

## Title

May a vindicated trustee be reimbursed from the trust estate even for those defense costs that were covered by his personal liability insurance carrier?

## Text

As to whether the vindicated trustee's claim against the trust estate for defense counsel's fees should be offset by payments made to defense counsel by the trustee's personal liability insurance carrier, at least one court has answered that it depends: "On remand, ... the judge should take the trustees' insurance coverage into account, giving it as much or as little weight as the judge deems appropriate, in arriving at a just and equitable award." *See Brady v. Citizens Union Savings Bank*, 38 N.E.3d 301, 88 Mass. App. Ct. 416 (2015); *see also Brady v. Citizens Union Savings Bank*, Case No. 16-P-308, 2017 Mass. App. LEXIS 26 (Mar. 9, 2017). One policy argument against setoff is that one who contracts for insurance with personal funds, not some third party, should receive the "benefit of the bargain." *Id.* But does this not effectively constitute an equitable double-dipping by (or windfall for) the vindicated trustee? Arguably it would not. The trustee already personally paid for the legal services in advance as a "component" of the insurance premiums. *Id.* Also, the nexus between the liability-insurance contract (law) and the trust's administration (equity) is not so close as to warrant setoff. *Id.* The vindicated trustee's right in equity to be reimbursed from the trust estate for his legal-defense costs is taken up generally in §3.5.2.3 of *Loring and Rounds: A Trustee's Handbook* [pages 159-168 of the 2017 Edition], which section is reproduced in its entirety in the appendix to this posting immediately below.

## Appendix

### §3.5.2.3 Right in Equity to Exoneration and Reimbursement, *i.e.*, Indemnity; Payment of Attorneys' Fees [from *Loring and Rounds: A Trustee's Handbook* (2017), with enhancements]

*If the trustee properly incurs a liability in the administration of the trust, he is entitled to indemnity out of the trust estate either by exoneration, that is using trust property in discharging the liability so that he will not be compelled to use his individual property in discharging it, or by way of reimbursement, that is if he has used his individual property in discharging the liability, by repaying himself out of the trust property.*<sup>80</sup>

**Exoneration and reimbursement.** An agent generally incurs no liability for acting within the scope of the agency. It is the principal who is on the hook. By contrast, it is the trustee who acts as principal in connection with the administration of the trust. It is the trustee, not the beneficiary, who is personally liable to third parties in contract<sup>81</sup> and tort,<sup>82</sup> "whether or not he is acting in accordance with his powers

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<sup>80</sup>Restatement (Second) of Trusts §244 cmt. b.

<sup>81</sup>*See generally* §7.3.1 of this handbook (trustee's liability as legal owner in contract to nonbeneficiaries); Lewin ¶21-05 through ¶21-07 (England).

<sup>82</sup>*See generally* §7.3.3 of this handbook (trustee's liability as legal owner in tort to nonbeneficiaries); Lewin ¶21-08 (England).

and duties as trustee.”<sup>83</sup> Again, a trustee is a principal. He is neither an agent nor, absent special facts, an employee of the trust.<sup>84</sup>

Inasmuch as there is a rigid restriction against personal participation by the trustee in any of the profits and gains resulting from the administration of the trust estate,<sup>85</sup> equity takes pains to hold the trustee harmless from personal liability for obligations *properly incurred*.<sup>86</sup> English law is in accord.<sup>87</sup> Thus, unless the terms of the trust provide otherwise,<sup>88</sup> a trustee is entitled to indemnity out of the trust estate, either by exoneration or reimbursement, for expenses properly incurred in the administration and management of the trust,<sup>89</sup> whether or not the trust contains a spendthrift provision.<sup>90</sup> In England, so too is an outgoing trustee, even after he has parted with the trust property,<sup>91</sup> as is the trustee of a voidable trust.<sup>92</sup> “A trustee has a first charge or lien upon the trust fund in respect of the liabilities, costs and expenses covered by his right of indemnity.”<sup>93</sup> In some jurisdictions, this equitable right of indemnity has been codified by statute.<sup>94</sup> The trustee may even be entitled to interest on personal funds reasonably and appropriately advanced.<sup>95</sup> The trustee, of course, has no fiduciary duty to make advances out of his own pocket, absent special facts, but to the extent he chooses to do so, he is entitled to take “security for indemnification.”<sup>96</sup> A trustee who has made good any loss occasioned by his breach of trust is entitled to be indemnified for expenses reasonably incurred to the extent the trust estate is benefited thereby.<sup>97</sup> A beneficiary who seeks equity must do equity.<sup>98</sup>

A right of exoneration is a right in the trustee to pay creditors directly from the trust estate<sup>99</sup> all of the expenses “reasonably and appropriately”<sup>100</sup> incurred by him as its owner,<sup>101</sup> including taxes,<sup>102</sup> repair

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<sup>83</sup>Lewin ¶21-04.

