor is whether full disclosure has been made in the final account. If it has, then the six-month period applies; if not, then the three-year period applies. It should be noted that the six-month period is bracketed in the UPC, indicating that it is recognized that a different period may be preferred in enacting jurisdictions. An examination of the law of 13 states that have enacted a provision like UPC Section 7-307 reveals that only Hawaii altered the six-month period, raising it to two years. Only Florida rejected the three-year period, substituting a reference to general statutes of limitation. Several reported California cases have involved a dispute over whether a three-year or four-year statute of limitations applies.

When the UPC provision was considered by the Commission in 1983, the decision was made to bar claims for breach one year after an interim or final accounting that fully discloses the subject of a claim. If not fully disclosed in an accounting, claims for breach of trust would be barred one year after the beneficiary discovers the facts or reasonably should have discovered them. This provision would not displace the general statute of limitations applicable to actions for relief on the ground of fraud, but the four-year general statute of limitations would no longer apply.

5. Laches

The trustee may not be liable for a breach of trust if the beneficiary delays for so long, without excuse, that it would be inequitable under the circumstances to permit the beneficiary to proceed. Restatement § 219; Witkin, Trusts § 84, at 5445; Bogert, Handbook § 169, at 634-38. As one court put it, the doctrine of laches may be invoked "even" in the case of an express trust. *Kleinclaus v. Dutard*, 147 Cal. 245, 249, 81 P. 516 (1905). This doctrine is firmly entrenched and need not be codified. The best approach is probably to mention the doctrine in a statutory comment as does the comment to UPC Section 7-307.

6. Exculpation

Restatement Section 222 recognizes that the trust instrument can relieve the trustee from liability for breach of trust, except (1) where the breach is committed in bad faith, intentionally, or with reckless indifference to the beneficiary's interest, (2) where the trustee has made profits from a breach, or (3) to the extent the exculpatory provision is inserted in the trust instrument as the result of the trustee's abuse of the fiduciary relationship to the trustor. California trust statutes do not deal with this matter except periferally in Civil Code Section 2258(b) applicable to a trustee following the written directions of the trustor under a revocable trust, in which case the trustee is not liable to any person having a vested or contingent interest. Is it wise to encourage the relaxation of a trustee's liability by exculpatory provisions in trust instruments? In most cases it will be the beneficiary who will suffer from the excused breach. The trustor may give a significant degree of discretion to the trustee, if that is desired, without also depriving the beneficiaries of important protections.

G. Statutory Treatment of Limitation, Bar, and Exculpation

No pattern emerges from modern trust codes in this area. Section 114.005 of the Texas Trust Code provides as follows:

(a) A beneficiary who has full legal capacity and is acting on full information may relieve a trustee from any duty, responsibility, restriction, or liability as to the beneficiary that would otherwise be imposed on the trustee by this subtitle, including liability for past violations, except as to the duties, restrictions, and liabilities imposed on corporate trustees by [provisions governing self-dealing].

(b) The release must be in writing and delivered to the trustee.

The comment to this provision indicates that it derives from an earlier Texas statute.

Section 30-4-3-19 of the Indiana Trust Code follows Restatement Sections 216 (consent), 217 (release), and 218 (affirmance) in the following language:

(a) Unless the terms of the trust provide otherwise or unless if to do so would frustrate, impair or defeat the purposes of the trust, a beneficiary, except as provided in subsection (b) of this section, relieves the trustee from liability for breach of trust as to that beneficiary's interest if he:

(1) consents to or acquiesces in the act or omission which constitutes a breach of trust;

(2) agrees to release or discharge the trustee from liability for breach of trust after the act or omission constituting the breach occurs;

(3) elects, under an option to affirm or reject a transaction entered into as a breach of trust, to affirm the transaction; or

(4) participates in the act of the trustee which constitutes the breach of trust.

