

Memorandum 87-66

Subject: Study L-643 - Punitive Damages for Breach of Trust

Draft Recommendation

Attached as Exhibit 1 is a draft recommendation that would limit exemplary damages to no more than three times the amount of compensatory damages or restitution. This is the same material that was included in the Commission's original *Recommendation Proposing the Trust Law* (December 1985). The California Trial Lawyers Association opposed this provision at the hearing in the Assembly Judiciary Committee and the bill did not have enough votes to surmount this opposition. Rather than lose the entire Trust Law, the exemplary damages limitation was deleted.

Another Survey?

At the July meeting, the possibility of surveying the corporate trustees concerning punitive damages for breach of trust was discussed. We did not include a question on punitive damages in the letter sent to corporate trustees, nor in the questionnaire relating to corporate trustees' fees that we sent to attorneys. Before we ask the corporate trustees for any more information, we would like to make sure that we have determined the questions needed to elicit the desired information. It is also a problem to draft questions that call for factual answers that are readily available to the corporate trustees. At this stage, there is no point in sending out letters asking for their preferences concerning limitations on punitive damages. The possibility should also be considered that sending out additional questionnaires threatens to violate the law of diminishing returns.

If another survey is to be conducted, we need to decide what we want to know and how we can find it out. Consider the following possible questions:

1. In currently open litigation involving living and testamentary trusts where your bank is a defendant in its

corporate capacity (as opposed to its fiduciary capacity), estimate the percentage of suits in which punitive damages have been requested against you. [This question was suggested in a letter from L. Bruce Norman on behalf of the California Bankers Association.]

2. What percentage of actions for breach of trust filed against your institution in the last 18 months have sought punitive damages?

3. Estimate the factor by which any punitive damages sought in actions for breach of trust filed against your institution exceed the compensatory damages.

4. As to claims that are litigated or settled, estimate the average amount of the award or settlement that is due to the claim for punitive damages. The estimate can be expressed in dollars or as a percentage of the total settlement.

5. Do you have any information showing that claims for breach of trust that seek punitive awards affect the general fees your institution charges for trust administration?

Of course, we are open to any suggestions for improved wording and to other sorts of inquiries. If the Commission decides on the appropriate questions, if any, at the September meeting, the staff will soon thereafter write another letter to the corporate trustees with whom we are in contact.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

Exhibit 1*Staff Draft*

Tentative Recommendation

Relating to

Exemplary Damages for Breach of Trust

The existing law concerning whether a trustee may be held liable for exemplary damages for a breach of trust is unsettled.¹ Under traditional principles, trustees are generally not liable for exemplary or punitive damages.² However, this view has been eroded in recent years.³ The Commission is informed that corporate trustees are

1. Compare former Civil Code §§ 2237-2238 & 2262 (repealed by 1986 Cal. Stat. ch. 820, § 7, operative July 1, 1987) and Prob. Code §§ 16440-16441 with *Vale v. Union Bank*, 88 Cal. App. 3d 330, 151 Cal. Rptr. 784 (1979); *Werschkull v. United California Bank*, 85 Cal. App. 3d 981, 149 Cal. Rptr. 829 (1978); *Rivero v. Thomas*, 86 Cal. App. 2d 225, 194 P.2d 533 (1948). See also Civil Code § 3294 (exemplary damages for breach of obligation not arising from contract available in cases of fraud, malice, or oppression).

2. The text of the Restatement does not authorize exemplary damages (see Restatement (Second) of Trusts §§ 205-212 (1957)), but comment f to Restatement Section 205 discusses absolute liability imposed on a trustee for failure to earmark property even though no loss results from the failure. Exemplary damages have "occasionally" been awarded for breach of investment duties because of particularly reprehensible conduct. G. Bogert, *The Law of Trusts and Trustees* § 701, at 199 (rev. 2d ed. 1982) (citing only *Sharts v. Douglas*, 94 Ind. App. 201, 163 N.E. 109 (1928)). See also G. Bogert, *The Law of Trusts and Trustees* § 862, at 41 (rev. 2d ed. 1982). Under prior Civil Code Section 2262, the penalty for wilfully failing to invest was compound rather than simple interest, with no mention of any other exemplary damages.

