
VII.

**Breach of Fiduciary Duty:
Causes of Action and Defenses**

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BREACH OF FIDUCIARY DUTY: CAUSES OF ACTION AND DEFENSES

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I. SCOPE NOTE

Trust and estate litigation often focuses on contesting the validity of the operative documents for fraud, duress, undue influence, and lack of mental capacity. However, recent years have borne witness to a rise in claims against the fiduciaries themselves for alleged breaches of their duties. As the baby boomer generation continues to age, one can reasonably anticipate fiduciary litigation to remain elevated for several decades.

This article examines breach of fiduciary duty claims in the context of trust and estate (and related and/or ancillary) litigation. Part II defines the broad contours of fiduciary relationships and the cause of action for breach of fiduciary duty. Part III provides a comparative analysis between breach of fiduciary duty and constructive fraud and identifies a non-exhaustive list of other causes of action commonly pled in conjunction with breach of fiduciary duty claims. Parts IV through VII examine the fiduciary duties particular to trustees, personal representatives, guardians, and attorneys-in-fact. Part VIII lists equitable remedies potentially available in fiduciary litigation and Part IX identifies affirmative defenses. Finally, Part X provides general litigation tips for parties involved in prosecuting or defending fiduciary duty claims.

II. WHAT IS A FIDUCIARY?

A. Two Types of Fiduciary Relationships

1. Those created by law and governing relationships created (a) by statute such as in estate administrations (administrator and heir) and guardianship and incompetency proceedings (guardian and ward) or (b) by contract (attorney and client); and
2. Those that arise from the circumstances underlying the relationship between the parties and the nature of the transactions at issue. Simply put, whenever one party places trust and confidence in another party, of which the second party is aware, the possibility of a fiduciary relationship arises.¹

As then New York Chief Judge Benjamin Cardozo famously surmised:

“Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by the fiduciary ties. A trustee is held to something stricter than the morals of the market place.

Not honesty alone, but the punctilio of honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court."

Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y.1928).

And as Justice Felix Frankfurter followed fifteen years later:

"But to say that a man is a fiduciary only begins the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respects has he failed to discharge these obligations? And what are the consequences of his deviations from duty?"

SEC v. Chenery Corp., 318 U.S. 80, 85-86, 63 S.Ct. 454, 458 (1943).

B. Examples of Fiduciary Relationships

The circumstances under which a fiduciary relationship can arise are limited only by the imagination. There is much wider realm of fiduciary litigation (e.g., ERISA claims) than is the focus of this manuscript. For our purposes, we are discussing a discrete set of fiduciaries:

1. Trustees;
2. Personal Representatives (Executors and Administrators);
3. General Guardians and Guardians of the Estate;
4. Attorneys-in-Fact; and
5. Lawyers and Accountants (to the extent they serve in one of the above capacities).

C. Threshold Considerations

Potential plaintiffs should examine four important questions in fiduciary duty cases:

1. What are the parameters of the defendant's fiduciary obligations?
2. By what standards will the defendant's fiduciary obligations be measured?
3. Who has the burden of proof?
4. Are there any documents or facts altering the fiduciary's obligations?²

The remainder of this presentation will focus on those issues.

D. Elements of a Breach of Fiduciary Duty

To prove a breach of fiduciary duty claim, the plaintiff must show:

1. the *existence* of a fiduciary relationship;
2. a *breach* of the duty owed; and
3. *damages* proximately caused by the breach.

See Green v. Freeman, 367 N.C. 136, 749 S.E.2d 262, 268 (2013).

E. The Clerk's Office or Superior Court: Where Does Jurisdiction Lie?

The clerks of superior court have original (and often exclusive) jurisdiction over the administration of trusts (N.C. Gen. Stat. § 36C-2-203) and estates (N.C. Gen. Stat. § 28A-2-4).

Clerks of superior court do not, however, have jurisdiction over actions seeking to modify, terminate, or revoke trusts (N.C. Gen. Stat. § 36C-4-410, *et seq.*), caveat proceedings to contest the validity of wills (N.C. Gen. Stat. § 28A-2-4(c)(3)), or *actions against fiduciaries for breach of their duties* (N.C. Gen. Stat. § 36C-2-203(f)(3) and N.C. Gen. Stat. § 28A-2-4(c)(2)), to name a few. Those cases must be filed and tried in Superior Court.

III. KISSING COUSINS: BREACH OF FIDUCIARY DUTY, CONSTRUCTIVE FRAUD, AND RELATED CLAIMS

A. Elements of Constructive Fraud

Although the North Carolina Supreme Court and Court of Appeals have articulated slightly different variations through the years, the elements of a constructive fraud claim are:

1. the existence of *a relationship of trust and confidence*;
2. that the defendant *took advantage of his position of trust* in order to benefit himself; and
3. that the plaintiff, as a result, was *injured*.

“Put simply, a plaintiff must show (1) the existence of a fiduciary duty, and (2) a breach of that duty.”

Keener Lumber Co. v. Perry, 149 N.C. App. 19, 28, 560 S.E.2d 817, 823 (2002).

B. Differences Between Constructive Fraud and Breach of Fiduciary Duty

At first blush, these causes of action appear virtually identical. Indeed, they are often pled in lawsuits as one and the same. Yet, there are critical differences between the two.

1. *The Defendant Must Benefit Himself in the Transaction for it to Constitute Constructive Fraud*

To breach a fiduciary duty, the defendant must fail to “act in good faith and with due regard to plaintiff’s interests.” However, unlike constructive fraud, to prevail on a claim for breach of fiduciary duty, there is no requirement that the defendant sought to benefit himself.

White v. Consol. Planning, Inc., 166 N.C. App. 283, 294, 603 S.E.2d 147, 155-56 (2004).

When the superior party obtains a possible benefit to the alleged abuse of the confidential or fiduciary relationship, the aggrieved party is entitled to a presumption that constructive fraud occurred.

Watts v. Cumberland County Hospital System, 317 N.C. 110, 116, 343 S.E.2d 879, 884 (1986).

Thus, once a prima facie case of constructive fraud is established, the burden shifts to the defendant to prove he acted in an “open, fair and honest” manner.

Hajmm Co. v. House of Raeford Farms, 94 N.C. App. 1, 12, 379 S.E.2d 868, 874 (1989), *affirmed in part and reversed in part on other grounds*, 328 N.C. 578, 403 S.E.2d 483 (1991).

To be “open, fair and honest” merely rebuts the presumption of fraud, it does not serve as an affirmative defense.

Estate of Smith v. Underwood, 127 N.C. App. 1, 9, 487 S.E.2d 807, 813 (1997).

If the presumption is rebutted, the accusing party bears the burden of producing actual evidence of fraud.

Watts v. Cumberland County Hosp. System, 317 N.C. 110, 115-16, 343 S.E.2d 879, 884 (1986).

In sum, we reach the logical syllogism that all constructive fraud claims are necessarily a breach of fiduciary duty, but not all breaches of fiduciary duty constitute constructive fraud.

2. *Statutes of Limitations*

- a. Breach of Fiduciary Duty: **3 Years** per N.C. Gen. Stat. § 1-52(1) (2015).

In cases where a trustee is accused of breaching his fiduciary duty, the statute begins to run when the claimant “‘knew, or by due diligence, should have known’ of the facts constituting the basis for the claim.”

Toomer v. Branch Banking & Trust, 171 N.C. App. 58, 68-69, 614 S.E.2d, 328, 336 (2005).

Unless it rises to the level of constructive fraud...

- b. Constructive Fraud: **10 Years** per N.C. Gen. Stat. § 1-56 (2015).

For constructive fraud, the aggrieved party is under no duty to make inquiry until something occurs to *excite his suspicions*. While the plaintiff cannot be willfully ignorant, so long as he remains ignorant through no fault of his own (i.e., he has not discovered the fraud and could not through reasonable diligence discover it), the statute will not begin to run.

Shepherd v. Shepard, 57 N.C. App. 680, 682-83, 292 S.E.2d 169, 171 (1989).

NOTE: To the extent that Plaintiffs' constructive fraud claim challenges a will, it is clear the will cannot be the subject of a constructive fraud claim because that type of action may only be brought by caveat.

James v. Schoonderwoerd, 2013 N.C. App. LEXIS 943, 17, 750 S.E.2d 920 (2013) (unpublished).

C. Other Causes of Action Commonly Pled in Conjunction with Breach of Fiduciary Duty Claims

While a breach of fiduciary duty does not, in and of itself, necessarily give rise to other causes of action, it shares similarities with various other cognizable claims for relief and is often alleged in conjunction with...

1. *Unfair and Deceptive Trade Practices (“UDTP”)*

Conduct which constitutes a breach of fiduciary duty and/or constructive fraud is sufficient to support a UDTP claim.

Compton v. Kirby, 157 N.C. App. 1, 20, 577 S.E.2d 905, 917 (2003).

In order to establish a prima facie claim for unfair trade practices, a plaintiff must show:

- (1) defendant committed an *unfair or deceptive act or practice*;
- (2) the action in question was *in or affecting commerce*; and
- (3) the act *proximately caused injury* to the plaintiff.

Dalton v. Camp, 353 N.C. 647, 656, 548 S.E.2d 704, 711 (2001).

If a UDTP claim is proven, the statute mandates actual damages be trebled and allows for the discretionary award of attorneys’ fees.

NOTE: Excluded from the definition of “commerce” in Chapter 75 of the North Carolina General Statutes are “professional services rendered by a member of a *learned profession*.”

RESULT: The very same conduct that could subject a trust officer at a bank to treble damages and attorneys fees’ for the commission of unfair and deceptive trade practices would not be available if the trustee is a lawyer or accountant.

4 Year statute of limitations for UDTP per N.C. Gen. Stat. § 75-16.2 (2015).

The period begins to run when the plaintiff discovers or should have discovered the wrongful conduct.

Hunter v. Guardian Life Ins. Co. of Am., 167 N.C. App. 477, 485, 593 S.E.2d 595, 601 (2003).

2. *Negligence*

In order to establish a prima facie case of negligence, the plaintiff must offer evidence that defendant:

- (1) owed him a *duty of care* (i.e., a fiduciary duty);

(2) that defendant *breached that duty*; and

(3) that defendant's breach was the *actual and proximate cause of plaintiff's injury*.

See Cowan v. Laughridge Construction Co., 57 N.C. App. 321, 323-24, 291 S.E.2d 287, 289 (1982).

The “duty” owed in a negligence case contemplates a much broader range of common law duties. As a result, a cause of action for negligence may exist even in the absence of a breach of fiduciary duty.