(b) The consent, acquiescence, agreement to release or discharge, affirmance, or participation by a beneficiary will not relieve the trustee from liability if:

(1) at the time it was given the beneficiary was under an incapacity;

(2) at the time it was given the beneficiary did not know of his rights or all of the material facts which the trustee knew or should have known;

(3) it was induced by the trustee's improper conduct;

(4) the trustee had an adverse interest in the transaction and the transaction was not fair and reasonable; or

(5) the trustee pays or delivers a beneficiary's interest to that beneficiary contrary to the terms of a trust with protective provisions.

The Louisiana Trust Code in Sections 2206 and 2207 adopts the basic principles of Restatement Sections 222 (exculpation) and 216-218 (consent, release, and affirmance):

2206. A. The trust instrument may relieve the trustee from liability, except as provided in Subsections B and C of this section.

B. A provision in the trust instrument is not effective to relieve the trustee from liability for breach of the duty of loyalty to a beneficiary or for breach of trust committed in bad faith.

C. A provision in the trust instrument is not effective to relieve the trustee from liability if it is inserted as a result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor.

2207. A competent beneficiary who is acting with knowledge of the material facts and whose action is not improperly induced by the conduct of a trustee may, by written instrument delivered to a trustee, relieve a trustee from liabilities that otherwise would be

imposed upon him. The instrument shall not be effective if it purports to limit a trustee's liability for improperly advancing money or conveying property to a beneficiary of a spendthrift trust or a trust under which a beneficiary's right to alienate is restricted, or if it limits prospectively and in general terms a trustee's liability for breach of the duty of loyalty to a beneficiary, or for breach of trust in bad faith.

Louisiana rejects the Restatement rule that permits a beneficiary of a spendthrift trust to relieve a trustee from liability for improperly advancing money or conveying property in breach of the spendthrift trust.

Louisiana also codified the equitable power of the court to relieve a trustee who acts in good faith. Section 2208 of the Louisiana Trust Code reads:

The proper court for cause shown and upon notice to an interested beneficiary may excuse a trustee wholly or partly from liability for a breach of trust if the trustee acted honestly and reasonably.

This provision is drawn from Section 19 of the Uniform Trusts Act (1937).

As the Commission is no doubt aware, a wide variety of approaches may be taken to codifying rules in this area of the law. It may be that no special statutory treatment is needed, other than the special rules about discharge after an accounting as discussed supra. The Indiana draft is an appealing treatment of the subject which the Commission should consider, if it is inclined to propose statutory treatment.

Part V

H. Conclusions

Remedies for Breach

The staff has proposed a section that would list the important remedies for breach. See supra p. 10 . This statute would be much more comprehensive than existing California law, but would not attempt to provide detailed rules. We would also make clear that the statute is not a limitation on remedies available under case law.

Measure of Damages

Consistent with the approach as to remedies, the staff has proposed that the basic rules on the measure of liability set out in Restatement Section 205 be codified, but not the more detailed Restatement rules. See supra p. 17 .

An open question is whether the statute should provide liability for attorney's fees incurred by the beneficiary in proceedings involving breach of trust.

Related Issues

The staff has proposed that the rules on liability for interest also be revised along the lines of the Restatement. See supra p. 18 .

The staff has proposed codifying rules on the liability for acts of agents, cotrustee liability and successor trustee liability based on Restatement rules. See supra pp. 19-20.

Limitation, Bar, and Exculpation

In the area of limitation, bar, and exculpation, the staff has proposed adopting clear rules on limitations and judicial discharge. See supra p.22 . We have not proposed to legislate concerning laches or exculpation. However, the Indiana provision on beneficiary consent, release, and affirmance was recommended as a model if legislation on these subjects is desired. See supra p. 24 .

Respectfully submitted,

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Staff Counsel

EXHIBIT 1

RESTATEMENT (SECOND) OF TRUSTS

§§ 197 - 226A

**TOPIC 4. REMEDIES OF THE BENEFICIARY AND
LIABILITIES OF THE TRUSTEE**

§ 197. Nature of Remedies of Beneficiary

Except as stated in § 198, the remedies of the beneficiary against the trustee are exclusively equitable.