<sup>84</sup>See generally *Loring v. United States*, 80 F. Supp. 781 (D. Mass. 1948).

<sup>85</sup>See generally §6.1.3 of this handbook (the trustee’s duty of loyalty).

<sup>86</sup>See generally 4 Scott & Ascher §221.1; Bogert §718. “Under the general law a trustee is in general not entitled to indemnity out of the trust property in respect of liabilities to third parties and costs and expenses incurred in consequence of unauthorised acts.” Lewin ¶39-94 (England).

<sup>87</sup>See *In re Beddoe* (*Downes v. Cottam*), [1893] 1 Ch. 547 (Eng.).

<sup>88</sup>4 Scott & Ascher §22.1.4 (Terms of the Trust).

<sup>89</sup>Restatement (Third) of Trusts §38(2); Lewin ch. 21 (England); 3 Scott & Ascher §§18.1.2 (Power to Incur Expenses) (U.S.), 18.1.2.5 (Expenses of Management) (U.S.); 4 Scott & Ascher §22.1 (Expenses Properly Incurred).

<sup>90</sup>4 Scott & Ascher §22.1.2 (Spendthrift Trusts).

<sup>91</sup>Lewin ¶14-50.

<sup>92</sup>Lewin ¶21-23. The purported trustee of a purported trust that is held void ab initio, however, may well not be entitled to indemnity out of the trust estate. Lewin ¶21-23.

<sup>93</sup>Lewin ¶21-26 (England); 4 Scott & Ascher §§22.1 (Expenses Properly Incurred) (U.S.), 22.1.1 (Lien for Indemnity) (U.S.).

<sup>94</sup>See, e.g., §31(1) of the English Trustee Act 2000; §47(2) of the Cayman Islands Trust Law (2001 revision); §59(4) NSW Trustee Act 1924; Article 22(2) of the Trusts Jersey Law (1984) (as substituted by Trusts (Amendment) (Jersey) Law (1989)).

<sup>95</sup>4 Scott & Ascher §22.1.

<sup>96</sup>4 Scott & Ascher §22.1.1 (Lien for Indemnity).

<sup>97</sup>4 Scott & Ascher §§22.1.3 (Trustee in Default), 22.2.1 (Benefit to Trust Estate).

<sup>98</sup>See §8.12 of this handbook (where the trust is recognized outside the United States) (containing a catalog of equity maxims).

<sup>99</sup>4 Scott & Ascher §22.1 (defining exoneration as “the power to use trust funds to discharge obligations that have arisen out of trust administration”).

<sup>100</sup>Restatement (Third) of Trusts §88 cmt. b.

<sup>101</sup>Restatement (Third) of Trusts §38 cmt. b; 4 Scott & Ascher §22.1.

costs,<sup>103</sup> brokers' commissions,<sup>104</sup> expenses of running a trade or business on behalf of the trust,<sup>105</sup> premiums for insuring against liability in contract and tort to nonbeneficiaries,<sup>106</sup> and other legitimate expenses of prudently collecting, managing, preserving,<sup>107</sup> and protecting the trust property,<sup>108</sup> including those properly incurred in hiring agents,<sup>109</sup> traveling,<sup>110</sup> leasing,<sup>111</sup> investing,<sup>112</sup> borrowing,<sup>113</sup> and bringing, defending, and settling litigation, including attorneys' fees, and expenses of consulting counsel when there is reasonable cause.<sup>114</sup> The expenditures must be in furtherance of the trust's purposes.<sup>115</sup> "Improvements may serve to make the property more productive,<sup>116</sup> or to make the premises safe and tenable; therefore a trustee can properly incur improvement costs if and as the property's retention and improvement are prudent and suitable to the purposes of the trust."<sup>117</sup> This right of exoneration is coupled with a right of reimbursement for sums paid from the trustee's own pocket for expenses properly

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<sup>102</sup>See generally §7.3.4.1 of this handbook (trustee's liability for taxes and shareholder assessments); 4 Scott & Ascher §22.1.

<sup>103</sup>Restatement (Third) of Trusts §88, cmt. b; 3 Scott & Ascher §18.1.2.2 (Repairs and Improvements); 4 Scott & Ascher §22.1 (Expenses Properly Incurred).

<sup>104</sup>4 Scott & Ascher §22.1.

<sup>105</sup>Lewin ¶21-14 (England).