For example, in *Brown v. Roth*, 133 N.C. App. 52, 514 S.E.2d 294 (1999), the Court of Appeals found that a real estate agent has a fiduciary duty “to exercise reasonable care, skill, and diligence in a transaction of business entrusted to him, he will be responsible to his principal for any loss resulting from his negligence in failing to do so.” The use of the term “fiduciary duty” in that case was used to describe the real estate agent’s duty to exercise care in the context of a general negligence claim rather than a breach of fiduciary claim.

3 Year statute of limitations for negligence per N.C. Gen. Stat. § 1-52(9) (2015).

3. *Gross Negligence*

In addition to the elements of negligence, gross negligence consists of *wanton conduct done with conscious or reckless disregard for the rights and safety of others*. An act is wanton when it is done of wicked purpose, or when done needlessly, manifesting a reckless indifference to the rights of others.

Trillium Ridge Condo. Ass'n v. Trillium Links & Vill., LLC, 2014 N.C. App. LEXIS 1015 (2014) (unpublished) (citations and quotations omitted).

The existence of aggravating factors surrounding willful and wanton conduct allows for the recovery of punitive damages pursuant to N.C. Gen. Stat. § 1D-15 and attorneys’ fees.

3 Year statute of limitations for gross negligence per N.C. Gen. Stat. § 1-52(9) (2015).

4. *Negligent Misrepresentation*

The tort of negligent misrepresentation occurs when:

- (1) a party *justifiably relies*;
- (2) to his *detriment*;
- (3) on information prepared *without reasonable care*;
- (4) by one who *owed the relying party a duty of care*.

Simms v. Prudential Life Ins. Co. of Am., 140 N.C. App. 529, 532, 537 S.E.2d 237, 240 (2000), *disc. review denied*, 353 N.C. 381, 547 S.E.2d 18 (2001).

The requirement of justifiable reliance means actual reliance, so the plaintiff must actually rely on false information to his harm.

Brinkman v. Barrett Kays & Assocs., P.A., 155 N.C. App. 738, 742, 575 S.E.2d 40, 43-44 (2003).

3 Year statute of limitations for negligent misrepresentation per N.C. Gen. Stat. § 1-52(9) (2015).

5. *Fraud and Fraud in the Inducement*

The elements of fraud and fraud in the inducement are the same:

- (1) *false representation or concealment* of a material fact;
- (2) reasonably calculated to *deceive*;
- (3) made with *intent* to deceive;
- (4) which *does in fact* deceive;
- (5) resulting in *damage* to the injured party.

McGahren v. Saenger, 118 N.C. App. 649, 654, 456 S.E.2d 852, 855, *disc. review denied*, 340 N.C. 568, 460 S.E.2d 318-19 (1995); *Tradewinds Airlines, Inc. v. C-S Aviation Servs.*, 733 S.E.2d 162, 168 (2012).

Both must be pled with particularity pursuant to Rule 9 of the North Carolina Rules of Civil Procedure and require a more rigorous adherence to the elements than constructive fraud since they depend specific misrepresentations rather than a confidential relationship.

See Barger v. McCoy Hillard & Parks, 346 N.C. 650, 666, 488 S.E.2d 215, 224 (1997).

3 Year statute of limitations for fraud and fraud in the inducement per N.C. Gen. Stat. § 1-52(9) (2015).

NOTE: Proof of fraud and/or fraud in the inducement necessarily constitutes an unfair and deceptive trade practice and shifts the burden of proof from the plaintiff to the defendant, who must then prove he is exempt from Chapter 75's provisions.

Whisnant v. Carolina Farm Credit, 204 N.C. App. 84, 95, 693 S.E.2d 149, 157 (2010).

In the alternative, punitive damages can be awarded for fraud or fraud in the inducement in lieu of treble damages pursuant to Chapter 75. However, pursuant to N.C. Gen. Stat. § 1D-25, punitive damages are capped at three times the amount of compensatory damages or \$250,000, whichever is greater. In short, so long as actual damages are \$83,333.34 or more, the plaintiff should elect treble damages when available.

6. *Conversion*

The essential elements of conversion are:

- (1) the *unauthorized assumption and exercise* of the right of ownership;
- (2) over goods or personal chattels *belonging to another*;
- (3) to the *alteration of their condition* (i.e., destruction) or the *exclusion* of the owner's rights.

Stratton v. Royal Bank of Canada, 211 N.C. App. 78, 83, 712 S.E.2d 221, 227 (2011).

This claim typically arises when a trustee or personal representative is alleged to have absconded with property rightfully belonging to the beneficiaries or heirs.

3 Year statute of limitations for conversion per N.C. Gen. Stat. § 1-52(4) (2015).

As a general rule, the claim accrues when the unauthorized assumption and exercise of ownership occurs—not when the plaintiff discovers the conversion.

See, e.g., White v. Consol. Planning, Inc., 166 N.C. App. 283, 309-11, 603 S.E.2d 147, 165-66 (2004).

However, when the defendant lawfully obtains possession or control and then exercises unauthorized dominion or control over the property (as is often the case in fiduciary litigation), demand and refusal become necessary elements of the tort.

See Hoch v. Young, 63 N.C. App. 480, 483, 305 S.E.2d 201, 203 (1983).

7. *Unjust Enrichment*

Under a claim for unjust enrichment, a plaintiff must establish three essential elements:

- (1) a measurable benefit was *conferred on the defendant*;
- (2) the defendant *consciously accepted* that benefit; and
- (3) the benefit was not conferred *officiously or gratuitously*.

Primerica Life Ins. Co. v. James Massengill & Sons Constr. Co., 211 N.C. App. 252, 259-260, 712 S.E.2d 670, 677 (2011).

This claim will almost universally be found whenever a trustee or personal representative is accused of self-dealing. The most obvious example is when a trustee elects an investment option that generates significant fees for the corporate fiduciary but lacks a concomitant return on investment for the beneficiaries or perhaps an even lower return than a more prudent investment.

3 Year statute of limitations for unjust enrichment per N.C. Gen. Stat. § 1-52(1) (2015).

8. *Professional Malpractice*

All professional malpractice claims have four basic elements:

- (1) the plaintiff was *owed a duty* for the professional to act with the reasonable standard of care for that profession;
- (2) the professional *breached that duty* by failing to act as he/she should or committing an act in violation of that duty;
- (3) the breach of that duty harmed the plaintiff and *caused injury*; and
- (4) the injury sustained is *compensable*.

See generally Wall v. Stout, 310 N.C. 184, 200, 311 S.E.2d 571, 581 (1984).

Professional malpractice claims may be brought against lawyers or accountants.

NOTE: Professional malpractice claims are not limited to those brought by, for example, settlors and testators.

In North Carolina, a professional malpractice claim may be based on privity of contract *or third-party beneficiary* contract liability.

United Leasing Corp. v. Miller, 45 N.C. App. 400, 263 S.E.2d 313 (1980).

Whether a non-client third party may recover for an attorney's malpractice under this alternative tort theory depends on several factors:

- (1) the extent to which the transaction was *intended to affect the third party*;
- (2) the *foreseeability of harm* to him;
- (3) the *degree of certainty* that he suffered injury;
- (4) the *closeness of the connection* between the attorney's conduct and the injury;
- (5) the *moral blame* attached to such conduct; and
- (6) the policy of *preventing future harm*.

Leary v. N.C. Forest Prods., Inc., 157 N.C. App. 396, 404, 580 S.E.2d 1, 6-7 (2003).

3 to 4 Year statute of limitations for professional malpractice (depending on the last act giving rise to the claim and date of discovery) pursuant to N.C. Gen. Stat. § 1-15(c) (2015).

9. *Breach of Contract*

The elements of a claim for breach of contract are:

- (1) *existence of a valid contract* and
- (2) *breach of the terms of the contract*.

Woolard v. Davenport, 166 N.C. App. 129, 134, 601 S.E.2d 319, 322, (2004).

Damages are not a required element of a breach of contract claim because a successful plaintiff is entitled to nominal damages upon proof of the breach.

As in the case of professional malpractice, this claim may also be available to third party beneficiaries and the burden of proof is less rigorous. In order to establish a claim based on the third party beneficiary contract doctrine, a complaint's allegations must show:

- (1) the *existence of a contract* between two other persons;
- (2) that the contract was *valid and enforceable*; and
- (3) that the contract was entered into for his *direct, and not incidental, benefit*.

Timothy L. Hardin v. York Mem'l Park, 730 S.E.2d 768, 775 (2012).

In the final analysis, and within the context of fiduciary duty litigation, breach of contract claims are typically the least of defendants' concerns.

3 Year statute of limitations for breach of contract per N.C. Gen. Stat. § 1-52(1) (2015).

10. *Breach of the Implied Covenant of Good Faith and Fair Dealing*

Because the implied covenant of good faith and fair dealing is implicit in any fiduciary relationship, this claim will exist whenever a fiduciary duty is alleged to exist and have been breached.

See Lackey v. Bressler, 86 N.C. App. 486, 493, 358 S.E.2d 560, 564 (1987).

3 Year statute of limitations for breach of the implied covenant of good faith and fair dealing per N.C. Gen. Stat. § 1-52(1) (2015).

11. *Declaratory Judgment*

Pursuant to N.C. Gen. Stat. 1-254, North Carolina Courts have jurisdiction to consider the construction and/or validity of documents and obtain a legal declaration as to the legal relations thereto.

N.C. Gen. Stat. § 1-255 provides:

Any person interested as or through an *executor, administrator, trustee, guardian or other fiduciary*, creditor, devisee, heir, next of kin, or *cestui que trust*, in the administration of a trust, or of the estate of a decedent, a minor, an incompetent person, or an insolvent person, may have a declaration of rights or legal relations in respect thereto:

- (1) To ascertain any class of creditors, *devisees, heirs, next of kin or others*; or
- (2) To direct the executors, administrators, or trustees to do or abstain from doing any particular act in their fiduciary capacity; or
- (3) To determine any question arising in the administration of the estate or trust, including questions of construction of wills and other writings.
- (4) To determine the apportionment of the federal estate tax, interest and penalties under the provisions of Article 27 of Chapter 28A.

As you might expect, declaratory judgment actions are often brought in conjunction with other claims to ascertain whether the fiduciary's conduct conforms to the intent of the governing document as well as to determine the validity of the document itself.

Declaratory judgment actions do not have to be brought after an alleged breach. For that reason, they are routinely utilized as a method to protect trustees, etc. from potential claims by clarifying the rights and obligations of the parties as well as, for instance, modifying trusts due to changed circumstances unforeseen by the settlor.

IV. BREACH OF FIDUCIARY DUTY: TRUSTEES

Claims against trustees usually fall within two camps: those centered on how the trust assets are managed (e.g., allegations of poor investment decisions, self-dealing, etc.) and those regarding how the trust is administered (e.g., favoring income beneficiaries over remaindermen).³ The following discussion is a roadmap through the duties imposed by according to the modified version of the Uniform Trust Code adopted in North Carolina. As we will see, most, but not all, of the statutory duties can be expanded, abridged, or even abrogated by the express terms of the trust at the settlor's election. Those exceptions aside, the North Carolina Uniform Trust Code only governs the trustee's duties when the terms of the trust are silent or somehow invalid. Many of the enumerated duties overlap significantly and, when possible, have been combined for ease of review.