§ 198. Legal Remedies of Beneficiary

(1) If the trustee is under a duty to pay money immediately and unconditionally to the beneficiary, the beneficiary can maintain an action at law against the trustee to enforce payment.

(2) If the trustee of a chattel is under a duty to transfer it immediately and unconditionally to the beneficiary and in breach of trust fails to transfer it, the beneficiary can maintain an action at law against him.

§ 199. Equitable Remedies of Beneficiary

The beneficiary of a trust can maintain a suit

(a) to compel the trustee to perform his duties as trustee;

(b) to enjoin the trustee from committing a breach of trust;

(c) to compel the trustee to redress a breach of trust;

(d) to appoint a receiver to take possession of the trust property and administer the trust;

(e) to remove the trustee.

§ 200. Persons Other Than Beneficiaries

No one except a beneficiary or one suing on his behalf can maintain a suit against the trustee to enforce the trust or to enjoin or obtain redress for a breach of trust.

§ 201. What Constitutes a Breach of Trust

A breach of trust is a violation by the trustee of any duty which as trustee he owes to the beneficiary.

§ 202. Following Trust Property into Its Product

(1) Where the trustee by the wrongful disposition of trust property acquires other property, the beneficiary is entitled at his option either to enforce a constructive trust of the property so acquired or to enforce an equitable lien upon it to secure his claim against the trustee for damages for breach of trust, as long as the product of the trust property is held by the trustee and can be traced.

(2) Except as stated in Subsection (1), the claim of the beneficiary against the trustee for breach of trust is that of a general creditor.

§ 203. Accountability for Profits in the Absence of a Breach of Trust

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.

§ 204. Non-Liability for Loss in the Absence of a Breach of Trust

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.

§ 205. Liability in Case of Breach of Trust

If the trustee commits a breach of trust, he is chargeable with

(a) any loss or depreciation in value of the trust estate resulting from the breach of trust; or

(b) any profit made by him through the breach of trust; or

(c) any profit which would have accrued to the trust estate if there had been no breach of trust.

§ 206. Liability for Breach of Duty of Loyalty

The rule stated in § 205 is applicable where the trustee in breach of trust sells trust property to himself individually, or sells his individual property to himself as trustee, or otherwise violates his duty of loyalty.

§ 207. Liability for Interest

(1) Where the trustee commits a breach of trust and thereby incurs a liability for a certain amount of money with interest thereon, he is chargeable with interest at the legal rate or such other rate as the court in its sound discretion may determine, but in any event he is chargeable with interest actually received by him or which he should have received.

(2) Where the trustee is chargeable with interest, he is chargeable with simple and not compound interest, unless

- (a) he has received compound interest, or
- (b) he has received a profit which cannot be ascertained but is presumably at least equal to compound interest, or
- (c) it was his duty to accumulate the income.

§ 208. Liability for Breach of Trust by Selling Trust Property

(1) If the trustee sells trust property which it is his duty to retain, the beneficiary can

(a) charge him with its value at the time of such sale, with interest thereon; or

(b) charge him with its value at the time of the decree, with the income which would have accrued thereon if he had not sold it, or require him to make specific reparation if this is reasonable under the circumstances; or

(c) require him to account for the proceeds of the sale.

(2) If the trustee sells trust property which it is his duty to retain, the beneficiary can enforce an equitable lien upon the proceeds of the sale as security for his claim under the rules stated in Clauses (a) and (b).

§ 209. Liability for Breach of Trust by Failing to Sell Trust Property

(1) If the trustee fails to sell trust property which it is his duty to sell, the beneficiary can charge him with the amount which he would have received if he had properly sold the property, with interest thereon.

(2) The beneficiary can enforce an equitable lien upon the property as security for his claim.

§ 210. Liability for Breach of Trust by Purchasing Property

(1) If the trustee purchases with trust funds property which it is his duty not to purchase, the beneficiary can

(a) charge him with the amount of the trust fund expended in such purchase, with interest thereon; or

(b) require him to account for the property so purchased.

(2) If the trustee purchases with trust funds property which it is his duty not to purchase and the beneficiary charges him with the amount of the trust fund expended in such purchase, the beneficiary can enforce an equitable lien upon the property so purchased as security for his claim.