<sup>106</sup>Restatement (Third) of Trusts §88, cmt. b. See generally §§7.3.1 of this handbook (trustee's liability as legal owner in contract to nonbeneficiaries) and 7.3.3 of this handbook (trustee's liability as legal owner in tort to nonbeneficiaries); Lewin ¶21-17 (England); 3 Scott & Ascher §18.1.2.1 (U.S.).

<sup>107</sup>See generally 3 Scott & Ascher §18.1.2.1 (Preservation of the Trust Property).

<sup>108</sup>Restatement (Third) of Trusts §88 cmt. b.

<sup>109</sup>Restatement (Third) of Trusts § 88 cmt. c; UTC § 709 cmt.; 3 Scott & Ascher §18.1.2.3 (Employment of Agents) (noting, however, that unless the terms of the trust or a statute provides otherwise, the trustee ordinarily cannot properly at trust expense employ agents to perform services that the trustee is being compensated to perform, e.g., keeping proper accounts or making the trust property productive, at least without an appropriate reduction of the trustee's own compensation). It goes without saying that a trustee may not retain an agent at trust expense to perform a nondelegable function, such as administering the dispositive provisions of a discretionary trust. 3 Scott & Ascher §18.1.2.3. See also 4 Scott & Ascher §22.1 (Expenses Properly Incurred).

<sup>110</sup>Lewin ¶21-13 (England).

<sup>111</sup>Restatement (Third) of Trusts §88 cmt. b.

<sup>112</sup>Restatement (Third) of Trusts §88 cmt. b.

<sup>113</sup>Restatement (Third) of Trusts §88 cmt. b. " ... [I]f a trustee borrows funds from a third party for use in the administration of the trust, the interest on the loan is payable (or reimbursable) from the trust estate, provided the rate of interest is reasonable and borrowing serves an appropriate trust purpose and is otherwise consistent with the trustee's fiduciary duties." Restatement (Third) of Trusts §88 cmt. b.

<sup>114</sup>Restatement (Third) of Trusts § 88 cmt. b; UTC §§ 709(a)(1), 1004. See generally Bogert § 718; 4 Scott & Ascher § 22.1; 3 Scott on Trusts § 188; Lewin ¶21-16 (England); Lee R. Russ, J.D., Annot., *Award of attorneys' fees out of trust estate in action by trustee against cotrustee*, 24 A.L.R.4th 624 (1983). See also F.M. English, Annot., *Right of coexecutor or cotrustee to retain independent legal counsel*, 66 A.L.R.2d 1169 (1959). But see *Barber v. Barber*, 915 P.2d 1204 (Alaska 1996) (trustee who brought complaint for instructions is a neutral party, not a "prevailing" party and therefore not entitled to legal fees); *Malachowski v. Bank One, Indianapolis*, 682 N.E.2d 530 (Ind. 1997) (though trustee prevailed, not awarded trustee fees because litigation not reasonably necessary). See generally § 3.4.4.1 of this handbook (multiple trustees (cotrustees)) (discussing in part when a cotrustee is entitled to reimbursement from the trust estate for the costs of separate representation).

<sup>115</sup>(Third) of Trusts §88 cmt. b; 3 Scott & Ascher §18.1.2.4.

<sup>116</sup>4 Scott & Ascher §22.2.2 (Separable Transactions).

<sup>117</sup>Restatement (Third) of Trusts §88 cmt. b; 3 Scott & Ascher §18.1.2.4. See also 3 Scott & Ascher §18.1.2.2 (Repairs and Improvements); 4 Scott & Ascher §22.1 (Expenses Properly Incurred).

incurred.<sup>118</sup> The trustee, however, still needs to be “cost-conscious.”<sup>119</sup> Unreasonable expenditures are not reimbursable.<sup>120</sup>

Premiums for internal fiduciary liability insurance are generally not chargeable to the trust estate. English default law is in accord,<sup>121</sup> although there is an exception for trustees of charitable trusts.<sup>122</sup>

What if the trustee without authority incurs an expense that confers a benefit on the trust estate? In that case, the trustee is ordinarily entitled to indemnity to the extent of the value of the benefit conferred.<sup>123</sup> The Restatement (Third) of Trusts is generally in accord.<sup>124</sup> Under the Uniform Trust Code, a trustee is entitled to be reimbursed out of the trust property, with interest as appropriate, expenses that were not properly incurred in the administration of the trust to the extent necessary to prevent unjust enrichment of the trust.<sup>125</sup> “Given this purpose, a court, on appropriate grounds, may delay or even deny reimbursement for expenses which benefited the trust.”<sup>126</sup> Also, if a trustee improperly incurs an expense the benefit of which the beneficiary can accept or reject, the trustee is not entitled to indemnity if the right of rejection is, in fact, exercised. Thus, if a trustee improperly purchases with his own funds an automobile for the trust, the trustee is not entitled to indemnity if the beneficiary declines to ratify the transaction. The trustee, however, may keep the automobile for himself.