A. General Considerations

1. *Voidability*: To the extent a trust was created by fraud, duress, or undue influence, it is voidable. N.C. Gen. Stat. § 36C-4-406 (2015).
2. *Removal of Trustees*: A trustee may be removed, *inter alia*, for serious breach of trust or unfitness, unwillingness, or persistent failure to administer the trust effectively. N.C. Gen. Stat. § 36C-7-706 (2015).

NOTE: If a breach of fiduciary duty claim is pending before the Superior Court, the party can join a claim for removal of the trustee or seek consolidation of any other trust proceeding before the clerk to avoid unnecessary costs or delay. N.C. Gen. Stat. § 36C-2-205(f) and (g) (2015).

3. *Special Skills*: A trustee who has special skills or expertise, or who is named upon reliance of those special skills or expertise, shall use those skills or expertise. N.C. Gen. Stat. § 36C-8-806 (2015).

This is a different standard than the reasonable and prudent person—professionals with special skills will be held to the prevailing standards of their profession.

B. Duty to Administer Trusts and to do so Prudently

1. Trustees are required to administer trusts in *good faith*, in accordance with its terms and purposes and in the interests of the beneficiaries. N.C. Gen. Stat. § 36C-8-801 (2015).

The duty of good faith is mandatory. N.C. Gen. Stat. § 36C-1-105(b)(2) (2015).

2. The trustee shall administer the trust as a *prudent person* would (i.e., reasonable care, skill, and caution) by considering the purposes, terms, distributional requirements, and other circumstances of the trust. N.C. Gen. Stat. § 36C-8-804.

Ancillary duties to prudent administration include, but are not limited to:

- a. the duty to take control and protect trust property (N.C. Gen. Stat. § 36C-8-809) (2015);
- b. the duty to collect trust property (N.C. Gen. Stat. § 36C-8-816(1) (2015));

- c. the duty to insure trust property (N.C. Gen. Stat. § 36C-8-816(11) (2015)); and
- d. the duty to abandon trust property of insufficient value or benefit to justify the costs of administration (N.C. Gen. Stat. § 36C-8-801(16) (2015)).

The standard of care regarding the duties of administration (beyond good faith) may be modified by the settlor.

C. Duty of Loyalty

“The reasons for the loyalty rule are evident. A man cannot serve two masters. He cannot fairly act for his interest and the interest of others in the same transaction. Consciously or unconsciously, he will favor one side or the other, and where placed in this position of temptation, there is always the danger that he will yield to the call of self-interest.”

Wachovia Bank & Trust Co. v. Johnston, 269 N.C. 701, 715, 153 S.E.2d 449, 459-60 (1967).

1. A trustee shall administer the trust *solely in the interests of the beneficiaries*. N.C. Gen. Stat. § 36C-8-802 (2015).

In other words, the trustee may not engage in self-dealing or in such a way that his interests conflict with those of the beneficiaries. Since this duty can be modified by the terms of the trust, settlors would be well advised to consider the purposes of the trust and how conflicts should be handled.

2. Given the potential for financial institution trustees to invest in products which their affiliates offer generally and thereby derive compensation in addition to fees for administering the trust, an argument can be made that the compensation is excessive and a breach of the duty of loyalty. Subsection (f) carves out an exception for these investment vehicles such that they are not automatically presumed to create a conflict of interest. To take advantage of this provision, the trustee must comply with the prudent investor rule of Article 9 and at least annually notify those entitled to the method and rate of compensation.
3. The duty of loyalty is not limited to self-dealing and conflicts of interest—the trustee cannot be guided by the interests of any third party. It is improper for a trustee to sell a trust asset for the purpose of benefitting the third person rather than the trust.

Examples of breach of the duty of loyalty would be a trustee leasing trust property to himself for below market rates, generating income at the expense of the trust, and the like.

THZ Holdings, LLC v. McCrea, 753 S.E.2d 344 (N.C. Ct. App. 2013): Transfers resulting in a breach of the duty of loyalty are *voidable* by the beneficiaries affected, regardless of whether the transaction was supported by fair consideration.

The trustee may also be charged with (a) loss or depreciation in the value of the trust estate resulting from the breach; (b) profit made through the breach of trust; or (c) profit which would have accrued to the trust estate if there had been no breach of trust. Restatement (Second) of the Law of Trusts, §§ 205 and 206 (1987).

These remedies are generally available in all breach of fiduciary duty and breach of trust claims.

D. Duty of Impartiality

1. If the trust has multiple beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests. N.C. Gen. Stat. § 36C-8-803 (2015).
2. The duty of impartiality derives from the duty of loyalty. The trustee must respect the interests of all the beneficiaries' interests, especially the conflicts between those beneficiaries interested in income and those interested in principal.
3. The duty to act impartially *does not mean the trustee must treat the beneficiaries equally*; instead, he must treat them equitably in light of the purposes and terms of the trust. A settlor that prefers that some beneficiaries' interests be favored over others should provide adequate guidance to the trustee in the terms of the trust.
4. The duty of impartiality implicates aspects of trust administration as well as investment and management of trust property.
5. To prevail on a claim that the trustee violated the duty of impartiality, the plaintiff will likely be required to prove the trustee *abused his discretion* when distributing income and/or principal. The trust itself, and the powers allocated to the trustee in that regard, will be crucial to the final determination of whether the trustee abused his discretion.

E. Duty (Not) to Delegate

At common law, trustees had a fiduciary *duty not to delegate* those functions they could reasonably be expected to perform personally. Given the increasing sophistication of trust assets and investment possibilities, the modern view is that the *failure to delegate* may constitute a breach of fiduciary duty. It is in the best interest of all parties that these decisions be made with the advice and assistance of experienced professionals.

See generally Heinitsh v. Wachovia Bank, 2007 NCBC 18, *13 (N.C. Super. Ct. June 11, 2007).

1. A trustee may delegate powers and duties and shall exercise reasonable care, skill, and caution in:
 - a. *Selecting* an agent;
 - b. Establishing the *scope and terms* of the delegation (consistent with the purposes and terms of the trust); and
 - c. Periodically reviewing the agent's actions in order to *monitor* the agent's performance and compliance with the terms of delegation.

N.C. Gen. Stat. § 36C-8-807 (2015).

2. An agent owes a duty of *reasonable care* to comply with the terms of the delegation.
3. Management of unique assets may require special expertise to ensure their value is protected and maximized such as in the case of real estate management, closely held business interests, collections of art work, and intellectual property (i.e., royalties, copyrights, and protecting against patent infringement).⁴
4. **AFFIRMATIVE DEFENSE:** If the trustee complies with the delegation requirements, he is not liable to the beneficiaries for the actions of the agent to whom the function was delegated. Nonetheless, the trustee would be wise act promptly upon discovery of any malfeasance or inaction of the agent, which is part of the responsibility of supervising and monitoring the agent's conduct.

Effective June 11, 2012, the North Carolina Uniform Trust Code was amended to create the position of a "power holder" in Article 8A. The primary difference between agents and power holders is that, in the typical case, the trustee will delegate responsibilities to agents while the settlor will designate power holders.

5. *Duties, Powers, and Liabilities of Power Holders and Trustees' Related Duties and Liabilities.*

- a. What is a Power Holder? Also referred to as “trust advisors” and “trust protectors” in common parlance, a “power holder” is a person under the terms of the trust who has the power to take certain actions with respect to the trust and who is not a trustee or settlor.
- b. Are Power Holders Fiduciaries? Yes, subject to specific exceptions (e.g., the power to remove and appoint trustees and power holders), and unless otherwise waived by the settlor. The settlor should exercise caution in waiving any fiduciary obligations lest there be no recourse against the power holder who abused the power.
- c. What are a Power Holder's Duties and Liabilities? Like a trustee, a power holder is required to act in good faith and in accordance with the purposes and terms of the trust and the interests of the beneficiaries. As such, a power holder is liable for any loss that results from breach of fiduciary duty resulting from the exercise or non-exercise of the power.
- d. What is a Trustee's Role When a Power Holder Has Been Appointed? If the terms of the trust confer upon a power holder the power to direct certain actions of a trustee, the trustee must act in accordance with the direction and is not liable for any resulting loss flowing therefrom unless compliance with the direction constitutes intentional misconduct of the trustee.

Unlike those circumstances in which the trustee delegates responsibilities to an agent, the trustee has no duty to monitor the conduct of the power holder, provide advice to the power holder, or consult with the power holder. The trustee is not required to give the beneficiaries any notice of actions taken or not taken by the power holder. The implementation of the power holder's directions do not constitute participation by the trustee in decisions within the power holder's authority.

- e. Although “the court” may remove a power holder for various reasons including the commission of a “serious breach of trust”, the North Carolina Uniform Trust Code is silent as to whether jurisdiction for removal resides with the clerk or the Superior Court and an amendment is probably necessary to ameliorate this

shortcoming. One would expect this to be the province of the clerk, as it is with trustees and guardians.

- f. One potential mechanism for shielding trustees from liability would be the settlor's creation of an unnamed power holder and give the trustee the power of appointment. The net result would essentially satisfy the duty of delegation but have the added benefit (for the trustee) of avoiding the periodic review and monitoring of the power holder's conduct. This potentiality is obviously fraught with downsides, so the settlor should proceed judiciously.

F. Duty to Inform, Report, and Maintain Adequate Records

- 1. A trustee shall keep adequate records of the administration of the trust and shall keep trust property separate from the trustee's own property. N.C. Gen. Stat. § 36C-8-810 (2015).
- 2. The trustee is also under a duty to:
 - a. Provide reasonable complete and accurate information as to the nature and amount of the trust property, at reasonable intervals, to qualified beneficiaries and
 - b. In response to a reasonable request of any qualified beneficiary, must:
 - i. provide a copy of the trust instrument;
 - ii. provide reasonably complete and accurate information as to the nature and amount of the trust property; and
 - iii. allow reasonable inspections of the subject matter of the trust and the accounts and other documents relating to the trust.

Like the duty of good faith, the duty to inform and report is mandatory, *at least in the context of litigation*.

