

Title

When trustee's unauthorized self-dealing causes no direct harm to trust corpus can trustee still be surcharged?

Text

Profit narrowly defined is total revenue minus total expenses, i.e., net gain. Profit broadly defined is merely a synonym for benefit. When a trustee's unauthorized self-dealing directly harms the trust estate, the trustee is personally liable to make the trust estate whole. The trustee, for example, purchases an asset for his own account from the trust estate for less than its fair market value and turns around and sells it to a third party for its fair market value. Equity fashions a cocktail of remedies for this breach of the duty of undivided loyalty, one of which is compelling the trustee to turn over to the trust estate the ill-gotten profit the trustee made on the transactions. But what if trustee's unauthorized self-dealing results in no direct harm to the trust estate? Is the trustee off the hook? The answer is no. As a matter of public policy, the trustee may not engage in such activity with impunity. "It matters not that there was no fraud meditated and no injury done; the rule forbidding self-dealing is not intended to be remedial of actual wrong, but preventive of the possibility of it." Hare and Wallace's Notes, 1 Lead. Cases in Eq., p. 210. Thus the trustee may be surcharged for the economic value of the total benefit that the trustee derived as a consequence of the unauthorized self-dealing. As an aside, equity generally does not get involved in the assessment of punitive damages. See §7.2.3.2 of *Loring and Rounds: A Trustee's Handbook* (2025), which section is reproduced in the appendix below.

Assume the trustee, a poor credit risk, obtains a substantial personal credit line from a bank using the trust's portfolio as collateral. The trustee draws down on the line of credit for personal business purposes. Eventually the trustee closes out his personal debt to the bank with personal funds and the collateral is released. The trust beneficiaries seek to surcharge trustee for the economic value of the general benefit the trustee derived personally from these shenanigans. The trustee's defense that his liability should be limited to any ill-gotten profit he made in the narrow sense of the word as a consequence of his malfeasance falls on deaf ears. See, e.g., *In re Credit Trust Under Will of Cameron*, 335 A.3d 760 (2025).

How then does equity come up with an economic value for the general benefit that the trustee derived as a consequence of this breach of the duty of loyalty? For starters, the trustee should be personally liable to the trust estate for the interest that the trustee did not charge himself during the time he was borrowing the portfolio. Also, if the interest charged on a commercial personal line of credit secured by collateral would have been less than that charged on a non-collateralized line of credit then the trustee would have economically benefited to the extent of the difference. And then there is this: If funds from the personal line of credit had been the *sine qua non* of the trustee's exploitation of business opportunities for personal purposes, then the trustee might be compelled to shift any economic benefit derived from that exploitation over to the trust estate. This would be the case even if the business opportunities themselves had

not been acquired in the course of the trust's general administration. Now that would be one serious benefit-based equitable remedy.

Appendix

§7.2.3.2 Damages (a Substantive Remedy) [From *Loring and Rounds: A Trustee's Handbook* (2025)]

Punitive or exemplary damages. The courts of equity had no power to award punitive damages.³⁵¹ “Equity suffers not Advantage to be taken of a Penalty or Forfeiture, where Compensation can be made.”³⁵² It therefore followed that an award of damages for breach of fiduciary duty could not have a punitive element to it, the office of trustee itself being a creature of equity.³⁵³ Thus there is an absence of any mention of punitive damages in the body of the Restatement (Third) of Trusts.³⁵⁴ Courts, in any case, have always considered it within their equitable powers to reduce or deny compensation—and reimbursement for expenses—to trustees who are held to be in breach of trust.³⁵⁵ Still, some courts have begun to assess punitive damages against professional trustees and these assessments are being upheld, particularly in cases where the breach of fiduciary duty involves fraud or malice.³⁵⁶ In one case, a reckless disregard for the beneficiaries, coupled with the fact that the trust administrator had provided false testimony, warranted an

³⁵¹“Traditionally, remedies for breach of trust at law were limited to suits to enforce unconditional obligations to pay money or deliver chattels.” UTC §1001 cmt. “Otherwise, remedies for breach of trust were exclusively equitable, and as such, punitive damages were not available and findings of fact were made by the judge and not the jury.” UTC §1001 cmt.

³⁵²Richard Francis, *Maxims of Equity* 44 (London, Bernard Lintot 1728) (maxim no. 12).

³⁵³*See generally* 22 Am. Jur. 2d *Equity* §738 (1990).

³⁵⁴*But see* Rest. (Third) of Trusts §100, cmt. d (“In the egregious case, however, punitive damages are permissible under the laws of many jurisdictions. This is especially so if the trustee has acted maliciously, in bad faith, or in a fraudulent, particularly reckless, or self-serving manner.”). *See also* UTC §1001 cmt. (noting that the UTC does not preclude the awarding of punitive damages for breaches of fiduciary duty).

³⁵⁵*See* Bogert §861 n.60 and accompanying text. *See also* Rest. (Third) of Trusts: Prudent Investor Rule §205 cmt. a (1992). *Cf.* Est. of Gould, 547 S.W.2d 863 (Mo. Ct. App. 1977) (an attorney’s conduct as executor being improper and his conduct as attorney wrong, he was properly removed from those positions and denied all compensation). For a discussion of the difference between punitive damages and appreciation damages, *see* Est. of Rothko, 84 Misc. 2d 830, 379 N.Y.S.2d 923 (Sur. Ct. 1975).