If a trustee properly enters into a contract on behalf of the trust and thereby incurs personal liability, he is entitled to be indemnified from the trust estate.<sup>127</sup> “Although the trustee breaks a contract properly made by him in the administration of the trust and thereby incurs a liability for breach of contract, he is entitled to indemnity to the extent to which he thereby benefited the trust estate.”<sup>128</sup> Also, “[w]here a tort to a third person results from the negligence of an agent or servant properly employed by the trustee in the administration of the trust, and the trustee is not personally at fault, although the trustee is liable to the

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<sup>118</sup>See generally Bogert § 718; *Hollaway v. Edwards*, 68 Cal. App. 4th Supp. 94, 80 Cal. Rptr. 2d 166 (1998) (awarding trustee attorneys’ fees incurred in defending a removal action brought by the cotrustee); *Franzen v. Norwest Bank Colo.*, 955 P.2d 1018 (Colo. 1998) (holding that trustee was entitled to reimbursement of attorney’s fees incurred in litigation initiated by beneficiary’s agent seeking revocation of trust).

<sup>119</sup>3 Scott & Ascher §18.1.2.6.

<sup>120</sup>3 Scott & Ascher §18.1.2.6 (When Trustee Improperly Incurs Expense).

<sup>121</sup>*Kemble v. Hicks*, [1999] P.L.R. 287 (Eng.).

<sup>122</sup>Charities Act 1993 §73F (England).

<sup>123</sup>Restatement (Second) of Trusts §245 cmt. d. See also Lewin ¶¶21-25 (England); 3 Scott & Ascher §18.1.2.6 (When Trustee Improperly Incurs Expense) (U.S.); 4 Scott & Ascher §22.2.1 (Benefit to Trust Estate) (U.S.).

<sup>124</sup>Restatement (Third) of Trusts §88 cmt. a.

<sup>125</sup>UTC § 709(a)(2). See generally 4 Scott & Ascher §22.2.1 (Benefit to Trust Estate).

<sup>126</sup>UTC § 709 cmt. “Appropriate grounds ... [for delay or even denying reimbursement for expenses which benefited the trust] ... include: (a) whether the trustee acted in bad faith in incurring the expense; (2) whether the trustee knew that the expense was inappropriate; (3) whether the trustee reasonably believed the expense was necessary for the preservation of the trust estate; (4) whether the expense has resulted in a benefit; and (5) whether indemnity can be allowed without defeating or impairing the purposes of the trust.” UTC § 709 cmt.

<sup>127</sup>4 Scott & Ascher §22.3 (Contractual Liability). See generally §7.3.1 of this handbook (trustee’s contractual liability as the legal owner to nonbeneficiaries).

<sup>128</sup>Restatement (Second) of Trusts §246 cmt. c. “Thus, if the trustee in the proper exercise of a power makes a contract to sell trust property, and subsequently receives a better offer for the property and sells it, he is entitled to indemnity for his liability on the contract to the extent which the breach of contract resulted in his obtaining a higher price.” Restatement (Second) of Trusts §246 cmt. c.

third person, he is entitled to indemnity out of the trust estate.”<sup>129</sup>

If the trustee in breach of trust satisfies from the trust estate a liability to a third person that was incurred in the course of administering the trust, the third person would not be obliged to make the trust estate whole if the third person were a BFP.<sup>130</sup> To qualify as a BFP, the third person would have to have given full value, taken legal title to the payment, and been reasonably unaware of the breach.<sup>131</sup> The beneficiary always has recourse against the wrongdoing trustee personally, whether or not the third person is a BFP:

The Chancellors, when appealed to by the beneficiaries, felt that there was no reason in equity or conscience why a person who had acquired property in good faith and for value should be disturbed. They therefore kept their hands off. As between the two innocent parties, they let the loss that resulted from the breach of trust lie where it fell. They left the beneficiaries to seek redress against the wrongdoing trustee.<sup>132</sup>

**Attorneys' fees.** A trustee is entitled to exoneration or reimbursement from the trust estate for attorneys' fees, provided the services rendered are appropriate for handling by an attorney-at-law.<sup>133</sup> Legal fees incurred by a trustee in obtaining allowance of his accounts come to mind;<sup>134</sup> or in bringing a complaint for instructions or declaratory judgment;<sup>135</sup> or an action to collect or protect the trust property.<sup>136</sup> “A trustee is also entitled to indemnity for the reasonable expenses of obtaining advice of counsel as to trust administration, at least when the need for such advice arises out of circumstances that are not the trustee's fault.”<sup>137</sup> One court has even ordered the beneficiaries of a terminated trust to return a portion of the final distribution so that the judicially removed trustee could mount a legal defense of his final accounts, accounts that were under attack by those very same beneficiaries.<sup>138</sup>