3. See *Vale v. Union Bank*, 88 Cal. App. 3d 330, 151 Cal. Rptr. 784 (1979) (exemplary damages awarded against bank as trustee of pension fund in action by fund participants); *Werschkull v. United California Bank*, 85 Cal. App. 3d 981, 149 Cal. Rptr. 829 (1978) (exemplary damages in class action by pension plan participants against employer-bank-trustee for wrongful diversion of funds); *Rivero v. Thomas*, 86 Cal. App. 2d 225, 194 P.2d 533 (1948) (in suit to declare and enforce constructive trust, exemplary damages available against trustee who breaches duties with oppression, fraud, or malice). See also E. Depper & A. Bernstein, *California Trust Administration* § 14.49, at 616 (Cal. Cont. Ed. Bar 1986).

particularly vulnerable to claims for punitive damages, in part because of their deep pockets. The exposure to this presumed liability for punitive damages is cited as a reason for increased fees charged by corporate trustees to administer trusts.⁴

The proposed law authorizes the court to assess exemplary damages for breach of trust involving willful misconduct, fraud, or gross negligence. Exemplary damages are limited, however, to an amount that does not exceed three times the amount of compensatory damages or restitution assessed under the general rules governing liability for breach of trust.⁵ The proposed law is intended to clarify the law in this area, thereby giving some guidance to the parties in a potential dispute. It represents a compromise between the positions of those who would completely insulate trustees from claims for exemplary damages and those who seek to punish trustees through the imposition of millions of dollars' worth of punitive damages.

4. See remarks of representatives of corporate trustees set out in Exhibit 1, Second Supplement to Law Revision Commission Memorandum 87-70 (Sept. 4, 1987).

5. Prob. Code §§ 16440-16441. Treble damages are authorized by several statutes in other areas of the law. See, e.g., Civil Code §§ 1716 (solicitation of money for goods not ordered or services not performed), 1719 (dishonored checks), 1739.4 (misrepresentation regarding political campaign items), 1748.1 (imposition of surcharge on use of credit card), 1812.123 (discount buying services contracts), 1882.2 (diversion of utility services); Code Civ. Proc. §§ 1029.8 (provision of goods or services by unlicensed person), 1174(b) (forcible entry or unlawful detainer with malice).

The Commission's recommendation would be effectuated by enactment of the following measure:

An act to repeal and add Section 16442 of the Probate Code, relating to trusts.

The people of the State of California do enact as follows:

Probate Code § 16442 (repealed). Other remedies not affected

SEC. 1. Section 16442 of the Probate Code is repealed.

~~16442. The provisions in this article for liability of a trustee for breach of trust do not prevent resort to any other remedy available under the statutory or common law.~~

Comment. Former Section 16442 is superseded by new Section 16442 (liability for exemplary damages).

Probate Code § 16442 (added). Liability for exemplary damages

SEC. 2. Section 16442 is added to the Probate Code, to read:

16442. If a breach of trust results from the trustee's willful misconduct, fraud, or gross negligence, the court may find the trustee liable for an amount of exemplary damages not exceeding three times the amount of liability determined under Section 16440.

Comment. Section 16442 is a new provision that clarifies the right to exemplary damages for breach of trust. Prior law was not clear. Compare former Civil Code §§ 2237-2238 & 2262 (repealed by 1986 Cal. Stat. ch. 820, § 7, operative July 1, 1987) and Prob. Code §§ 16440-16441 with *Vale v. Union Bank*, 88 Cal. App. 3d 330, 151 Cal. Rptr. 784 (1979) (exemplary damages awarded against bank as trustee of pension fund in action by fund participants); *Werschkull v. United California Bank*, 85 Cal. App. 3d 981, 149 Cal. Rptr 829 (1978) (exemplary damages in class action by pension plan participants against employer-bank-trustee for wrongful diversion of funds); *Rivero v. Thomas*, 86 Cal. App. 2d 225, 194 P.2d 533 (1948) (in suit to declare and enforce constructive trust, exemplary damages available against trustee who breaches duties with oppression, fraud, or malice).