In *Wilson v. Wilson*, 203 N.C. App. 45, 690 S.E.2d 710 (2012), the trust contained a provision waiving the trustee's responsibility to provide accountings to any beneficiary. The beneficiaries sued and sought the relevant information through the discovery process. The trial court granted a motion for protective order preventing discovery of the relevant documentation. The Court of Appeals, relying on N.C. Gen. Stat. § 36C-1-105(b)(9), which confers upon the court the power to take "such action as may be necessary in the interests of justice", held that included the

power to compel discovery to assist beneficiaries in enforcing their rights under the trust. Noting that any notion of a trust without accountability is a contradiction in terms, the Court of Appeals reasoned that the duty of good faith would be completely eviscerated if beneficiaries had no means to hold the trustee to account.

As a result, it would be prudent for the legislature to specifically codify the mandatory nature of the duty to inform and report. Otherwise, beneficiaries' only recourse is to seek that information through the discovery process, thereby increasing litigation and unnecessarily burdening the courts.

Currently, only the duty of good faith and the duty to inform and report are mandatory.

G. Enforcement and Defense of Claims

A trustee shall take *reasonable steps* to enforce claims of the trust and to defend claims of the trust. N.C. Gen. Stat. § 36C-8-81 (2015). In certain circumstances, it may not be reasonable to pursue a claim in light of the expected recovery or it may be reasonable to suffer a default in lieu of defending the action.

This duty overlaps with the duty to administer and, more specifically, the duty to collect in that a successor trustee may be obligated to pursue a former trustee to redress a breach of trust. N.C. Gen. Stat. § 36C-8-812 (2015).

H. The Uniform Prudent Investor Act

The Uniform Prudent Investor Act prescribes duties relevant to the *investment and management* of trust property while Article 8 of the North Carolina Uniform Trust Code contains the duties and powers relevant to the *investment, administration, and distribution* of trust property. There is therefore significant overlap between the two. As a result, the Uniform Prudent Investor Act was recodified to eliminate the redundancies of the duties of loyalty, impartiality, delegation, costs of administration, and trustees with special skills.

I. Breach of Trust v. Breach of Fiduciary Duty

1. *What is a Breach of Trust?*

A breach of trust action is essentially a breach of contract action in which the "contract" is the trust itself. This is not to be confused with the trustee's breach of the beneficiaries' trust, which is a breach of fiduciary duty and/or constructive fraud claim.

A breach of trust is a violation of a duty owed under the trust, which may include the duties enumerated in Article 8 or those articulated elsewhere in the Code. N.C. Gen. Stat. § 36C-10-1001 (2015).

2. *What are the Remedies for Breach of Trust?* They are broad and flexible and include:

- a. Compelling the trustee to perform the trustee's duties;
- b. Enjoining the trustee from committing a breach of trust;
- c. Compelling the trustee to redress a breach of trust by paying money, restoring property, or other means;
- d. Ordering a trustee to account;
- e. Appointing a special fiduciary to take possession of the trust property and administer the trust;
- f. Suspending the trustee;
- g. Removing the trustee as provided in N.C. Gen. Stat. § 36C-7-706;
- h. Reducing or denying compensation to the trustee;
- i. Subject to N.C. Gen. Stat. § 36C-10-1012, voiding an act of the trustee, imposing a lien or a constructive trust on trust property, or tracing trust property wrongfully disposed of and recovering the property or its proceeds; or
- j. Ordering any other appropriate relief.

AFFIRMATIVE DEFENSE: If the trustee can show he acted *honestly and reasonably*, the court may partially or wholly relieve the trustee of liability for breach of trust.

3. *What are the Damages for Breach of Trust?*

The standard for determining money damages rests on two principles: (1) restoring the trust to the position it would have been in had the harm not occurred and (2) disallowing the trustee to profit from his own wrong. N.C. Gen. Stat. § 36C-10-1002 (2015).

Indeed, the trustee may be held accountable for profits made from the trust even in the absence of breach, but does not include loss or depreciation in value absent a breach of trust. N.C. Gen. Stat. § 36C-10-1003 (2015).

AFFIRMATIVE DEFENSE: If more than one trustee is liable to the beneficiaries for breach of trust, a trustee is not entitled to contribution if the trustee is substantially more at fault or acted in bad faith or with reckless indifference to the trust or the interests of the beneficiaries. Further, a trustee who received a benefit from the breach of trust is not entitled to contribution from another trustee to the extent of the benefit received.

In judicial proceedings regarding the administration of a trust, the court may award costs and expenses, including reasonable attorneys' fees. Depending on the equities, the court may award a party its own fees and costs *from the trust* or charge those costs and fees *against another party*. N.C. Gen. Stat. § 36C-10-1004 (2015).

Belk v. Belk, 728 S.E.2d 356 (N.C. App. 2012): This case involved former Mecklenburg County District Court Judge Bill Belk who served as the custodian for his daughter of accounts created under the North Carolina Uniform Transfers to Minors Act. Belk was alleged to have made speculative and imprudent investments with funds held in those accounts and the petitioners (mother and daughter) sought his removal, together with the recovery of damages and attorneys' fees. In affirming the trial court's award of damages and attorneys' fees, the Court of Appeals applied this statute by analogy and reasoned it was necessary to restore the custodial accounts to the same position they would have been in had the breach not occurred.

4. *What is the Statute of Limitations for Breach of Trust?*

No proceeding against a trustee for breach of trust may be commenced more than five years after the first to occur of:

- (a) the removal, resignation, or death of the trustee;
- (b) the termination of the beneficiary's interest in the trust; or
- (c) the termination of the trust.

N.C. Gen. Stat. § 36C-10-1005(a) (2015).

NOTE: This statute creates an outside limitation of five years to bring a cause of action for breach of fiduciary duty, if one of the three triggering events occurs. For example, if a beneficiary does not reasonably discover

a breach of fiduciary duty until four years after the resignation of the trustee, the statute of limitations will still toll one year later, not three.

Robert K. Ward Living Trust v. Peck, 748 S.E.2d 606 (N.C. Ct. App. 2013): The Court of Appeals held that the plain language of the statute of limitations for a breach of trust indicates the “continuing wrong doctrine” will not extend the viability of such an action. Simply put, any conduct committed by Peck after his resignation was not a continuation of any conduct he may have begun as trustee and, since he had no legal authority to act under the trust, could not engage in a continued course of wrongful conduct as trustee. Therefore, a lawsuit brought six years after his resignation was barred by the five-year statute of limitations.

Wortman v. Hutaff, 2012 NCBC 9 (N.C. Super. Ct. January 30, 2012): This case involved an estate in which the residuary poured over into a trust. The trustees attempted to resign as executors and trustees by filing written resignations with the clerk of court, but there is no hearing or approval of the resignations. Several years later, and during the estate administration, one of the primary estate assets (real property owned by an LLC of which one of the trustees had been a one-third member) fell into foreclosure and sold for less than the value of the loan to another limited liability company, of which the same trustee was a member. The trust beneficiaries sued for breach of fiduciary duty for failing to participate in and monitor the management of the LLC after their purported resignations. The trustees filed a motion to dismiss on the basis that they owed no fiduciary duties because of their purported resignations. Judge Murphy denied the motion to dismiss because the trustees had not resigned in accordance with the North Carolina Uniform Trust Code. Since the trustees merely filed resignation papers with the clerk and did not (1) give written notice to the qualified beneficiaries or (2) obtain court approval of the resignations, the resignations were ineffective, and they still owed fiduciary duties to the trust beneficiaries.

Indeed, until the trust property is delivered to a successor trustee, a trustee who has resigned or has been removed still has the duties of a trustee and the powers necessary to protect trust property. N.C. Gen. Stat. § 36C-7-707 (2015). As a result, the best practice for trustees is not to simply resign, but to petition for the appointment of a successor trustee and deliver the trust property concurrently with their resignation to limit their liability.

5. *What Defenses are Available to Trustees?*

- a. Reasonable Reliance: A trustee who acts in reasonable reliance on the terms of the trust as expressed in a trust instrument is not liable

for a breach of trust to the extent that the breach resulted from the reliance. N.C. Gen. Stat. § 36C-10-1006 (2015).

- b. Unknown Events: If the happening of an event such as marriage, divorce, performance of educational requirements, or death affects the administration or distribution of a trust and the trustee has exercised reasonable care to ascertain the happening of the event, the trustee will not be liable for loss resulting from a lack of knowledge. N.C. Gen. Stat. § 36C-10-1007 (2015).
- c. Exculpation Clauses: A settler can include terms in the trust relieving the trustee of liability for breach of trust (i.e., for conflict of interest); however, exculpation clauses are unenforceable to the extent the breach of trust was committed *in bad faith with reckless indifference* to the purposes of the trust or the interests of the beneficiaries. N.C. Gen. Stat. § 36C-10-1008 (2015).
- d. Consent, Release, or Ratification: A trustee is not liable to a beneficiary for breach of trust at the beneficiary *consented to the conduct* constituting the breach, *released the trustee from liability* for the breach, or *ratified the transaction* constituting the breach unless the consent, release, or ratification was induced by *improper conduct of the trustee* or the beneficiary did not have sufficient *knowledge of his rights* or of the *material facts* relating to the breach. No consideration is required for the consent, release, or ratification to be valid. N.C. Gen. Stat. § 36C-10-1009 (2015).
- e. Limitations on Personal Liability of Trustee:
 - i. *Contracts*: A trustee is not personally liable on a contract properly entered into in the trustee's fiduciary capacity in the course of administering the trust if the trustee in making the contract disclosed the fiduciary capacity.
 - ii. *Torts*: A trustee is only personally liable for torts committed in the course of administering a trust if the trustee is personally at fault (i.e., either intentionally or negligently).
 - iii. *Indemnification*: A trustee is entitled to indemnification from the trust for any claim (other than a breach of trust) for which the trustee is otherwise liable:
 - (1) If the claim arose from a common incident of activity in which the trustee was properly engaged for the trust;

(2) If the trustee was not personally at fault; or

(3) To the extent that the trustee's actions increase the value of the trust property.

N.C. Gen. Stat. § 36C-10-1010 (2015).

V. BREACH OF FIDUCIARY DUTY: PERSONAL REPRESENTATIVES

A. Commencement of Duties: The duties and powers of a personal representative (executors and administrators) commence upon the personal representative's appointment. N.C. Gen. Stat. § 28A-13-1 (2015).

B. General Duties: A personal representative is a fiduciary who, in addition to the specific duties stated in this Chapter, is under a general duty to *settle the estate* of the personal representative's decedent as *expeditiously and with as little sacrifice of value* as is reasonable under all of the circumstances. N.C. Gen. Stat. § 28A-13-2 (2015). Personal representatives have three primary duties:

1. Determine, locate, and assemble the *assets* of the estate;
2. Determine the lawful *debts* of the estate and pay them; and
3. *Distribute* the remaining property to those entitled to take according to the will or through intestacy.