*Functions that should not be delegated to counsel at trust expense.* On the other hand, if the attorney-at-law is performing services that the trustee personally or through ministerial agents ought to be

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<sup>129</sup>Restatement (Second) of Trusts §247 cmt. b. *See generally* 4 Scott & Ascher §22.4 (Tort Liability). *See generally* §7.3.3 of this handbook (trustee's liability as legal owner in tort to nonbeneficiaries).

<sup>130</sup>*See generally* §5.4.2 of this handbook (rights of the beneficiary as against BFPs and other transferees of the underlying trust property), 8.3.2 of this handbook (bona fide purchase for value of trust property, specifically what constitutes notice that a transfer is in breach of trust?), and §8.15.63 of this handbook (doctrine of bona fide purchase; the BFP). *See also* §8.3.6 of this handbook (negotiable instruments and the duty of third parties to inquire into the trustee's authority). For a comparison of the BFP, a creature of equity, with the holder in due course, a creature of law, *see* §8.15.68 of this handbook (holders in due course in the trust context).

<sup>131</sup>5 Scott & Ascher §29.2.7 (Debts Incurred During Trust Administration).

<sup>132</sup>5 Scott & Ascher §29.1.1 (Bona Fide Purchaser).

<sup>133</sup>4 Scott & Ascher §22.1.

<sup>134</sup>4 Scott & Ascher §22.1.

<sup>135</sup>*See generally* 3 Scott & Ascher §16.8 (Application for Instructions); 4 Scott & Ascher §22.1 (Expenses Properly Incurred); Chapter 1 of this handbook (in part discussing the right of trustees and beneficiaries to seek instructions from the court); §8.42 of this handbook (the complaint for instructions versus the complaint for declaratory judgment). *See also* §8.13 of this handbook (when a beneficiary is entitled to have his or her legal fees paid from the trust estate).

<sup>136</sup>4 Scott & Ascher §22.1 (Expenses Properly Incurred); Restatement (Third) of Trusts §88 cmt. d. “The right of indemnification applies even though the trustee is unsuccessful in the action, as long as the trustee's conduct was not imprudent or otherwise in violation of a fiduciary duty.” Restatement (Third) of Trusts §88 cmt. d.

<sup>137</sup>4 Scott & Ascher §22.1 (Expenses Properly Incurred).

<sup>138</sup>*See* Kasperbauer v. Fairfield, 170 Cal. App. 4th 785 (2009).

performing, such as collecting and keeping track of dividends, keeping the trust's records, or preparing accountings, then those legal costs are probably not reimbursable from the trust estate absent special facts.<sup>139</sup> The trustee will most likely have to pay those costs out of his own pocket.<sup>140</sup>

*When the trustee is entitled to have counsel fees paid from the trust estate.* What about nonroutine legal matters? Attorneys' fees reasonably incurred by the trustee in connection with the preservation, protection, administration, and distribution of the trust property are generally reimbursable from the trust estate, such as legal fees and costs incurred by a trustee in successfully defending allegations that the trustee had breached his trust.<sup>141</sup> Indenture trustees are no exception.<sup>142</sup> In Nebraska, the standard is "substantially successful"; the trustee's defense need not be "100 percent successful" in order for the trustee to be entitled to recover costs, including attorneys' fees.<sup>143</sup> "Ultimately, however, the issue of the trustee's entitlement to indemnification for litigation expenses lies in the sound discretion of the court."<sup>144</sup>

As to whether the vindicated-trustee's claim against the trust estate for defense counsel's fees should be offset by payments made to counsel by the trustee's personal liability insurance carrier, at least one court has answered that it depends: "On remand, ...the judge should take the trustees' insurance coverage into account, giving it as much or as little weight as the judge deems appropriate, in arriving at a just and equitable award."<sup>1</sup> One policy argument against set-off is that one who contracts for insurance with personal funds, not some third party, should receive the "benefit of the bargain."<sup>2</sup> But does this not effectively constitute an equitable double-dipping by (or windfall for) the vindicated-trustee? Arguably it would not: (1) The trustee had paid for the legal services in advance as a "component" of the insurance premiums,<sup>3</sup> and (2) the nexus between the liability-insurance contract (law) and the trust's administration

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<sup>139</sup>See generally Restatement (Third) of Trusts §88 cmt. c. See, e.g., *Mears v. Addonizio*, 336 N.J. Super. 474, 765 A.2d 260 (App. Div. 2001) (providing that fees of attorney for trustee not payable from trust when the trustee was merely a nominal party in litigation). Attorneys' fees in bringing trustee's account before the court, however, would be allowable. See, e.g., *Mears v. Addonizio*, 336 N.J. Super. 474, 765 A.2d 260 (App. Div. 2001).

