

## Trusts Analysis

(Trusts I.C.2., E.1., I.3.; II.F.3.)

- Legal Problems:
- (1) May a trustee with absolute and uncontrolled discretion be held liable for abuse of discretion?
  - (2) Does a trustee breach her duty of loyalty by purchasing trust property at its fair market value, and if so, must the trustee return the profits to the trust?
  - (3) When a charitable gift of trust assets cannot be carried out because the charitable beneficiary no longer exists, should these assets be returned to the settlor's estate?

### DISCUSSION

#### Summary

Even when a trustee has absolute and uncontrolled discretion, she may be held liable for actions representing an abuse of discretion. Failure to distribute trust income to Edna based on a personal motive constitutes an abuse of discretion, and it is likely that Trustee would be liable for withholding income from Edna based on her disagreement with Edna's political opinions.

A trustee has a duty of loyalty to trust beneficiaries. A trustee breaches the duty of loyalty by purchasing trust assets from the trust in her personal capacity, even if she pays the trust the fair market value of those assets. Because Trustee breached her duty of loyalty by purchasing property from the trust, Trustee must return the profit to the trust.

When a charitable disposition of trust assets cannot be carried out and the trust has terminated, the court should determine whether, in making the gift, the settlor had a general or specific charitable purpose. If the court finds that the settlor had a general charitable purpose, as is likely in this case, it should exercise its cy pres power and authorize distribution of the trust property to a charity that falls within the settlor's general charitable purpose.

#### **Point One (30–40%)**

Even when a trustee has absolute and uncontrolled discretion, she may be held liable for actions representing an abuse of discretion. A failure to distribute trust income based entirely on a personal motive constitutes an abuse of discretion.

A trustee has a fiduciary duty to carry out the terms of the trust established by the settlor; failure to do so constitutes a breach of trust. In this case, the trust instrument conferred upon Trustee absolute and uncontrolled discretion to make income distributions, including distribution of all trust income to only one beneficiary. Trustee's distribution thus appears to be consistent with the terms of the trust, and a court will not ordinarily question a trustee's exercise of a

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discretionary power, particularly when the trustee is granted absolute and uncontrolled discretion. *See* RESTATEMENT (SECOND) OF TRUSTS § 187, cmts. g & j.

However, even when a trustee is granted absolute and uncontrolled discretion, her actions may be reviewed for abuse of discretion. *See id.* § 187; UNIF. TRUST CODE § 814(a). Application of this standard will insulate the trustee with respect to decisions about which reasonable individuals might disagree. But when the trustee's decision is based exclusively on personal reasons unrelated to the settlor's goals, the trustee's decision may be overturned. *See* RESTATEMENT (SECOND) OF TRUSTS § 187, cmts. g & j.

Here, Trustee withheld all income from Edna solely because of her personal disagreement with Edna's political opinions. Such vindictiveness probably represents an abuse of discretion. It is likely that a court would hold that Trustee's decision not to pay Edna any trust income during the last year of the trust was an abuse of discretion and therefore a breach of the duty to carry out the terms of the trust.

[NOTE: The call is structured in such a way that the applicant need not discuss what damages Edna might be entitled to for this breach. The amount of her damages may not be easily calculable.]

### **Point Two (30–40%)**

Because Trustee breached her duty of loyalty by purchasing trust property in her personal capacity, Trustee must return the profits to the trust.

It is a fundamental trust concept that trustees have a duty of loyalty to trust beneficiaries. *See* RESTATEMENT (SECOND) OF TRUSTS § 170(1); UNIF. TRUST CODE § 802(a). The duty of loyalty includes the duty not to engage in self-dealing, such as purchasing property from the trust without court approval. The prohibition on self-dealing applies even if the purchase price is fair and reasonable. *See* RESTATEMENT (SECOND) OF TRUSTS § 170(1), cmt. b; UNIF. TRUST CODE § 802(b).

[NOTE: The trust standard differs from the corporate standard. Under the corporate standard, fairness, under certain circumstances, may shield directors from liability for a self-dealing transaction.]

Trustee clearly breached her duty of loyalty to the trust beneficiaries by buying trust assets in her personal capacity. Under the no-further-inquiry rule, the reasonableness of Trustee's action and her goal to save the trust the sales commission are irrelevant. Therefore, Trustee is liable to the trust beneficiaries for all profits resulting from the breach. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 205, 206; UNIF. TRUST CODE § 1002(a)(2).

### **Point Three (30–40%)**

The court should find that Settlor had a general charitable intent. Therefore, the trust property should not be returned to Settlor's estate. Instead, the court should exercise its cy pres power and order that the property be distributed to a charity that falls within the general charitable purposes expressed in the trust.

Although a settlor or the settlor's estate is generally entitled to the return of any trust property that cannot be distributed in accordance with the terms of the trust, an exception applies to charitable trust dispositions that reflect a general charitable intention. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 411, 413; RESTATEMENT (THIRD) OF TRUSTS § 8, cmt. g. In such a case,

a court should exercise its cy pres power and direct distribution of the failed disposition to another charity. *See* RESTATEMENT (SECOND) OF TRUSTS § 399; RESTATEMENT (THIRD) OF TRUSTS § 67.

Until recently, it was necessary to demonstrate that the settlor had a general charitable intention before the cy pres doctrine could be applied. *See* RESTATEMENT (SECOND) OF TRUSTS § 399. However, the latest Restatement of Trusts adopts the position that there should be a presumption that the settlor had a general charitable intention. *See* RESTATEMENT (THIRD) OF TRUSTS § 67, cmt. b; *accord* UNIF. TRUST CODE § 413.

Under either approach, a court should find that Settlor had a general charitable intention given that the trust instrument itself specified that the gift to Business College derived from Settlor's "long-standing interest in the area of education." Because Settlor had a general charitable intention to benefit education, Settlor's estate is not entitled to a return of any portion of the trust property. Instead, a court should exercise its cy pres power and direct distribution to another educational institution. *See* RESTATEMENT (SECOND) OF TRUSTS § 399; RESTATEMENT (THIRD) OF TRUSTS § 67; UNIF. TRUST CODE § 413.