§ 211. Liability for Breach of Trust by Failing to Purchase Property

If the trustee fails to purchase specific property which it is his duty to purchase, the beneficiary can charge him with its value at the time of the decree together with the income which would have accrued thereon if he had purchased it; or require him to purchase such property if this is reasonable under the circumstances and hold it in trust, paying therefor out of the trust property only so much as he would have had to pay if he had properly purchased it, and charge him with

the income which would have accrued thereon if he had properly purchased it.

**§ 212. Violations of More Than One of the Duties Specified
in §§ 208-211**

(1) Except as stated in Subsection (4), if the trustee in breach of trust sells trust property which it is his duty to retain and with the proceeds purchases other property, the beneficiary can pursue any one of the remedies stated in §§ 208 and 210.

(2) Except as stated in Subsection (4), if the trustee in breach of trust purchases with trust funds property which it is his duty not to purchase and also fails to purchase specific property which it is his duty to purchase, the beneficiary can pursue any one of the remedies stated in §§ 210 and 211.

(3) Except as stated in Subsection (4), if the trustee in breach of trust fails to sell trust property which it is his duty to sell and fails to purchase other specific property which it is his duty to purchase with the proceeds, the beneficiary can pursue any one of the remedies stated in §§ 209 and 211.

(4) Where, under the circumstances stated in Subsections (1), (2) and (3), the trustee has in good faith failed to comply with the terms of the trust and has incurred a loss, he has a defense to the extent that a loss would have occurred even though he had complied with the terms of the trust.

§ 213. Balancing Losses against Gains

A trustee who is liable for a loss occasioned by one breach of trust cannot reduce the amount of his liability by deducting the amount of a gain which has accrued through another and distinct breach of trust; but if the two breaches of trust are not distinct, the trustee is accountable only for the net gain or chargeable only with the net loss resulting therefrom.

§ 214. Several Beneficiaries

(1) If there are several beneficiaries of a trust, any beneficiary can maintain a suit against the trustee to enforce the duties of the trustee to him or to enjoin or obtain redress for a breach of the trustee's duties to him.

(2) If there are several beneficiaries of a trust and the trustee commits a breach of trust for which there are two or more alternative remedies,

(a) if none of the beneficiaries is under an incapacity and all agree upon a particular remedy, they are entitled to that remedy;

(b) if one or more of the beneficiaries is under an incapacity or they do not all agree upon a particular remedy, the court will enforce the remedy which in its opinion is most conducive to effectuating the purposes of the trust.

§ 215. Liability of Trustee under Incapacity

Whether a trustee who is under an incapacity is liable for a breach of trust depends upon the extent of his incapacity and the character of the breach of trust.

§ 216. Consent of Beneficiary

(1) Except as stated in Subsections (2) and (3), a beneficiary cannot hold the trustee liable for an act or omission of the trustee as a breach of trust if the beneficiary prior to or at the time of the act or omission consented to it.

(2) The consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust, if

(a) the beneficiary was under an incapacity at the time of such consent or of such act or omission; or

(b) the beneficiary, when he gave his consent, did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or

(c) the consent of the beneficiary was induced by improper conduct of the trustee.

(3) Where the trustee has an adverse interest in the transaction, the consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust not only under the circumstances stated in Subsection (2), but also if the transaction to which the beneficiary consented involved a bargain which was not fair and reasonable.

§ 217. Discharge of Liability by Release or Contract

(1) A beneficiary may preclude himself from holding the trustee liable for a breach of trust by a release or contract effective to discharge the trustee's liability to him for that breach.

(2) A release or contract is not effective to discharge the trustee's liability for a breach of trust, if

(a) the beneficiary was under an incapacity at the time of making such release or contract; or

(b) the beneficiary did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or

(c) the release or contract of the beneficiary was induced by improper conduct of the trustee; or

(d) the transaction involved a bargain with the trustee which was not fair and reasonable.

