

Attorneys Fees in Trust Litigation

Take-Away: Judge Learned Hand once wrote: “*To compel a trustee to bear the expense of an unsuccessful attack would be to diminish the compensation to which he is entitled and which was part of the inducement of his acceptance to the burden of his duties.*”

Background: Finding a trustee to serve could be a challenge when the prospective trustee understands that he or she may be forced to pay for their own legal fees and litigation expenses that are incurred when defending a beneficiary’s claim of breach of trust, however meritless that claim subsequently proves to be. Knowing that the trustee *might* be reimbursed far into the future for such litigation costs and fees paid out of the trustee’s own pocket will not provide much solace to the prospective trustee who has to defend his or her decisions. Often a breach of trust will arise from the trustee’s simple negligence, and not any bad faith or maliciousness. If it is negligence, a trustee might still be permitted by the court to pay its legal defense fees from the trust estate, even if a technical breach of trust is found.

Reimbursement: The Michigan Trust Code (MTC) allows a trustee to be reimbursed out of the trust’s property, with interest when appropriate, for both of the (i) expenses that were properly incurred in the administration of the trust; and (ii) to the extent necessary to prevent unjust enrichment of the trust, expenses that were not properly incurred in the administration of the trust. [MCL 700.7709(1).] Advances and reimbursement under this section are not considered self-dealing by the trustee and their receipt is not a breach of the trustee’s fiduciary duty. [MCL 700.7709(3).] Key to this provision, though, is that the trustee may be *reimbursed*, at a later date, from the trust estate. This statute, however, does not explicitly authorize a trustee to pay for its legal defense costs directly from the trust assets during trust litigation.

Court Discretion: Similarly, the MTC also provides that if a trustee participates in a civil action or a proceeding in good faith, whether successful or not, the trustee is entitled to receive from trust property all expenses and disbursements, including reasonable attorney fees that the trustee incurs in connection with its participation. [MCL 700.7904(2).] This section does not mention *reimbursement*. The Reporter’s Comments to this section notes: “*Nothing in subsection (2) is intended to require a trustee to defer reimbursement for its expenses and disbursements until the conclusion of a proceeding.*”

Presumably, this means that the trustee could petition the court for the authority to directly pay its litigation costs and attorneys fees from the trust corpus during the litigation, but that entails a petition filed with the court and the court exercising its discretion to permit the trustee to pay itself from the trust estate during the litigation.

Deterrent? If a trustee is required to personally fund its legal defense in a breach of trust claim, litigation that could stretch over several years, that result might be a significant deterrent to the proposed trustee ever agreeing to provide fiduciary services in a time when the need for such fiduciary services is rapidly growing in the face of the 'Great Wealth Transfer' which is at hand, and the explosion of probate litigation across the nation. If a trustee were allowed the direct payment of these litigation expenses from the trust estate, rather than having to wait for reimbursement at a much later date, then perhaps this deterrent to serve as trustee would dramatically lessen.

Florida Trust Code: Florida tweaked its version of the Uniform Trust Code which it adopted in 2016, to provide that a trustee may pay attorney's fees directly from trust assets without the approval of any person and without any court authorization, unless the court grants a beneficiary's petition to prohibit such payment. [Florida Statute 736.0802.] This statute provides a balancing act to protect both the trustee and the beneficiary, by inserting several procedural safeguards.

Trustee Notice: With the filing of a complaint/proceeding for a breach of trust the trustee must give Notice to qualified trust beneficiaries that the trustee intends to pay its legal defense fees from the trust property.

Beneficiary Petition: Once he or she receives the trustee's Notice, the beneficiary can file a petition with the court to prohibit the trustee from using trust assets to make such payment of the trustee's litigation expenses and legal fees. If payment by the trustee has already been made, the court can compel the trustee to reimburse the trust estate, with interest. The trustee's Notice (just described) must inform the beneficiary of his/her right to file such a petition. For the court to enter what is the equivalent of an injunction, it must find a reasonable basis to conclude that there has been a breach of trust. [Florida Statute

736.0802(10)(e)(1).] The practical effect of this provision is to require a ‘mini-trial’ on the beneficiary’s petition with the beneficiary having the burden of proof.

Direct Payment to Trustee: Regardless of whether the court entered an order prohibiting any fee payment, if the breach of trust case is later withdrawn, dismissed, or judicially resolved in the trial court without of a determination that the trustee has committed a breach of trust, the trustee is authorized to use trust assets to pay attorney’s fees and costs without a notice of intent or order of court, and such fees may include those previously ordered to be refunded to the trust by the court.

UTC: The Uniform Trust Code (UTC) gives a court broad discretion to award reasonable attorney’s fees and costs to any party in trust litigation, paid by another party or the trust itself, based on ‘justice and equity’, which is an intentional shift away from the ‘American Rule’ where each party pays his or her own way. [UTC Section 1004.] This provision allows a trustee to defend the trust and its beneficiaries the ability to challenge the trustee’s actions, even without a showing of bad faith, which is intended to ensure the proper administration of the trust. Consequently, this provision gives the trial judge significant power to decide who pays. Some of the states that have formally adopted UTC 1004 have added this good faith standard. The 2021 ACTEC Fiduciary Litigation Committee has noted regarding UTC 1004:

“Under this standard, the trustee’s fees can be paid out of the trust even if breach is found, provided the trustee prosecutes or defends the action in good faith, even if not successful in the proceeding.”

Conclusion: The estate planning world needs skilled trustees to handle the Baby Boomer’s generational wealth transfer. Barriers that could deter an experienced trustee from agreeing to serve in that fiduciary capacity need to be reexamined. Michigan would be wise to take a close look at Florida’s amended statute, with its procedural protections for both the trustee and the beneficiaries, as one step towards encouraging individuals and professional trustees to serve a fiduciaries, while still protecting beneficiaries from bad actors.

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