<sup>140</sup>4 Scott & Ascher §22.2 (Expenses Improperly Incurred).

<sup>141</sup>Restatement (Third) of Trusts §88 cmt. d; 3 Scott & Ascher §18.1.2.4 (Expenses of Judicial Proceedings); 4 Scott & Ascher §22.1 (Expenses Properly Incurred). See *Regions Bank v. Lowrey*, 101 So. 3d 210 (Ala. 2012) (confirming that a trustee may be reimbursed from the trust estate for expenses, including attorneys' fees, incurred by the trustee in defending a breach-of-trust action, provided the trustee had not been found to have committed a material breach of trust); *Spencer v. Di Cola*, 16 N.E.3d 1 (Ill. App. Ct. 2014) (the appellate court not agreeing with the beneficiary that the defendant-trustee's successful defense of her position as trustee was inappropriately "self-serving," an office which, after all, had been authorized by the very terms of the trust, it affirmed the lower court's decision to award the defendant-trustee her legal defense costs and to allow her to satisfy those obligations with entrusted funds); *Nat'l City Bank, N.E. v. Beyer*, No. H-99-017, 2001 WL 1664079 (Ohio Ct. App. Dec. 31, 2001) (holding that a successful judicial defense against breach-of-trust allegations benefits the trust estate such that the trustee is entitled to reimbursement of his legal fees). *But see Boatmen's Trust Co. of Ark. v. Buchbinder*, 343 Ark. 1, 32 S.W.3d 466 (2000) (denying the trustee a right of indemnity from the trust estate for its attorneys' fees though it was the prevailing party in the breach-of-trust action).

<sup>142</sup>See *Bogert* §250, n. 44. See generally §9.31 of this handbook (corporate trusts; trusts to secure creditors; the Trust Indenture Act of 1939; Protecting bondholders).

<sup>143</sup>See *In re Estate of Stuchlik*, 289 Neb. 673 (2014).

<sup>144</sup>4 Scott & Ascher § 22.1.

<sup>1</sup> *Brady v. Citizens Union Savings Bank*, 38 N.E.3d 301, 88 Mass. App. Ct. 416 (2015).

<sup>2</sup> *Brady v. Citizens Union Savings Bank*, 38 N.E.3d 301, 88 Mass. App. Ct. 416 (2015).

<sup>3</sup> *Brady v. Citizens Union Savings Bank*, 38 N.E.3d 301, 88 Mass. App. Ct. 416 (2015).

(equity) is not so close as to warrant the issuance of an equitable set-off order.<sup>4</sup>

As to the fees that the trustee's attorneys incur in litigation that is ongoing between the trustee and the beneficiaries, the trustee should seek permission from the court before deducting those fees from the trust estate.<sup>145</sup> This is because the litigation has placed the trustee's interests in conflict with those of the beneficiaries, thus requiring the trust to “report to the court for guidance.”<sup>146</sup> In England, if the trustee has suspended income payments in the face of sufficient principal to cover any litigation costs that the court might eventually award the trustee, the court may order that the payments be resumed.<sup>147</sup>

*The trustee's legal costs are not reimbursable from the trust estate when the trustee is personally at fault.* All bets are off when the trustee is personally at fault.<sup>148</sup> The costs of mounting an unsuccessful defense to an allegation of breach of fiduciary duty are generally not reimbursable.<sup>149</sup> Certainly the obligation to pay any attorneys' fees that were incurred by a trustee in the unsuccessful defense of a breach of fiduciary duty action ought not to be directly or indirectly imposed on those to whom the duty ran.<sup>150</sup> Attorneys' fees incurred by the trustee in correcting a trustee error—such as misdelivery of the trust property—also are not reimbursable.<sup>151</sup> That having been said, if the culpable fiduciary had acted in good faith and not egregiously outside the bounds of his legitimate discretionary authority, then equity may cut him some slack—at least one court has done just that for a culpable fiduciary-protector.<sup>152</sup> In any case, counsel would be well advised to personally bind the trustee in contract to pay his or her fees out of the trustee's own pocket to the extent those fees are held not to be an obligation of the trust estate.

