



Northway Wealth Advisors

What Every Fiduciary Needs to Know

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Fiduciary: An individual or entity entrusted with a duty to act for someone else's benefit, while subordinating one's personal interests to that of the other person, for example, the trustee of a personal trust or the executor of an individual's estate.

"A fiduciary standard means, basically, put the interests of the client first. No excuses. Period."
– John C. Bogle, founder and CEO, The Vanguard Group

As a general matter, any competent adult human being can serve as a trustee or executor. By contrast, only those corporate entities such as banks or specifically authorized trust companies may do so. Since there are vastly more human beings than banks or trust companies, it stands to reason that individual fiduciaries outnumber corporate or professional fiduciaries by a wide margin. However, while the professionals can be expected to understand the nature of their fiduciary role, and the authorities, responsibilities and risks that attend that role, most individuals who agree to serve in a fiduciary capacity do so without even a rudimentary understanding of what they are being asked to do, or how to do it. Nor do they generally understand the risks they assume, which risks include the potential for becoming personally responsible financially for failure to perform that role adequately. All this is exacerbated by the sobering reality that fiduciary-related lawsuits are on the rise, and many law firms now include fiduciary litigation among their stated practice specialties. To help address the pressing need for education on this topic, I offer the following overview of the fiduciary role and applicable fiduciary principles.¹

The Fiduciary Role²

All fiduciaries, whether executor or trustee, individual or corporate, are held to the good faith

¹ Note that this overview is summary in nature and is not intended to provide exhaustive coverage of the many nuances inherent in a subject that involves subjective judgments which are by necessity based on unique facts and circumstances applicable at specific moments in time. Consult your professional advisor for further information and advice specific to your individual situation.

² There is no such thing as "national" fiduciary (trust and estate) law; individual state law governs fiduciary responsibility within state borders and/or under instruments to which the laws of that state apply. There are, however, treatises and other authoritative texts which provide structure and guidance for legislatures, courts and practitioners, chief among which are the Uniform Trust Code, the Uniform Probate Code, the Uniform Prudent Investor Act and the Restatements of the Law of Trusts (the most current of which is the Third), some or all of which are referred to and cited within this paper. Quotations herein of, and citations herein to, the Uniform Trust Code, the Uniform Probate Code, the Uniform Prudent Investor Act, the statutes, rules or regulations of any state or governmental body, or any version of the Restatement of Law of Trusts, are not intended to, and should not be interpreted as, expressions of any legal opinion; they are included simply as illustrations and examples in support of my understanding of the customs and practices prevailing from time to

adherence to three general duties – prudent care, loyalty and impartiality – and the general obligation to act always in good faith. In evaluating performance of these obligations, the fiduciary is held to the standard of reasonableness. The reasonableness of an action is judged based upon the facts and circumstances at the time of such action, and not necessarily by its result.³ Failure to meet the standard (“breach”) may subject the fiduciary to removal⁴ and/or personal liability (“surcharge”) to the fiduciary account in an amount calculated to make the account whole for any damages caused by the breach, or for any profit the fiduciary made by reason of the breach, whichever is greater.⁵

General Fiduciary Principles

Testamentary transfers and transfers in trust require the appointment or selection of one or more persons or corporate entities to serve in a fiduciary capacity as executor or trustee. The fiduciary role is unique under law and should not be undertaken lightly. As Justice Benjamin Cardozo memorably wrote in *Meinhard v. Salmon*,⁶ the duty owed by a fiduciary is “something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor most sensitive, is then the standard of behavior.”⁷

The rationale for holding the fiduciary to a standard of conduct higher than that “permissible in a workday world for those acting at arm’s length”⁸ is because of the unique nature of the authority and responsibility the fiduciary possesses over and for the assets which are in its care. Ownership and control of the subject assets are split into two separate interests: legal title and beneficial interest. The fiduciary possesses legal title to the assets, and therefore control. However, he, she or it may not exercise that control for their own interest, but solely for the interests of the beneficiaries, who possess no such control.⁹ The beneficiaries look to the fiduciary to deal responsibly with the assets in a manner consistent with the donor’s intent, the terms of the operative document, and their respective interests.