C. Breach of Duty: A personal representative shall be liable and chargeable in the personal representative's accounts for any loss to the estate arising from the personal representative's *embezzlement or commingling of the estate with other property*; for loss to the estate through *self-dealing*; for any loss to the estate from *wrongful acts or omissions* of the personal representative's joint personal representatives which the personal representative could have prevented by the exercise of ordinary care; and for any loss to the estate arising from the personal representative's *failure to act in good faith and with such care, foresight and diligence as an ordinarily reasonable and prudent person* would act with the ordinarily reasonable and prudent person's own property under like circumstances. If the exercise of power concerning the estate is improper, the personal representative is liable for breach of fiduciary duty to interested persons for resulting damage or loss to the same extent as a trustee of an express trust. N.C. Gen. Stat. § 28A-13-10 (2015).

Fortune v. First Union Nat'l Bank, 87 N.C. App. 1, 359 S.E.2d 801 (1987), *rev'd on other grounds*, 323 N.C. 146, 371 S.E.2d 483 (1988): An executor, in performing those duties related to managing the estate's assets, acts as a trustee to

beneficiaries of the estate. As such, the executor is liable for the depreciation of assets which an ordinarily prudent fiduciary would not have allowed to occur.

- D. Sureties: While fiduciaries are by default required to post bonds to insure the proper performance of their duties, this requirement is either not required or waived in the vast majority of probated estates and trust administrations. Since estate administrations are necessarily devoid of this possibility, all estate administrators will be required to secure bonds. As a result, in addition to claims brought against the administrator, intestate heirs often can seek recovery from the obligors of the bond for breaches of fiduciary duty. N.C. Gen. Stat. § 28A-8-6 (2015).

VI. BREACH OF FIDUCIARY DUTY: GENERAL GUARDIANS AND GUARDIANS OF THE ESTATE

- A. Adjudication of Incompetence: Guardians may be appointed for (a) minors who, for example, receive assets through inheritance or (b) incompetent adults. An adjudication of incompetence for adults requires two findings:

1. that the person *lacks sufficient capacity* to manage his or her affairs or to make or communicate important decisions regarding his or her person, family, or property; and
2. the person's lack of capacity is *due to mental illness, mental retardation, senility, injury*, or some similar cause or condition.

- B. Guardians of the Person, Guardians of the Estate, and General Guardians: Guardians may be appointed for those deemed incompetent to handle their own affairs. As their names imply:

1. A guardian of the person makes decisions about the incompetent person's *general care and well-being*, such as living conditions and medical treatment.
2. A guardian of the estate *makes financial decisions* and manages the incompetent person's assets.
3. A general guardian has the duties and obligations of *both a guardian of the person and guardian of the estate*.

In the vast majority of cases, only guardians of the estate and general guardians will owe fiduciary duties to their wards.

C. Powers and Duties of Guardians of the Estate:

1. N.C. Gen. Stat. § 35A-1251 lists 24 non-exclusive, discrete administrative *powers* by general guardians and guardians of the estate incident to the collection, preservation, and management of the *incompetent ward's estate* in their best interests.
2. N.C. Gen. Stat. § 35A-1252 lists 17 non-exclusive, discrete administrative *powers* by general guardians and guardians of the estate incident to the collection, preservation, and management of the *minor ward's estate* in their best interests.
3. N.C. Gen. Stat. § 35A-1253 lists 5 non-exclusive, discrete *duties* by general guardians and guardians of the estate incident to the appointment, not the least of which appears in subsection (4):

To observe the standard of judgment and care under the circumstances then prevailing that an ordinary and prudent person of discretion and intelligence, who is a fiduciary of the property of others would observe as *such fiduciary in acquiring, investing, reinvesting, exchanging, retaining, selling, and managing the ward's property*. If the guardian has special skills or is named as guardian on the basis of representations of special skills or expertise, to use those skills.

Guardians who exercise their powers according to the statutory requirements will be shielded from attack by the ward's heirs. In *Clay v. Monroe*, 189 N.C. App. 482, 658 S.E.2d 532 (2008), the administrator of the decedent's estate filed a claim against the erstwhile guardian attacking the reasonableness of the sale of real estate (which was ordered and approved by the clerk of court), alleging he breached his fiduciary duty for failing to procure an appraisal prior to the sale. Acknowledging the sales were necessary to meet the ward's monthly expenses during his lifetime, the Court of Appeals reasoned:

This procedural safeguard exists for two reasons: (1) to protect the ward from unscrupulous practices by a court-appointed fiduciary, and (2) to protect the fiduciary from the venality of heirs who did not see fit to participate in the ward's care during his or her life, but who later emerge and attack the guardian's work after the ward's death in an effort to increase their inheritance.

Id. at 487-488, 658 S.E.2d at 536.

4. Article 10 of the Incompetency and Guardianship statutes specifies responsibilities of general guardians and guardians of the estates regarding *returns and accountings* to be filed with the clerk of court. Special care should be taken to do so appropriately, since the failure to properly account for the ward's estate is the most likely cause to ignite fiduciary litigation against the guardian.
- E. Guardian's Bond: Just as in the case of administering estates, general guardians and guardians of the estate are required to post bonds before receiving property. N.C. Gen. Stat. § 35A-1230 (2015). As such, actions can be commenced against the sureties as well as guardians for a breach of their duties. N.C. Gen. Stat. § 35A-1234 (2015).
 - F. Clerk's Liability: Should the clerk appoint a guardian without first taking a good and sufficient bond, a suit may also be instituted against the clerk's official bond for all losses and damages sustained therefrom. The clerk is also liable on his official bond for any losses and damages sustained from the clerk's willful or negligent acts or omissions. N.C. Gen. Stat. § 35A-1238 (2015).

VII. BREACH OF FIDUCIARY DUTY: ATTORNEYS-IN-FACT

- A. Powers of Attorneys-in-Fact: The powers and duties of an attorney-in-fact, including fiduciary duties, are as broad or as narrow as the power of attorney specifies, including whether and to what extent the attorney-in-fact is responsible for filing inventories with the clerk of court or is permitted gift the principal's assets to himself. N.C. Gen. Stat. § 32A-1, *et seq.* (2015).
- B. Durable Power of Attorney: A properly recorded, durable power of attorney will survive the incompetence of the ward and thereby obviate the need for incompetency proceedings, should such cause otherwise arise. N.C. Gen. Stat. § 32A-8, *et seq.* (2015).
- C. Liability of Attorney-in-Fact: An attorney-in-fact has a fiduciary duty to act in the best interests of the principal. An attorney-in-fact's liability to the principal, however, will be determined by whether his conduct conforms to or exceeds the powers granted by the power of attorney.

In this context, breach of fiduciary duty claims most commonly arise when the attorney-in-fact has gifted property to himself in excess of the gifting authority.

See Hutchins v. Dowell, 138 N.C. App. 673, 676, 531 S.E.2d 900, 902 (2000).

However, since a competent adult may grant whatever powers regarding his affairs as he would like, there are little or no mandatory fiduciary duties for the unlimited and unrestrained attorney-in-fact. For that reason, most litigation

surrounding powers of attorney center on their procurement through *fraud, duress, undue influence, or lack of capacity* rather than breach of fiduciary duty.

VIII. ADDITIONAL EQUITABLE REMEDIES

- A. Constructive Trusts: The imposition of a constructive trust is an equitable remedy for breach of fiduciary duty. A constructive trust can be imposed on a fiduciary who, for example, has accumulated ill-gotten gains from the breach of loyalty. Should the fiduciary use funds to obtain property in violation of a fiduciary duty, he holds the property as a constructive trustee and has a duty to account to the beneficiaries.
- B. Accounting: Coupled with the duty of trustees and personal representatives to inform and report, an accounting is an equitable remedy sometimes pled in breach of fiduciary duty cases to ascertain the management of trust and estate assets.
- C. Unrealized Gains: In addition to being held liable for losses and secret gains made by the fiduciary, the fiduciary may also be held liable for unrealized gains that would have likely been realized but for the breach of fiduciary duty.
- D. Injunctive Relief: Since breach of fiduciary duty is, by its very nature, a claim grounded in equity, courts are generally free to fashion whatever remedies are appropriate under the circumstances, including injunctive relief.

IX. ADDITIONAL AFFIRMATIVE DEFENSES

Just as there is not an exhaustive list of possible causes of action that can arise in fiduciary litigation, there is no exhaustive list of affirmative defenses. The best practice is to allege any available affirmative defenses in the responsive pleading to avoid inadvertently waiving them. The following are the more prevalent:

- A. *Equitable Estoppel*: Also denominated as “quasi-estoppel” or “estoppel by benefit”, this theory applies when a party accepts a transaction or benefit and then later attempts to take a position inconsistent with the prior acceptance of that same transaction or instrument.

Whitacre P'ship v. BioSignia, Inc., 358 N.C. 1, 18, 591 S.E.2d 870, 882 (2004).

- B. *Collateral Estoppel*: *Res judicata* or claim preclusion bars parties from re-litigating matters that were or could have been raised in a prior action between the same parties or those in privity with them.

Brawley v. Elizabeth Townes Homeowners Ass'n, 2014 N.C. App. LEXIS 920, 4 (2014).

- C. *Laches*: Laches has been defined as such neglect or omission to assert a right, taken in conjunction with lapse of time and other circumstances causing prejudice to an adverse party, as will operate as a bar in equity. Delay which will constitute laches depends on the facts and circumstances of each case, but only applies when the circumstances have so changed during the lapse of time that it would be inequitable and unjust to permit the prosecution of the action.

Young v. Young, 43 N.C. App. 419, 424, 259 S.E.2d 348, 351 (1979).

- D. *Unclean Hands*: The “clean hands” doctrine prevents recovery in equity where the party seeking relief has engaged in some nefarious conduct that would make an award in their favor unjust.

Crumley & Assocs., P.C. v. Charles Peed & Assocs., P.A., 219 N.C. App. 615, 622, 730 S.E.2d 763, 768 (2012).

- E. *Accord and Satisfaction*: An accord is an agreement in which one party undertakes to give or perform, and the other to accept, in satisfaction of a disputed claim which is something other than or different from what the second party considered himself entitled to receive.

Collier v. Bryant, 216 N.C. App. 419, 436, 719 S.E.2d 70, 83 (2011).

- F. *In pari delicto*: This common law defense arises from the maxim *in pari delicto potior est conditio possidentis* or “in a case of equal or mutual fault the condition of the party in possession is the better one.” The law generally forbids redress to one for an injury done him by another, if he himself first be in the wrong about the same matter whereof he complains. Essentially, when both have the same knowledge, willfulness, or wrongful intent and are equally blameworthy, the law will aid the one who is comparatively more innocent.

Commscope Credit Union v. Butler & Burke, LLP, 2014 N.C. App. LEXIS 1131, 9-10, 764 S.E.2d 642 (2014).