§ 218. Discharge of Liability by Subsequent Affirmance

(1) Except as stated in Subsection (2), if the trustee in breach of trust enters into a transaction which the beneficiary can at his option reject or affirm, and the beneficiary affirms the transaction, he cannot thereafter reject it and hold the trustee liable for any loss occurring after the trustee entered into the transaction.

(2) The affirmance of a transaction by the beneficiary does not preclude him from holding the trustee liable for a breach of trust, if at the time of the affirmance

(a) the beneficiary was under an incapacity; or

(b) the beneficiary did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or

(c) the affirmance was induced by improper conduct of the trustee; or

(d) the transaction involved a bargain with the trustee which was not fair and reasonable.

§ 219. Laches of the Beneficiary

(1) The beneficiary cannot hold the trustee liable for a breach of trust if he fails to sue the trustee for the breach of trust for so long a time and under such circumstances that it would be inequitable to permit him to hold the trustee liable.

(2) The beneficiary is not barred merely by lapse of time from enforcing the trust, but if the trustee repudiates the trust to the knowledge of the beneficiary, the beneficiary may be barred by laches from enforcing the trust.

§ 220. Discharge by Decree of the Court

The beneficiary may be barred by a decree of a proper court from holding the trustee liable for a breach of trust.

§ 221. Trustee's Discharge in Bankruptcy

The beneficiary of a trust is barred from holding the trustee liable for breach of trust to the extent to which the National Bankruptcy Act discharges the liability of the trustee.

§ 222. Exculpatory Provisions

(1) Except as stated in Subsections (2) and (3), the trustee, by provisions in the terms of the trust, can be relieved of liability for breach of trust.

(2) A provision in the trust instrument is not effective to relieve the trustee of liability for breach of trust committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary, or of liability for any profit which the trustee has derived from a breach of trust.

(3) To the extent to which a provision relieving the trustee of liability for breaches of trust is inserted in the trust instrument as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor, such provision is ineffective.

§ 223. Liability of Successor Trustee

(1) A trustee is not liable to the beneficiary for a breach of trust committed by a predecessor trustee.

(2) A trustee is liable to the beneficiary for breach of trust, if he

(a) knows or should know of a situation constituting a breach of trust committed by his predecessor and he improperly permits it to continue; or

(b) neglects to take proper steps to compel the predecessor to deliver the trust property to him; or

(c) neglects to take proper steps to redress a breach of trust committed by the predecessor.

§ 224. Liability for Breach of Trust of Co-trustee

(1) Except as stated in Subsection (2), a trustee is not liable to the beneficiary for a breach of trust committed by a co-trustee.

(2) A trustee is liable to the beneficiary, if he

(a) participates in a breach of trust committed by his co-trustee; or

(b) improperly delegates the administration of the trust to his co-trustee; or

(c) approves or acquiesces in or conceals a breach of trust committed by his co-trustee; or

(d) by his failure to exercise reasonable care in the administration of the trust has enabled his co-trustee to commit a breach of trust; or

(e) neglects to take proper steps to compel his co-trustee to redress a breach of trust.

§ 225. Liability for Acts of Agents

(1) Except as stated in Subsection (2), the trustee is not liable to the beneficiary for the acts of agents employed by him in the administration of the trust.

(2) The trustee is liable to the beneficiary for an act of such an agent which if done by the trustee would constitute a breach of trust, if the trustee

(a) directs or permits the act of the agent; or

(b) delegates to the agent the performance of acts which he was under a duty not to delegate; or

(c) does not use reasonable care in the selection or retention of the agent; or

(d) does not exercise proper supervision over the conduct of the agent; or

(e) approves or acquiesces in or conceals the act of the agent; or

(f) neglects to take proper steps to compel the agent to redress the wrong.

§ 226. Liability for Payments or Conveyances Made to Persons Other Than the Beneficiary

If by the terms of the trust it is the duty of the trustee to pay or convey the trust property or any part thereof to a beneficiary, he is liable if he pays or conveys to a person who is neither the beneficiary nor one to whom the beneficiary or the court has authorized him to make such payment or conveyance.