Section 801 of the Uniform Trust Code¹⁰ states that “[u]pon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the

time in the personal trust and estate administration industry.

³ The fiduciary is not a guarantor of any particular result; if the process by which it came to its decision was reasonable under the circumstances, it should not be held liable if the result of that decision is not that which was intended.

⁴ The Uniform Trust Code (“UTC”) § 1001. The UTC was drafted and approved and recommended for enactment in all the States in 2000 by the National Conference of Commissioners on Uniform State Laws, and last revised or amended in 2010.

See <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=6bae0bb2-00ea-8080-d084-5be9ef7bbc66>.

Its purpose is to “provide States with precise, comprehensive, and easily accessible guidance on trust law questions. On issues on which States diverge or on which the law is clear or unknown, the Code will for the first time provide a uniform rule.” UTC, p. 1. The UTC is not a statute but merely a form or guide for drafting State statutes with the aim of increasing uniformity.

⁵ UTC, § 1002.

⁶ *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (N.Y. App. Div. 1928) (“Meinhard Opinion”).

⁷ The Meinhard Opinion has been invoked in more than a thousand published opinions. Robert W. Hillman, “Closely- Held Firms and the Common Law of Fiduciary Duty: What Explains the Enduring Qualities of a Punctilio?” *Tulsa Law Review*, Vol. 41, 2006, available at <https://digitalcommons.law.utulsa.edu/tlr/vol41/iss3/3/>, accessed March 22, 2021 (“Hillman”), p. 445, note 24.

⁸ Hillman, p. 433. This standard has often been referred to as “the highest under law.”

⁹ See, e.g., the Uniform Trust Code, §802(a) (2010)(the “UTC”). Quotations herein of, and citations herein to, the Uniform Trust Code, the Uniform Probate Code, the Uniform Prudent Investor Act, the statutes, rules or regulations of any state or governmental body, or any version of the Restatement of Law of Trusts, are not intended to, and should not be interpreted as, expressions of any legal opinion; they are included simply as illustrations and examples in support of my understanding of the customs and practices prevailing from time to time in the trust and estate administration industry.

¹⁰ See footnote 3, *supra*.

interests of the beneficiaries.”¹¹ Trustees of personal trusts are held to the good faith exercise of three general fiduciary duties: prudent administration; loyalty; and impartiality. Each of these fiduciary duties is explained in summary detail below.

Prudent administration -- In administering the trust, a trustee must use the same reasonable care, skill and caution that a reasonably prudent person would. This latter requirement is often referred to as the “prudent person” rule as most famously summarized by Justice Samuel Putnam in the 1930 case, *Harvard v. Amory*: “All that can be required of a trustee ... is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.”¹² This requirement of prudence is codified in Section 804 of the Uniform Trust Code: “A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.”¹³ In practice, this means the trustee must take a holistic view of his, her or its fiduciary responsibilities and, taking into account the purpose and particulars of the trust, make decisions and take actions with respect to the trust property with the same level of care and common sense that the trustee would make or do with its own property. It is in effect the “Golden Rule” of fiduciary responsibility. Trustees with special skills or expertise, such as corporate trustees, are required to utilize those skills or expertise in administering the trust.¹⁴

The duty of prudent administration includes the responsibility to “keep adequate records of the administration of the trust,”¹⁵ to keep trust beneficiaries “reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests”¹⁶ and generally to “promptly respond to a beneficiary’s request for information related to the administration of a trust.”¹⁷

Loyalty -- The duty of loyalty requires the trustee to place the interests of the trust and its beneficiaries above his, her or its own interests, *i.e.*, to place loyalty to the fiduciary relationship above loyalty to self. Section 802 of the Uniform Trust Code states it this way: “[a] trustee shall administer the trust solely in the interests of the beneficiaries.” In practice, this means administering the trust solely in the interests of the beneficiaries as they exist under the trust instrument and avoiding conflicts of interest, both real and perceived.