- G. *Contributory Negligence*: Contributory negligence, as its name implies, is negligence on the part of the plaintiff which joins, simultaneously or successively, with the negligence of the defendant alleged in the complaint to produce the injury of which the plaintiff complains. It does not negate negligence of the defendant as alleged in the complaint, but presupposes or concedes such negligence by him. Contributory negligence by the plaintiff can exist only as a co-ordinate or counterpart of negligence by the defendant as alleged in the complaint.

Jackson v. McBride, 270 N.C. 367, 372, 154 S.E.2d 468, 471 (1967) (citations, internal quotation marks, and emphasis omitted).

- H. *Intervening Negligence*: Intervening negligence of an independent responsible agency may “insulate” the primary negligence charged to a defendant, for example, where such intervening negligence has no logical connection by way of causation with the original negligence, and stands, therefore, independently as the sole proximate cause.

See Montgomery v. Blades, 218 N.C. 680, 684, 12 S.E.2d 217, 219-220 (1940).

In the context of fiduciary litigation, this would most foreseeably arise when one co-trustee files a cross-claim against one or more other co-trustees alleging their negligent mismanagement of trust property was the proximate cause of the plaintiff’s damages.

- I. *Assumption of Risk*: The two elements of the common law defense of assumption of risk are: (1) actual or constructive knowledge of the risk, and (2) consent by the plaintiff to assume that risk. In the context of fiduciary litigation, the crux of such a defense will rest on the level of involvement of the beneficiaries in the investment decisions of the fiduciary. To the extent, for example, the beneficiaries advocate an aggressive, highly speculative investment strategy (and it is not proscribed by the terms and interests of the trust) the trustee may be shielded from liability so long as he adequately educated them on the risks involved and they endorsed the scheme nonetheless.

See Allred v. Capital Area Soccer League, Inc., 194 N.C. App. 280, 287, 669 S.E.2d 777, 781 (2008).

- J. *Failure to Mitigate*: This defense precludes recovery for those consequences of the tortfeasor’s act which could have been avoided by acting as a reasonable prudent man. As with other defenses, the burden is on defendant to show plaintiff neglected to mitigate damages. In a negligence action, it is well settled the party wronged must use due care to minimize the loss occasioned by defendant’s negligence. Unlike a plaintiff’s failure to establish the element of proximate cause, the failure to mitigate damages is not an absolute bar to all recovery; rather, a plaintiff is barred from recovering those losses which could have been prevented through the plaintiff’s reasonable efforts.

See generally Smith v. Childs, 112 N.C. App. 672, 682-683, 437 S.E.2d 500, 507 (1993) (quotations and citations omitted).

This rule is only applicable where the plaintiff could not have reasonably avoided the loss and, for that reason, will be of limited applicability in fiduciary litigation. Since beneficiaries typically have no control over the assets, their ability to mitigate damages from waste or unwise investments will be similarly attenuated in most instances. However, if they sit idly by with full knowledge of the waste

or imprudence and refrain from seeking to have the trustee removed for breach of trust or the like, this defense may be available.

- K. *Lack of Standing*: Only interested parties have standing to sue for claims related to a breach of trust, maladministration of an estate, etc. Most often, we think of beneficiaries and heirs as those having standing to sue. However, one co-trustee also has standing to sue another co-trustee to compel him to perform his duties under the trust, enjoin him from committing a breach of trust, or to compel him to redress a breach of trust.

Yost v. Yost, 213 N.C. App. 516, 521-522, 713 S.E.2d 758, 763 (2011).

X. CONCLUDING REMARKS: LITIGATION TIPS

A. Plaintiffs

1. Make sure all elements of each claim for relief are *sufficiently pled*. For example, fraud claims must be pled with particularity or risk being dismissed at an early stage of the lawsuit. Proving both the existence of a fiduciary relationship and its scope is easy to overlook, yet critical.
2. Since the fundamental quality of the fiduciary relationship is that the highest duty of fidelity is owed by one in whom trust and confidence are placed, focus on (a) the *unfairness and inequity* of the alleged wrongful conduct and (b) the *relative bargaining powers* of the parties.
3. To the extent there are differing *levels of sophistication or expertise* between the parties that either facilitated the malfeasance or may explain how it passed undiscovered, those issues should be thoroughly investigated in discovery.
4. Any evidence regarding the degree to which the defendant exercised *dominion or control over the assets* or otherwise concealed pertinent information should be highlighted.

B. Defendants

1. *Motions to dismiss*, although not overwhelmingly successful, can force a plaintiff to stake positions on ambiguous claims or reveal the true nature of a “fiduciary” relationship and the parameters of its scope.
2. Scrutinize the governing documents for any *ambiguities in its terms* that justify the fiduciary’s conduct. Similarly, verify whether any *exculpatory or indemnification clauses* shield the fiduciary from liability.

3. *Focus on causation.* To the extent the alleged misconduct is grounded in omissions, rather than actions, causation may be more difficult to prove.
4. Any evidence tending to *diminish or eliminate gaps in the sophistication, expertise, or education* of the parties will reduce sympathy for the plaintiff.
5. *Attack damages calculations.* To the extent the lackluster investment performed at comparative levels to other benchmark indices (think the S&P 500 in 2008), the plaintiff will not be able to show he was damaged monetarily or at least that the damage was not caused by the defendant.

¹ Kutcher, Robert A., *Breach of Fiduciary Duties*, Chapter 1 p. 3 of *Business Torts Litigation* (2d Ed.), Ann E. Georgehead, Robert Y. Gwin, and David A. Sol, Eds. (2005).

² Stockham, Michael W. and Mackenzie S. Wallace, *Fiduciary Duty Litigation and Burden Shifting*, Trial Evidence Committee, ABA Section of Litigation, March 4, 2014.

³ See Becker, Theodore M., *et al.*, *Suing and Defending Fiduciaries*, p.1, Section of Real Property, Probate and Trust Law, American Bar Association 2001 Annual Meeting (August 6, 2001).

⁴ Davenport, Erwin, *Risk Management for Trustees*, State Bar of Texas 29th Annual Advanced Estate Planning and Probate Course, Fort Worth, Ch. 22, pp.17-18 (June 8-10, 2005).

Breach of Fiduciary Duty

Causes of Action and Defenses



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Two Types of Fiduciary Relationships

- ▶ Those created by law and governing relationships created (a) by statute such as in estate administrations (administrator and heir) and guardianship and incompetency proceedings (guardian and ward) or (b) by contract (attorney and client); and
- ▶ Those that arise from the circumstances underlying the relationship between the parties and the nature of the transactions at issue.



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Examples of Fiduciary Relationships:

- ▶ Trustees (and Agents and Power Holders);
- ▶ Personal Representatives (Executors and Administrators);
- ▶ General Guardians and Guardians of the Estate;
- ▶ Attorneys-in-Fact; and
- ▶ Lawyers and Accountants (to the extent they serve in one of the above capacities).



Elements of a Breach of Fiduciary Duty:

- ▶ To prove a breach of fiduciary duty claim, the plaintiff must show:
 1. the *existence* of a fiduciary relationship;
 2. a *breach* of the duty owed; and
 3. *damages* proximately caused by the breach.



Threshold Considerations:

Potential plaintiffs should examine four important questions in fiduciary duty cases:

1. What are the parameters of the defendant's fiduciary obligations?
2. By what standards will the defendant's fiduciary obligations be measured?
3. Who has the burden of proof?
4. Are there any documents or facts altering the fiduciary's obligations?



The Clerk's Office or Superior Court: Where Does Jurisdiction Lie?

- ▶ The clerks of superior court have original (and often exclusive) jurisdiction over the administration of trusts and estates.
- ▶ Clerks of superior court do not, however, have jurisdiction over
 - (1) actions seeking to modify, terminate, or revoke trusts;
 - (2) caveat proceedings to contest the validity of wills; or
 - (3) *actions against fiduciaries for breach of their duties.*

Those cases must be filed and tried in Superior Court.



Kissing Cousins: Breach of Fiduciary Duty and Constructive Fraud

Breach of Fiduciary Duty

1. the *existence* of a fiduciary relationship;
2. a *breach* of the duty owed; and
3. *damages* proximately caused by the breach.

Constructive Fraud

1. the existence of a *relationship of trust and confidence*;
2. that the defendant took advantage of his position of trust *in order to benefit himself*; and
3. that the plaintiff, as a result, was *injured*.



Differences Between Constructive Fraud and Breach of Fiduciary Duty

► *The Defendant Must Benefit Himself in the Transaction for it to Constitute Constructive Fraud*

When the superior party obtains a possible benefit to the alleged abuse of the confidential or fiduciary relationship, the aggrieved party is entitled to a presumption that constructive fraud occurred.

Thus, once a prima facie case of constructive fraud is established, the burden shifts to the defendant to prove he acted in an "open, fair and honest" manner.

To be "open, fair and honest" merely rebuts the presumption of fraud, it does not serve as an affirmative defense.

If the presumption is rebutted, the accusing party bears the burden of producing actual evidence of fraud.



Differences Between Constructive Fraud and Breach of Fiduciary Duty

► *Statutes of Limitations*

► Breach of Fiduciary Duty: 3 Years per N.C. Gen. Stat. § 1-52(1) (2015)

In cases where a trustee is accused of breaching his fiduciary duty, the statute begins to run when the claimant “‘knew, or by due diligence, should have known’ of the facts constituting the basis for the claim.”

Unless it rises to the level of constructive fraud..

► Constructive Fraud: 10 Years per N.C. Gen. Stat. § 1-56 (2015)

For constructive fraud, the aggrieved party is under no duty to make inquiry until something occurs to *excite his suspicions*. While the plaintiff cannot be willfully ignorant, so long as he remains ignorant through no fault of his own (i.e., he has not discovered the fraud and could not through reasonable diligence discover it), the statute will not begin to run.



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Other Causes of Action Commonly Pled in Conjunction with Breach of Fiduciary Duty Claims

Unfair and Deceptive Trade Practices (“UDTP”)

Conduct which constitutes a breach of fiduciary duty and/or constructive fraud is sufficient to support a UDTP claim.

In order to establish a prima facie claim for unfair trade practices, a plaintiff must show:

1. defendant committed an *unfair or deceptive act or practice*;
2. the action in question was *in or affecting commerce*; and
3. the act *proximately caused injury* to the plaintiff.



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Unfair and Deceptive Trade Practices

- ▶ If a UDTP claim is proven, the statute mandates actual damages be trebled and allows for the discretionary award of attorneys' fees.
- ▶ NOTE: Excluded from the definition of "commerce" in Chapter 75 of the North Carolina General Statutes are "professional services rendered by a member of a *learned profession*."
- ▶ RESULT: The very same conduct that could subject a trust officer at a bank to treble damages and attorneys fees' for the commission of unfair and deceptive trade practices would not be available if the trustee is a lawyer or accountant.