§ 226 A. Liability for Payments or Conveyances Made under an Invalid Trust

If the trustee pays or conveys the trust property or any part thereof to the person who by the terms of the trust is entitled to it, and the trust is later held to be invalid in whole or in part, the trustee is liable to the person entitled to the property, if, but only if, when he made such payment or conveyance he knew that the trust was invalid or had or should have had reasonable doubt as to its validity.

EXHIBIT 2

Selected California Statutes on Breach of Trust

CIVIL CODE

§ 863. Title vested in trustee; enforcement rights of beneficiaries

TRUSTEES OF EXPRESS TRUSTS TO HAVE WHOLE ESTATE. Except as hereinafter otherwise provided, every express trust in real property, valid as such in its creation, vests the whole estate in the Trustees, subject only to the execution of the trust. The beneficiaries take no estate or interest in the property, but may enforce the performance of the trust.

§ 2230. Prohibited transactions; exceptions

CERTAIN TRANSACTIONS FORBIDDEN. SAME. Neither a trustee nor any of his agents may take part in any transaction concerning the trust in which he or any one for whom he acts as agent has an interest, present or contingent, adverse to that of his beneficiary, except as follows:

1. When the beneficiary, having capacity to contract, with a full knowledge of the motives of the trustee, and of all other facts concerning the transaction which might affect his own decision, and without the use of any influence on the part of the trustee, permits him to do so;

2. When the beneficiary not having capacity to contract, the proper Court, upon the like information of the facts, grants the like permission; or,

3. When some of the beneficiaries having capacity to contract, and some not having it, the former grant permission for themselves, and the proper Court for the latter, in the manner above prescribed.

§ 2231. Influence to obtain advantage from beneficiary

TRUSTEE'S INFLUENCE NOT TO BE USED FOR HIS ADVANTAGE. A trustee may not use the influence which his position gives him to obtain any advantage from his beneficiary. (Enacted 1872.)

§ 2232. Undertaking trust adverse to interest of beneficiary

TRUSTEE NOT TO ASSUME A TRUST ADVERSE TO INTEREST OF BENEFICIARY. No trustee, so long as he remains in the trust, may undertake another trust adverse in its nature to the interest of his beneficiary in the subject of the trust, without the consent of the latter.

§ 2233. Adverse interest; disclosure; removal

TO DISCLOSE ADVERSE INTEREST. If a trustee acquires any interest, or becomes charged with any duty, adverse to the interest of his beneficiary in the subject of the trust, he must immediately inform the latter thereof, and may be at once removed. (Enacted 1872.)

§ 2234. Violations as fraud against beneficiary

TRUSTEE GUILTY OF FRAUD, WHEN. Every violation of the provisions of the preceding sections of this Article is a fraud against the beneficiary of a trust. (Enacted 1872.)

§ 2235. Transactions between trustee and beneficiary; presumption

All transactions between a trustee and his beneficiary during the existence of the trust, or while the influence acquired by the trustee remains, by which he obtains any advantage from his beneficiary, are presumed to be entered into by the latter without sufficient consideration, and under undue influence. The presumptions established by this section do not apply to the provisions of an agreement between a trustee and his beneficiary relating to the hiring or compensation of the trustee. (Amended by Stata.1963, c. 1215, p. 2733, § 1.)

§ 2236. Mingling trust property with that of trustee

A trustee who willfully and unnecessarily mingles the trust property with his own, so as to constitute himself in appearance its absolute owner, is liable for its safety in all events, and for the value of its use.

§ 2237. Breach of trust; measure of liability; property used for non-trust purposes

MEASURE OF LIABILITY FOR BREACH OF TRUST. A trustee who uses or disposes of the trust property, contrary to Section 2229, may, at the option of the beneficiary, be required to account for all profits so made, or to pay the value of its use, and, if he has disposed thereof, to replace it, with its fruits, or to account for its proceeds, with interest.

§ 2238. Breach of trust; measure of liability; property used or disposed of in good faith

SAME. A trustee who uses or disposes of the trust property in any manner not authorized by the trust, but in good faith, and with intent to serve the interests of the beneficiary, is liable only to make good whatever is lost to the beneficiary by his error. (Enacted 1872.)