*The costs of a legal malpractice action against trust counsel are generally not reimbursable from the trust estate.* Costs incurred by the trustee in bringing an action against trust counsel for rendering faulty legal advice that led to the trustee's breaching a fiduciary duty also would not be reimbursable from the trust estate. In principle, the trustee is personally obliged to make the beneficiaries whole for his breaches of fiduciary duty. Moreover, the beneficiaries are not obliged to fund a legal malpractice action the outcome of which could only inure to the benefit of the trustee. On the other hand, if the trustee is both

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<sup>4</sup> See Gary Fearn v. Anglo-Dutch Paint & Chemical Ltd., [2010] EWHC 2366 (Ch) [England]

<sup>145</sup> See J.P. Morgan Trust Co., N.A. v. Siegel, 965 So. 2d 1193 (Fla. Dist. Ct. App. 2007).

<sup>146</sup> J.P. Morgan Trust Co., N.A. v. Siegel, 965 So. 2d 1193, 1195 (Fla. Dist. Ct. App. 2007).

<sup>147</sup> Lewin ¶38-09.

<sup>148</sup> See generally 3 Scott & Ascher § 18.1.2.4 (Expenses of Judicial Proceedings); 4 Scott & Ascher § 22.2 (Expenses Improperly Incurred). See, e.g., Yianilos v. Hunter, No. D066333, 2015 Cal. App. Unpub. LEXIS 8461 (Nov. 23, 2015) (unpublished) (cotrustee surcharged for the fiduciary litigation defense costs that she had paid directly from entrusted funds, the court having found that she had committed multiple breaches of trust). For a definition of the term surcharge, see § 7.2.3.2 of this handbook.

<sup>149</sup> Restatement (Third) of Trusts §88 cmt. d; 3 Scott & Ascher §18.1.2.4 (Expenses of Judicial Proceedings); 4 Scott & Ascher §§22.1 (Expenses Properly Incurred), 22.2 (Expenses Improperly Incurred). See, e.g., Grate v. Grzetich, 373 Ill. App. 3d 228, 867 N.E.2d 577 (2007) (attorneys' fees incurred by a trustee in the unsuccessful defense of an action for conversion of trust assets brought by the guardian of the disabled beneficiary were not reimbursable from the trust estate as the fees had not been incurred in protecting the trust estate).

<sup>150</sup> See Restatement (Third) of Trusts § 88 cmt. d; UTC § 709 cmt. (Reimbursement of Expenses); 3 Scott & Ascher § 18.1.2.4 (Expenses of Judicial Proceedings); 4 Scott & Ascher §§22.1 (Expenses Properly Incurred), 22.2 (Expenses Improperly Incurred); *In re Estate of Stowell*, 595 A.2d 1022 (Me. 1991) (denying reimbursement of attorneys' fees to trustee where litigation was result of his breach of fiduciary duties).

<sup>151</sup> 4 Scott & Ascher §22.2 (Expenses Improperly Incurred). See, e.g., *May v. Oklahoma Bank & Trust Co.*, 261 P.3d 1138 (Okla. 2011) (bank not entitled to legal fees it incurred in correcting its own negligence).

<sup>152</sup> See *In the Matter of the Piedmont Trust & Riviera Trust*, [2016] JRC 016 (R.C. Jersey).

impecunious and dilatory, the beneficiaries themselves, under principles of subrogation, may be entitled to initiate the malpractice action against counsel in order that they can be made whole.<sup>153</sup>

*The trustee's legal defense costs are chargeable to the beneficiaries if it is found that the litigation was pursued in bad faith.* In most states and under federal law, “when a baseless claim is maintained vexatiously, obdurately or in bad faith, an exception to the American Rule applies and allows the recovery of counsel fees against the opposing party.”<sup>154</sup> When a beneficiary engages in frivolous litigation against the trustee, or against the trust relationship itself, the beneficiary's equitable interest under the trust may be charged with the attendant costs.<sup>155</sup> Thus, if a beneficiary engages in vexatious and burdensome litigation against the trustee and the other beneficiaries, the court may order that the attorneys' fees of all the defendants be charged against the plaintiff-beneficiary's equitable interest, to the extent the interest is identifiable, discrete, and severable.<sup>156</sup> To the extent the interest is not, the court may have the equitable power to impose on the plaintiff-beneficiary personal liability for the fees.<sup>157</sup>

When a trustee has prevailed in a suit for breach of trust brought vexatiously, obdurately, or in bad faith by a beneficiary, he may have a fiduciary duty to the other beneficiaries to bring an action against the beneficiary to compel the beneficiary to bear the burden of the trustees' attorneys' fees, rather than have the trust estate (and the other beneficiaries to the extent of their interest in the trust estate) bear that burden.<sup>158</sup> Circumstances may even warrant that the trustee also bring an action on behalf of the trust estate against the nuisance beneficiary's counsel.<sup>159</sup> As noted above, an advance by the trustee of money for the protection of the trust gives rise to a lien against trust property to secure reimbursement with reasonable interest.<sup>160</sup>

*Whether expenses incurred by trust counsel in collecting his or legal fees are reimbursable from the trust estate.* There is little law on the question of whether an attorney who has represented a trustee is

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<sup>153</sup>Cf. §8.15.50 of this handbook (subrogation doctrine) (discussing the subrogation rights of third parties *against* the trust estate).