³⁵⁶*See* Bogert §862 n.34 and accompanying text; 4 Scott & Ascher §24.9 n.36 and accompanying text; 3 Scott on Trusts §205 n.1 and accompanying text; Campisi et al., *Emerging Damages Claims and the Right to Jury Trials in Fiduciary Litigation*, 27 Real Prop. Prob. & Tr. J. 541, 542–553 (1992) (containing a review of availability of punitive damages and appreciation damages in fiduciary litigation in the various states). *See, e.g.,* Smith v. Underwood, 487 S.E.2d 807 (N.C. Ct. App. 1997) (allowing punitive damages where a plaintiff has proven at least nominal damages and where an element of aggravation, such as fraud, causes the injury); Shoemaker v. Est. of Freeman, 967 P.2d 871 (Okla. 1998) (holding that evidence supports an award of punitive damages where trustee has failed to transfer farm to remaindermen as required by terms of the trust); InterFirst Bank of Dallas, N.A. v. Risser, 739 S.W.2d 882 (Tex. App. 1987) (assessing \$10 million in punitive damages against trustee bank that sold trust property to a debtor of the bank). *But see* Kann v. Kann, 690 A.2d 509, 520 (Md. 1997) (holding “allegations of breach of fiduciary duty, in and of themselves, do not give rise to an omnibus or generic cause of action at law [H]ere ... the claim is exclusively equitable and not triable of right before a jury [P]unitive damages are not at all available in equity.”).

award of punitive damages, this in the absence of a finding of fiduciary self-dealing.³⁵⁷ Stonewalling the court is ill-advised as well:

Moreover we agree with the district court that the size of the punitive damages award is not out of proportion to the actual damages sustained. Evidence in the record revealed that Mercantile is part of a twenty-one-bank holding company. Mercantile, standing alone, claims assets in excess of \$48 million. Clearly a substantial sting would be required to deter this financial institution from profiting in the future by ignoring—and thereby impairing—the rights of trust beneficiaries such as Virginia Haberstick The complete and utter failure of the bank to offer an explanation for its inaction bespeaks an ulterior motive. One can only assume from this record that more remunerative trusts occupied the trust officers' time.³⁵⁸

One court has upheld an award of exemplary damages against a predecessor trustee in an action for breach of fiduciary duty brought by the successor.³⁵⁹ It did so, however, by misconstruing the nature of the action as legal rather than equitable. As the dissent pointed out: “While the nature of the available remedies may be a strong indicator of the legal or equitable nature of an action, ... the fact that a plaintiff seeks a money judgment has by no means been considered decisive that the action is one at law.”³⁶⁰

The UTC would not preclude the awarding of punitive damages for breaches of fiduciary duty.³⁶¹ In fact, under Kansas's version of the UTC, a trustee who embezzles or knowingly converts to the trustee's own use trust property would be liable for double the property's value.³⁶² Apart from its UTC, the availability of punitive damages in Kansas has long existed in, but only in, Kansas statutory law.³⁶³ In Kansas, however, a claim for punitive damages will not survive the death of the wrongdoer, nor would it in the majority of U.S. states.³⁶⁴

A Texas court, invoking common law and statutory authority, has awarded exemplary damages in a trust matter.³⁶⁵

Without an award of actual damages, however, there can be no award of punitive damages, at least that is the case in Missouri.³⁶⁶ And in Wyoming, as well.³⁶⁷

³⁵⁷ See *Jo Ann Howard & Assocs., PC v. Nat'l City Bank*, 11 F.4th 876, 883 (8th Cir. 2021).

³⁵⁸ *Hamilton v. Mercantile Bank of Cedar Rapids*, 621 N.W.2d 401 (Iowa 2001) (assessing punitive damages against a successor trustee for making “absolutely no effort” to ascertain condition of degraded trust real estate upon and after it assumed the trusteeship).

³⁵⁹ *Peterson v. McMahon*, 99 P.3d 594 (Colo. 2004).

³⁶⁰ *Peterson v. McMahon*, 99 P.3d 594, 600 (Colo. 2004).

³⁶¹ UTC §1001 cmt.

³⁶² Kan. Stat. Ann. §58a-1002(a)(3). See also *McCabe v. Duran*, 180 P.3d 1098 (Kan. Ct. App. 2008) (the court declining to retroactively apply the double-damages provision of Kansas's version of the UTC).

³⁶³ See *Ellis Living Tr. v. Ellis Living Tr.*, 385 P.3d 533 (Kan. Ct. App. 2016).

³⁶⁴ See *Ellis Living Tr. v. Ellis Living Tr.*, 385 P.3d 533 (Kan. Ct. App. 2016).

³⁶⁵ See *Wells Fargo, N.A. v. Militello*, No. 05-15-01252-CV, 2017 App. LEXIS 5640 (Tex. App. June 20, 2017) (upholding the following trial-court order: “It is further ORDERED that Plaintiff is awarded exemplary damages pursuant to Texas Trust Code Section 114.008(a)(1), Texas Civil Practice and Remedies Code Section 41.003 and the Texas common law on breach of fiduciary duty, fraud, negligence, and gross negligence in the amount of \$3,465, 490.20.”).

³⁶⁶ See *O'Riley v. U.S. Bank, N.A.*, 412 S.W.3d 400, 418 (Mo. Ct. App. 2013).

³⁶⁷ See *Gowdy v. Cook*, 455 P.3d 1201 (Wyo. 2020) (“Punitive damages cannot be awarded when compensatory damages are not recoverable.”).