Impartiality -- The duty of impartiality derives from the duty of loyalty and is sometimes considered a subset thereof. Section 803 of the Uniform Trust Code states it as follows: “If a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries’ respective interests.” In practice, this means that the trustee must identify who the beneficiaries are (both current and future, vested and contingent), identify their respective interests as contemplated by the purpose, structure and terms of the trust and the intent of the trust grantor, and deal impartially among beneficiaries with the same interests, neither favoring nor disfavoring some over others.

¹¹ UTC, § 801.

¹² *Harvard College and Massachusetts General Hospital v. Amory*, 26 Mass. 446 (9 Pick 1830), p. 461.

¹³ UTC § 804.

¹⁴ UTC § 806.

¹⁵ UTC § 810.

¹⁶ UTC § 813.

¹⁷ *Id.*

Good faith -- Good faith is required in all instances.¹⁸ Commentary to Section 814 of the Uniform Trust Code states, “[t]he obligation of a trustee to act in good faith is a fundamental concept of fiduciary law although there are different ways that it can be expressed.”¹⁹ The Restatement (Third) of Trusts provides the following commentary: “Although a trustee’s duties, like trustee powers, may be affected by the terms of the trust, the fiduciary duties of trusteeship are subject to minimum standards that require the trustee to act in good faith and in a manner consistent with the purposes of the trust and the interests of the beneficiaries.”²⁰ While “few doubt its significance, the duty’s meaning is notoriously unclear.”²¹ The law of one state (in a non-trust administration context) defines good faith as “honesty in fact in the conduct or transaction concerned and the observance of reasonable commercial standards of fair dealing.”²² It is arguably easier to define or identify examples of bad faith than good faith.²³ Thus, good faith is probably best defined generally as the absence of bad faith, which in turn is defined as “acting with the intent to defraud or deceive another person.”²⁴ As a result, it is my view that a reasonable understanding in the fiduciary industry is that good faith is presumed to exist in the absence of evidence of fraud, dishonesty or intentional deception.²⁵

Conclusion

The fiduciary role is an important one. It should be accepted thoughtfully and implemented diligently. A request to serve in the role is the highest possible expression by a trust settlor or testator of their confidence in the fiduciary’s integrity and judgment. In that sense, it is the literal embodiment of the word “trust.”

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¹⁸ UTC § 105(a)(2).

¹⁹ Comment to UTC § 814 (2010 version). Ironically, the UTC does not include a definition of good faith. See UTC § 103.

²⁰ Restatement (Third) of Trusts, §70(b) Comment.

²¹ Paul MacMahon, “Good Faith and Fair Dealing as an Underenforced Legal Norm,” *Minnesota Law Review*, Vol. 99, 2015, available at <https://scholarship.law.umn.edu/cgi/viewcontent.cgi?article=1275&context=mlr>, p. 2051.

²² KY Rev Stat § 45A.015 (2022).

²³ “What is Good Faith?” <https://www.rubylawfirm.com/what-is-good-faith/> (accessed October 21, 2022).

²⁴ “Bad Faith,” Legal Dictionary, available at <https://legaldictionary.net/bad-faith/>, accessed October 18, 2021.

²⁵ See, e.g., *Brown v. Brown*, 530 S.W.3d 35, 41 (Mo. Ct. App. 2017): “In general, the presumption is that a trustee administers the trust in good faith and the burden of proving the contrary is on the party questioning the trustee’s actions and seeking to establish a breach of trust.” See also, *Barnett v. Rogers*, 400 S.W.3d 38,49 (Mo. Ct. App. 2013), *Parker v. Pike*, 617 S.W.2d 536, 540 (M. Ct. App. 1981).