§ 2239. Co-trustees; liability for acts of others

CO-TRUSTEES, HOW FAR LIABLE FOR EACH OTHER. A trustee is responsible for the wrongful acts of a co-trustee to which he consented, or which, by his negligence, he enabled the latter to commit, but for no others. (Enacted 1872.)

§ 2262. Interest on failure to invest

INTEREST, SIMPLE OR COMPOUND, ON OMISSION TO INVEST TRUST MONEYS. If a trustee omits to invest the trust moneys according to the last section, he must pay simple interest thereon, if such omission is negligent merely, and compound interest if it is willful.

§ 2283. Removal of trustee by superior court; application to trust created by will

The superior court may remove any trustee who has violated or is unfit to execute the trust, or may accept the resignation of a trustee. This section shall not, however, apply to a trustee of a trust created by a will admitted to probate in any court of this state.

(Amended by Stats.1969, c. 272, p. 621, § 1.)

§ 3422. Final injunction; grounds

INJUNCTION, WHEN ALLOWED. Except where otherwise provided by this Title, a final injunction may be granted to prevent the breach of an obligation existing in favor of the applicant:

1. Where pecuniary compensation would not afford adequate relief;
2. Where it would be extremely difficult to ascertain the amount of compensation which would afford adequate relief;
3. Where the restraint is necessary to prevent a multiplicity of judicial proceedings; or,
4. Where the obligation arises from a trust,

PROBATE CODE

§ 1123.5. Removal of trustee or cotrustee; notice; hearing

The court in which the administration is pending or, after final distribution, the court sitting in probate which has jurisdiction over a testamentary trust shall have power to remove a trustee of a testamentary trust, whether or not any property has been distributed to him, who has violated or is unfit to execute the trust or has acquired any interest or become charged with any duty adverse to the interest of any beneficiary in the subject of the trust. The court may remove one or all of the cotrustees of a testamentary trust and appoint new trustees where the court determines that hostility, ill feeling, or continued lack of cooperation among and between cotrustees has impaired the proper administration of the trust. The proceeding may be initiated by the court upon its own motion or by verified petition of a beneficiary of, or any other person interested in, the trust, including any person in being who shall or may participate in the corpus or income of the trust. The clerk shall set the matter for hearing and post notice in the manner prescribed by Section 1200. The trustee whose removal is sought shall be personally served with a copy of the motion or petition and with notice of the time and place of the hearing thereon, at least 10 days before the hearing, provided, that if such trustee is not a resident of this state, or has absconded or concealed himself from the state, the court may fix the manner of giving notice to him by mail, publication or otherwise, as the court may determine, and the court may proceed upon such notice as if the trustee had been personally served. In addition, the petitioner, or the court when acting upon its own motion, shall cause a copy of the petition or motion and of the notice of hearing to be mailed to the personal representative, if any part of the estate remains to be distributed to the trustee, and to each cotrustee and to the beneficiaries, including therein all persons in being who shall or may participate in the corpus or income of the trust, at their last known or other ad-

addresses, as provided in Section 1200, whether any of the persons to whom notice is to be given have requested special notice or given notice of appearance, or to be personally served upon such persons.

§ 1138.1. Petition by trustee, beneficiary or remainderman to superior court; grounds

(a) A trustee, beneficiary, or remainderman may petition the superior court for any of the following purposes:

. . .

(2) Settling the accounts and passing upon the acts of the trustee.

. . .

(4) Instructing the trustee.

(5) Compelling the trustee to submit his accounts and report his acts as trustee to a beneficiary or remainderman when it appears that the trustee has failed to submit an accounting and report within 60 days after written request of a beneficiary or remainderman and no accounting and report has been made within six months preceding such request.

. . .

(7) Fixing, directing, or allowing payment of compensation to the trustee in accordance with Section 2274 of the Civil Code.

(8) Appointing a trustee.

. . .

(10) Removing a trustee.