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Conversion

- ▶ Conversion is a civil cause of action for theft.
- ▶ This claim typically arises when a trustee or personal representative is alleged to have absconded with property rightfully belonging to the beneficiaries or heirs.
- ▶ 3 Year statute of limitations for conversion.
- ▶ As a general rule, the claim accrues when the unauthorized assumption and exercise of ownership occurs—not when the plaintiff discovers the conversion.
- ▶ However, when the defendant lawfully obtains possession or control and then exercises unauthorized dominion or control over the property (as is often the case in fiduciary litigation), demand and refusal become necessary elements of the tort.



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Unjust Enrichment

- ▶ This claim will almost universally be found whenever a fiduciary is accused of self-dealing. The most obvious example is when a trustee elects an investment option that generates significant fees for the corporate fiduciary but lacks a concomitant return on investment for the beneficiaries or perhaps an even lower return than a more prudent investment.
- ▶ 3 Year statute of limitations for unjust enrichment.



Professional Malpractice

- ▶ All professional malpractice claims have four basic elements:
 1. the plaintiff was *owed a duty* for the professional to act with the reasonable standard of care for that profession;
 2. the professional *breached that duty* by failing to act as he/she should or committing an act in violation of that duty;
 3. the breach of that duty harmed the plaintiff and *caused injury*; and
 4. the injury sustained is *compensable*.
- ▶ Sound familiar? Breach of fiduciary duty claims against lawyers and accountants often breed malpractice claims and vice versa.



Professional Malpractice

- ▶ Whether a non-client third party may recover for an attorney's malpractice under this alternative tort theory depends on several factors:
 1. the extent to which the transaction was *intended to affect the third party*;
 2. the *foreseeability of harm* to him;
 3. the *degree of certainty* that he suffered injury;
 4. the *closeness of the connection* between the attorney's conduct and the injury;
 5. the *moral blame* attached to such conduct; and
 6. the policy of *preventing future harm*.



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Declaratory Judgment

- ▶ North Carolina Courts have jurisdiction to consider the construction and/or validity of documents such as wills and trusts and declare the legal relations thereto.
- ▶ Declaratory judgment actions are often brought in conjunction with other claims to ascertain whether the fiduciary's conduct conforms to the intent of the governing document as well as to determine the validity of the document itself.
- ▶ Declaratory judgment actions do not have to be brought after an alleged breach.



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Breach of Fiduciary Duties: Trustees

- ▶ Breach of fiduciary duty claims against trustees usually fall within two camps:
 1. those centered on how the trust assets are *managed* (e.g., allegations of poor investment decisions, self-dealing, etc.) and
 2. those regarding how the trust is *administered* (e.g., favoring income beneficiaries over remaindermen).



General Considerations

- ▶ Voidability: To the extent a trust was created by fraud, duress, or undue influence, it is voidable.
- ▶ Removal of Trustees: A trustee may be removed, *inter alia*, for serious breach of trust or unfitness, unwillingness, or persistent failure to administer the trust effectively.
- ▶ Special Skills: A trustee who has special skills or expertise, or who is named upon reliance of those special skills or expertise, shall use those skills or expertise.



Duty to Administer Trusts and to do so Prudently

- ▶ Trustees are required to administer trusts in *good faith*, in accordance with its terms and purposes and in the interests of the beneficiaries.
- ▶ *The duty of good faith is non-waiveable and mandatory.*



Prudent Administration

- ▶ The trustee shall administer the trust as a *prudent person* would (i.e., reasonable care, skill, and caution) by considering the purposes, terms, distributional requirements, and other circumstances of the trust. Ancillary duties to prudent administration include, but are not limited to:
 1. the duty to take control and protect trust property;
 2. the duty to collect trust property;
 3. the duty to insure trust property; and
 4. the duty to abandon trust property of insufficient value or benefit to justify the costs of administration.
- ▶ The standard of care regarding the duties of administration (beyond good faith) may be modified by the settlor.



Duty of Loyalty

"The reasons for the loyalty rule are evident. A man cannot serve two masters. He cannot fairly act for his interest and the interest of others in the same transaction. Consciously or unconsciously, he will favor one side or the other, and where placed in this position of temptation, there is always the danger that he will yield to the call of self-interest."

Wachovia Bank & Trust Co. v. Johnston, 269 N.C. 701, 715, 153 S.E.2d 449, 459-60 (1967).



Duty of Loyalty

► A trustee shall administer the trust *solely in the interests of the beneficiaries*.

In other words, the trustee may not engage in self-dealing or in such a way that his interests conflict with those of the beneficiaries. Since this duty can be modified by the terms of the trust, settlors would be well advised to consider the purposes of the trust and how conflicts should be handled.

The duty of loyalty is not limited to self-dealing and conflicts of interest—the trustee cannot be guided by the interests of any third party. It is improper for a trustee to sell a trust asset for the purpose of benefitting the third person rather than the trust.



Duty of Impartiality

- ▶ If the trust has multiple beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests.



Duty of Impartiality

- ▶ The duty to act impartially does not mean the trustee must treat them beneficiaries equally; instead, he must treat them equitably in light of the purposes and terms of the trust. A settlor that prefers some beneficiaries' interests be favored over others should provide adequate guidance to the trustee in the terms of the trust.



Duty (Not) to Delegate

- ▶ At common law, trustees had a fiduciary *duty not to delegate* those functions they could reasonably be expected to perform personally. Given the increasing sophistication of trust assets and investment possibilities, the *failure to delegate* may constitute a breach of fiduciary duty. It is in the best interest of all parties that these decisions be made with the advice and assistance of experienced professionals.



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Duty to Delegate

A trustee may delegate powers and duties and shall exercise reasonable care, skill, and caution in:

- ▶ *Selecting* an agent;
- ▶ Establishing the *scope and terms* of the delegation (consistent with the purposes and terms of the trust); and
- ▶ Periodically reviewing the agent's actions in order to *monitor* the agent's performance and compliance with the terms of delegation.



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Duty to Delegate

- ▶ **AFFIRMATIVE DEFENSE:** If the trustee complies with the delegation requirements, he is not liable to the beneficiaries for the agent's actions.
- ▶ Nonetheless, the trustee would be wise act promptly upon discovery of any malfeasance or inaction of the agent, which is part of the responsibility of supervising and monitoring the agent's conduct.



Duties, Powers, and Liabilities of Power Holders

- ▶ Effective June 11, 2012, the North Carolina Uniform Trust Code was amended to create the position of a "power holder" in Article 8A. The primary difference between agents and power holders is that, in the typical case, the trustee will delegate responsibilities to agents while the settlor will designate power holders.



What is a Power Holder?

- ▶ What is a Power Holder? Also referred to as “trust advisors” and “trust protectors” in common parlance, a “power holder” is a person under the terms of the trust who has the power to take certain actions with respect to the trust and who is not a trustee or settlor.



Are Power Holders Fiduciaries?

- ▶ Yes, unless otherwise waived by the settlor. The settlor should exercise caution in waiving any fiduciary obligations lest there be no recourse against the power holder who abused the power.



What are a Power Holder's Duties and Liabilities?

- ▶ Like a trustee, a power holder is required to act in good faith and in accordance with the purposes and terms of the trust and the interests of the beneficiaries. A power holder is liable for any loss that results from breach of fiduciary duty resulting from the exercise or non-exercise of the power.



What is a Trustee's Role When a Power Holder Has Been Appointed?

- ▶ If the terms of the trust confer upon a power holder the power to direct certain actions of a trustee, the trustee must act in accordance with the direction and is not liable for any resulting loss flowing therefrom unless compliance with the direction constitutes intentional misconduct of the trustee.



What is a Trustee's Role When a Power Holder Has Been Appointed?

- ▶ Unlike those circumstances in which the trustee delegates responsibilities to an agent:
 1. trustee has no duty to monitor the conduct of the power holder;
 2. provide advice to the power holder;
 3. consult with the power holder; or
 4. give the beneficiaries any notice of actions taken or not taken by the power holder.



Duty to Inform, Report, and Maintain Adequate Records

- ▶ A trustee shall keep adequate records of the administration of the trust and shall keep trust property separate from the trustee's own property.



Duty to Inform, Report, and Maintain Adequate Records

The trustee is under a duty to:

- ▶ In response to a reasonable request of any qualified beneficiary, must:
 1. provide a copy of the trust instrument;
 2. provide reasonably complete and accurate information as to the nature and amount of the trust property; and
 3. allow reasonable inspections of the subject matter of the trust and the accounts and other documents relating to the trust.



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Duty to Inform, Report, and Maintain Adequate Records

- ▶ Like the duty of good faith, the duty to inform and report is mandatory, *at least in the context of litigation*.
- ▶ In *Wilson v. Wilson*, 203 N.C. App. 45, 690 S.E.2d 710 (2012), the Court of Appeals, relying on N.C. Gen. Stat. § 36C-1-105(b)(9), which confers upon the court the power to take “such action as may be necessary in the interests of justice”, held that included the power to compel discovery to assist beneficiaries in enforcing their rights under the trust. Noting that any notion of a trust without accountability is a contradiction in terms, the Court of Appeals reasoned that the duty of good faith would be completely eviscerated if beneficiaries had no means to hold the trustee to account.
- ▶ As a result, it would be prudent for the legislature to specifically codify the mandatory nature of the duty to inform and report. Otherwise, beneficiaries’ only recourse is to seek that information through the discovery process, thereby increasing litigation and unnecessarily burdening the courts.
- ▶ Currently, only the duty of good faith and the duty to inform and report are mandatory.



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Breach of Trust v. Breach of Fiduciary Duty

- ▶ *What is a Breach of Trust?*
- ▶ A breach of trust action is essentially a breach of contract action in which the “contract” is the trust itself. This is not to be confused with the trustee’s *breach of the beneficiaries’ trust*, which is a breach of fiduciary duty and/or constructive fraud claim.
- ▶ A breach of trust is a violation of a duty owed under the trust, which may include the duties enumerated in Article 8 or those articulated elsewhere in the Code.



What are the Remedies for Breach of Trust?

- ▶ Compelling the trustee to perform the trustee's duties;
- ▶ Enjoining the trustee from committing a breach of trust;
- ▶ Compelling the trustee to redress a breach of trust by paying money, restoring property, etc.;
- ▶ Ordering a trustee to account;
- ▶ Appointing a special fiduciary to take possession of and administer the trust;
- ▶ Suspending the trustee;
- ▶ Removing the trustee;
- ▶ Reducing or denying compensation to the trustee;
- ▶ Voiding an act of the trustee, imposing a lien or a constructive trust on trust property, or tracing trust property wrongfully disposed of and recovering the property or its proceeds; or
- ▶ Ordering any other appropriate relief.



What are the Damages for Breach of Trust?