<sup>154</sup>Martin A. Heckscher, *Fees, Fees, Fees: A Blessing and a Bane, How to Charge, Collect and Defend Them*, 31 ACTEC L.J. 21, 30 (2005).

<sup>155</sup>See 3 Scott on Trusts §188.4 n.13 and accompanying text. See generally §8.13 of this handbook (in litigation pertaining to a trust, when is the beneficiary entitled to reimbursement from the trust estate for legal fees).

<sup>156</sup>See, e.g., *Larkin v. Wells Fargo Bank, N.A.*, No. A13-1839, 2014 Minn. App. Unpub. LEXIS 1077 (Oct. 6, 2014) (unpublished) (“ [The plaintiff-beneficiary's] ... continuing attempt to undermine the settlement was not beneficial, particularly after the settlement agreement was confirmed in binding arbitration, by the district court, and by this court on appeal, and his alternate proposed settlement agreement was nonsensical and included ad hominem attacks on other trust beneficiaries. The evidence supports the district court's finding that ... [he] ... engaged in vexatious and burdensome litigation.”). It is interesting to note that the district court had ordered the plaintiff-beneficiary to pay the trustee's attorneys' fees “either personally or as a deduction from his share of the trust.”

<sup>157</sup>See generally §5.6 of this handbook (in part discussing the potential personal liability of the litigious beneficiary).

<sup>158</sup>See generally 3 Scott & Ascher §18.1.2.4 (noting that “[i]f one beneficiary unsuccessfully tries, through litigation, to advance his or her own beneficial interest, the trustee may properly charge the resulting litigation expenses against the beneficiary's share”).

<sup>159</sup>See, e.g., *Pederson Trust*, 757 N.W.2d 740 (N.D. 2008) (nuisance beneficiary and his counsel jointly and severally liable for trustee's litigation costs).

<sup>160</sup>4 Scott & Ascher § 22.1.1 (Lien for Indemnity); UTC § 709(b). Cf. *Nickerson v. Fiduciary Trust Co.*, 6 Mass. App. Ct. 317, 375 N.E.2d 357 (1978) (holding that probate court had not abused its discretion under Mass. Gen. Laws Ann. 215 §39A in awarding the trustee of an irrevocable trust the counsel fees it had incurred as a result of the settlor's unsuccessful action to invalidate or reform the trust).



entitled to be paid from the trust estate for time spent and costs incurred by the attorney in collecting or defending the attorney's reasonable legal fees.<sup>161</sup> If the attorney can demonstrate that his or her efforts to get paid have somehow benefited the trust estate, then a court should have no problem awarding “fees on fees” from the trust estate.<sup>162</sup> Absent a showing that the trust estate has received a benefit from the attorney’s collection efforts, if the attorney has acted reasonably and in good faith in seeking to have his or her fees paid from the trust estate and the beneficiaries have acted unreasonably and in bad faith in opposing those efforts, then the equitable exception to the “fees-on-fees” or “fees-for-fees” prohibition should apply.<sup>163</sup> If the trustee has unreasonably or in bad faith been frustrating the attorney's efforts to get paid, it would seem that the trustee should be ordered to pay the “fees on fees” out of personal funds without recourse to the trust estate.

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<sup>161</sup>See Martin A. Heckscher, *Fees, Fees, Fees: A Blessing and a Bane, How to Charge, Collect and Defend Them*, 31 ACTEC L.J. 21, 32–36 (2005) (discussing the “fee on fees” issue in the context of attorneys representing fiduciaries of probate estates).

<sup>162</sup>*In re O’Neill Trust*, No. 319546, 2015 Mich. App. LEXIS 1053 (May 19, 2015) (unpublished).

<sup>163</sup>See *In re O’Neill Trust*, No. 319546, 2015 Mich. App. LEXIS 1053 (May 19, 2015) (unpublished) (the fees-for-fees prohibition would not be applicable if the beneficiaries unjustifiably and in bad faith were to litigate in opposition to trust counsel’s legitimate efforts to be compensated with entrusted funds).