- ▶ The standard for determining money damages rests on two principles: (1) restoring the trust to the position it would have been in had the harm not occurred and (2) disallowing the trustee to profit from his own wrong.
- ▶ Indeed, the trustee may be held accountable for profits made from the trust even in the absence of breach, but does not include loss or depreciation in value absent a breach of trust.



What are the Damages for Breach of Trust?

- ▶ In judicial proceedings regarding the administration of a trust, the court may award costs and expenses, including reasonable attorneys' fees. Depending on the equities, the court may award a party its own fees and costs *from the trust* or charge those costs and fees *against another party*.
- ▶ *Belk v. Belk*, 728 S.E.2d 356 (N.C. App. 2012): This case involved former Mecklenburg County District Court Judge Bill Belk who served as the custodian for his daughter of accounts created under the North Carolina Uniform Transfers to Minors Act. Belk was alleged to have made speculative and imprudent investments with funds held in those accounts and the petitioners (mother and daughter) sought his removal, together with the recovery of damages and attorneys' fees. In affirming the trial court's award of damages and attorneys' fees, the Court of Appeals applied this statute by analogy and reasoned it was necessary to restore the custodial accounts to the same position they would have been in had the breach not occurred.



What is the Statute of Limitations for Breach of Trust?

- ▶ No proceeding against a trustee for breach of trust may be commenced more than **five (5) years** after the first to occur of:
 1. the removal, resignation, or death of the trustee;
 2. the termination of the beneficiary's interest in the trust; or
 3. the termination of the trust.



Resignation of Trustees: Best Practices

- ▶ Until the trust property is delivered to a successor trustee, a trustee who has resigned or has been removed still has the duties of a trustee and the powers necessary to protect trust property.
- ▶ As a result, the best practice for trustees is not to simply resign, but to petition for the appointment of a successor trustee and deliver the trust property concurrently with their resignation to limit their liability.



What Affirmative Defenses are Available to Trustees for Breach of Trust?

- ▶ Reasonable Reliance: A trustee who acts in reasonable reliance on the terms of the trust as expressed in a trust instrument is not liable for a breach of trust to the extent that the breach resulted from the reliance.



What Affirmative Defenses are Available to Trustees for Breach of Trust?

- ▶ Exculpation Clauses: A settlor can include terms in the trust relieving the trustee of liability for breach of trust (i.e., for conflict of interest); however, exculpation clauses are unenforceable to the extent the breach of trust was committed *in bad faith with reckless indifference* to the purposes of the trust or the interests of the beneficiaries.



What Affirmative Defenses are Available to Trustees for Breach of Trust?

- ▶ Consent, Release, or Ratification: A trustee is not liable to a beneficiary for breach of trust at the beneficiary *consented to the conduct* constituting the breach, *released the trustee from liability* for the breach, or *ratified the transaction* constituting the breach unless the consent, release, or ratification was induced by *improper conduct of the trustee* or the beneficiary did not have sufficient *knowledge of his rights* or of the *material facts* relating to the breach.
- ▶ No consideration is required for the consent, release, or ratification to be valid.



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Breach of Fiduciary Duty: Personal Representatives

- ▶ A personal representative is a fiduciary who is under a general duty to *settle the estate* of the personal representative's decedent as *expeditiously and with as little sacrifice of value* as is reasonable under all of the circumstances. Personal representatives have three primary duties:
 1. Determine, locate, and assemble the *assets* of the estate;
 2. Determine the lawful *debts* of the estate and pay them; and
 3. *Distribute* the remaining property to those entitled to take according to the will or through intestacy.



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Personal Representative: Liability

- ▶ A personal representative is liable for breach of fiduciary duty to the same extent as a trustee is for breach of an express trust.
- ▶ Enumerated grounds for breach of fiduciary duty:
 1. Embezzlement;
 2. Commingling of estate assets with personal assets;
 3. Self-dealing; and
 4. Failure to act in good faith and as a reasonable and prudent person.



Sureties: Third Party Liability

In certain circumstances, fiduciaries are required to post bonds to insure the faithful performance of their duties:

- ▶ Administrators of estates ARE required to post bonds.
- ▶ Executors are typically NOT required to post bonds (the exceptions consume the rule).
- ▶ Guardians of estates of incompetents ARE required to post bonds.
- ▶ Trustees are typically NOT required to post bonds.

In those instances in which bonds are available, plaintiffs can seek recovery from the sureties for breaches of fiduciary duties.



Breach of Fiduciary Duty: General Guardians and Guardians of the Estate

- ▶ Familiar Standard of Care: To observe the standard of judgment and care under the circumstances then prevailing that an ordinary and prudent person of discretion and intelligence, who is a fiduciary of the property of others would observe as *such fiduciary in acquiring, investing, reinvesting, exchanging, retaining, selling, and managing the ward's property*. If the guardian has special skills or is named as guardian on the basis of representations of special skills or expertise, to use those skills.



Breach of Fiduciary Duty: Attorneys-in-Fact

- ▶ Powers of Attorneys-in-Fact: The powers and duties of an attorney-in-fact, including fiduciary duties, are as broad or as narrow as the power of attorney specifies, including whether and to what extent the attorney-in-fact is responsible for filing inventories with the clerk of court or is permitted gift the principal's assets to himself.
- ▶ Liability of Attorney-in-Fact: An attorney-in-fact has a fiduciary duty to act in the best interests of the principal. An attorney-in-fact's liability to the principal, however, will be determined by whether his conduct conforms to or exceeds the powers granted by the power of attorney. It is not unusual for the grant of authority to be fairly broad.
- ▶ FOR THAT REASON, breach of fiduciary duty claims most commonly arise when the attorney-in-fact has gifted property to himself or others in excess of the gifting authority.



Additional Equitable Remedies

- ▶ Constructive Trusts: The imposition of a constructive trust is an equitable remedy that can be imposed, for example, when a fiduciary uses funds to obtain property in violation of a fiduciary duty. He holds the property as a constructive trustee and has a duty to account to the beneficiaries.
- ▶ Accounting: Coupled with the duty of trustees and personal representatives to inform and report, an accounting is an equitable remedy sometimes pled in breach of fiduciary duty cases to ascertain the management of trust and estate assets.
- ▶ Unrealized Gains: In addition to being held liable for losses and secret gains made by the fiduciary, the fiduciary may also be held liable for unrealized gains that would have likely been realized but for the breach of fiduciary duty.
- ▶ Injunctive Relief: Since breach of fiduciary duty is, by its very nature, a claim grounded in equity, courts are generally free to fashion whatever remedies are appropriate under the circumstances, including injunctive relief.



Additional Affirmative Defenses

- ▶ Equitable Estoppel: Also denominated as “quasi-estoppel” or “estoppel by benefit”, this theory applies when a party accepts a transaction or benefit and then later attempts to take a position inconsistent with the prior acceptance of that same transaction or instrument.
- ▶ Collateral Estoppel: *Res judicata* or claim preclusion bars parties from re-litigating matters that were or could have been raised in a prior action between the same parties or those in privity with them.



Additional Affirmative Defenses

- ▶ Laches: Laches has been defined as such neglect or omission to assert a right, taken in conjunction with lapse of time and other circumstances causing prejudice to an adverse party, as will operate as a bar in equity. Delay which will constitute laches depends on the facts and circumstances of each case, but only applies when the circumstances have so changed during the lapse of time that it would be inequitable and unjust to permit the prosecution of the action.
- ▶ Unclean Hands: The “clean hands” doctrine prevents recovery in equity where the party seeking relief has engaged in some nefarious conduct that would make an award in their favor unjust.
- ▶ Accord and Satisfaction: An accord is an agreement in which one party undertakes to give or perform, and the other to accept, in satisfaction of a disputed claim which is something other than or different from what the second party considered himself entitled to receive.



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Additional Affirmative Defenses

- ▶ In pari delicto: In a case of *equal or mutual fault* the condition of the party in possession is the better one. Essentially, when both have the same knowledge, willfulness, or wrongful intent and are equally blameworthy, the law will aid the one who is comparatively more innocent.
- ▶ Contributory Negligence: Contributory negligence, as its name implies, is negligence on the part of the plaintiff which joins, simultaneously or successively, with the negligence of the defendant alleged in the complaint to produce the injury of which the plaintiff complains.
- ▶ Intervening Negligence: Intervening negligence of an independent responsible agency may “insulate” the primary negligence charged to a defendant, for example, where such intervening negligence has no logical connection by way of causation with the original negligence, and stands, therefore, independently as the sole proximate cause.



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Additional Affirmative Defenses

- ▶ Assumption of Risk: The two elements of the common law defense of assumption of risk are: (1) actual or constructive knowledge of the risk, and (2) consent by the plaintiff to assume that risk.
- ▶ Failure to Mitigate: This defense precludes recovery for those consequences of the tortfeasor's act which could have been avoided by acting as a reasonable prudent man. Failure to mitigate damages is not an absolute bar to all recovery; rather, a plaintiff is barred from recovering those losses which could have been prevented through the plaintiff's reasonable efforts.
- ▶ Lack of Standing: Only interested parties have standing to sue for claims related to a breach of trust, maladministration of an estate, etc. Most often, we think of beneficiaries and heirs as those having standing to sue. However, one co-trustee also has standing to sue another co-trustee to compel him to perform his duties under the trust, enjoin him from committing a breach of trust, or to compel him to redress a breach of trust.



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Concluding Remarks: Litigation Tips for Plaintiffs

- ▶ Since the fundamental quality of the fiduciary relationship is that the highest duty of fidelity is owed by one in whom trust and confidence are placed, focus on (a) the *unfairness and inequity* of the alleged wrongful conduct and (b) the *relative bargaining powers* of the parties.
- ▶ To the extent there are differing *levels of sophistication or expertise* between the parties that either facilitated the malfeasance or may explain how it passed undiscovered, those issues should be thoroughly investigated in discovery.
- ▶ Any evidence regarding the degree to which the defendant exercised *domination or control over the assets* or otherwise concealed pertinent information should be highlighted.



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Concluding Remarks: Litigation Tips for Defendants

- ▶ Scrutinize the governing documents for any *ambiguities in its terms* that justify the fiduciary's conduct. Similarly, verify whether any *exculpatory or indemnification clauses* shield the fiduciary from liability.
- ▶ *Focus on causation.* To the extent the alleged misconduct is grounded in omissions, rather than actions, causation may be more difficult to prove.
- ▶ Any evidence tending to *diminish or eliminate gaps in the sophistication, expertise, or education* of the parties will reduce sympathy for the plaintiff.
- ▶ *Attack damages calculations.* To the extent the lackluster investment performed at comparative levels to other benchmark indices (think the S&P 500 in 2008), the plaintiff will not be able to show he was damaged monetarily or at least that the damage was not caused by the defendant.



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