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EDITOR'S NOTE: The following is the text of a lecture delivered by Mr. Dicus at a luncheon meeting of the Association arranged by the Committee on Trust Law.

One of the earliest things the law student learns in the study of trusts is that a trustee is charged with a measure of conduct not required or expected in most other legal relationships. A prospective successor trustee would do well to pause and reflect upon the conduct to be expected of him and in so doing he might profitably read Cardozo's famous and frequently quoted remarks in *Meinhard v. Salmon*, 249 N. Y. 458, 164 N. E. 545, in which he refers to a trustee's duty in the following language:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A Trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive is then the standard of behavior. As to this there has developed a tradition that is unbending and invetérate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

Usually we think of such statements as concerning only the trustee in office. But they are of vital concern to the successor, for he is obligated to take stock of his predecessor's administration by the application of those same strict principles of conduct as well as to measure his own ability to perform within them.

At the outset, therefore, and before he has assumed office, the successor should review his own ability or capacity to perform. With utter frankness and sincerity he should consider his relationship to his beneficiaries and the trust assets and determine whether he can administer his fiduciary responsibilities with undivided loyalty. If, because of personal or business relationships or interests, he is unable to give an uncompromising loyalty to his administration, he should refuse to accept office.

Assuming that the successor is able to square his conscience on all "moral" issues, and that he concludes there are no practical considerations which would prevent him from performing in a creditable manner, he must then turn his attention to what is usually his most important and difficult task—the checking of his predecessor's accounts. This duty is the basis of the particular subject I wish to cover today. The subject is broad, and as you can imagine covers the entire field of trust law. In the space available,

I hope to be able to outline briefly a few of the questions the prospective successor should ask himself and some of the steps he should take to protect himself after embarking on his undertaking.

The examination of his predecessor's accounts is not a task which the successor should take lightly for it is prompted by his duty to the beneficiaries and the duty to himself to avoid personal liability. Self interest alone should cause the successor to be aware of the character and extent of his responsibilities and liabilities, for the books are filled with cases demonstrating the lack of economy in carelessness and ignorance.

### Inherited Responsibility

We start with the basic principle that the successor does not inherit the sins of his predecessor. By mere succession to office he does not assume or succeed to his predecessor's breaches of trust. All authorities are clear on this point. As with most generalities, however, there are exceptions, and the successor should not be misled for he may in effect inherit responsibility for his predecessor's sins if he fails in his primary duty to obtain possession of all assets which should comprise the trust estate. He must take proper and timely action to redress any breaches of trust committed by the predecessor and to recover any property which the predecessor has failed to deliver to him. If the successor is negligent in so doing, he may be required to answer to the beneficiaries for his failure to properly discharge his own duties.

It is apparent, therefore, that the successor must concern himself with his predecessor's administration. He must know whether he has received the entire trust estate and whether there have been breaches of trust. And the only way in which the successor can know is to check the accounts and find for himself. He cannot sit by and accept his predecessor's representations without verification.

It may be difficult to muster up enough courage and patience to undertake a thorough checking of the predecessor's accounts, particularly if they have grown fat with age and dust, but in the long run it will pay dividends. The accounts should and must be checked regardless of the length of time covered, their condition or the manner in which they are presented. A neatly typed and well organized account can be as misleading as any other, and should not be accepted on the basis of appearance.

### Releases

Wherever possible, the successor should attempt to get releases from the beneficiaries. If all beneficiaries are *sui juris* and give the successor a clean bill of health as to the assets actually delivered to him, he should be able to rest comfortably with a less exhaustive examination of the accounts than would otherwise be required. In obtain such releases I would want to make certain that the beneficiaries had examined the predecessor's accounts and were familiar with his administration of the trust in order to avoid any subsequent contention that they were uninformed or had been misled.

Seldom is the successor able to get releases from all beneficiaries, for most trusts have life tenants or remaindermen who are minors or are not in being. Even if the life tenant is the only one from whom a release could be obtained, I think it is worthwhile to get it. In such a case the life tenant should be asked to approve the schedule of assets tendered to the successor as well as to certify that he or she has received all income to which he or she is entitled.

Since the successor can seldom get releases from all beneficiaries he must proceed without them. There is, of course, a duty on the predecessor to account fully and properly. Even so, the successor cannot sit by and accept the accounts submitted as correct and at the same time exercise his own duty to exercise reasonable diligence. There is authority to the effect that the accounts must properly call to the attention of the parties the specific matters to which they must object if dissatisfied, and this seems proper in order to avoid the consequences of misleading accounts and fraudulent concealment. In one case which I came across, however, the court said that there was no duty to disclose grounds of objection such as facts which would show imprudence in making or watching an investment or the omission of debits or improper credits.

In my opinion, however, decisions of that kind should only be accepted as a caution to beneficiaries and successors of the need to investigate the predecessor's administration, and should not be taken as authority for improper accounting or concealment, human nature being what it is.

**Reasonable Diligence**

Under all the circumstances, and by the very nature of the task, it is difficult to lay down definite ground rules for the checking of an account. The successor must exercise reasonable diligence, according to most authorities, which means we are dealing with an abstract test which can only be applied or measured in the light of known facts and circumstances. I don't think the successor must play the role of super detective and employ FBI methods in searching for grounds of objection, but he should use reasonable diligence and skill and not be blind to the obvious or fail to reach all reasonable inferences from the facts reviewed. He must exercise reasonable skill, prudence and caution and should not be guilty of supine negligence in being ignorant of facts which ordinary intelligence would have disclosed to him, or, if known, in not exercising his best judgment upon them. He must realize that every breach of trust committed by his predecessor has an inherent quality of risk about it so far as he is concerned.

Assuming that our successor is coming into office without the benefit of a court accounting—a subject I will mention later on—he will naturally wonder what to do and how he can satisfy himself as to the correctness of the accounts submitted. I think I would advise him that I knew no shortcuts to use, and that he must start in at the beginning and not give up until he

has reached the end. I think I would also advise him to consult his attorney and unless he was a trained trust administrator and aware of the problems involved, the attorney should review the accounts with him.

The natural starting point, of course, is at the very beginning of the previous administration. In the case of a trust agreement, I would want to start with the schedule of assets turned over to the predecessor by the grantor, or in the case of a testamentary trustee, the executor's accounts and inventory should be taken as the starting point.

This is usually a simple and accurate place to begin, although I have known of a case where only part of the scheduled assets was ever delivered by the grantor to the trustee and of another case where no schedule was ever made up at all. Such cases create uncertainty and many problems, all of which could be avoided by greater care exercised at the time.

With something to tie to in the nature of an opening inventory of the trust corpus, the successor should verify all cash receipts, disbursements, purchases, sales and distributions and see whether the accounts are accurate and complete.

In checking receipts, I think the successor should verify all interest and dividends. If the trust contained bonds and mortgages which would produce $x$ dollars, the income account should tally on this point.

**Dividends and Disbursements**

Likewise, the dividends paid on each stock should be verified and should tally with the account. Because of changing dividend rates, stock dividends, stock splits, exchanges, extraordinary cash dividends, liquidating dividends and the like, the successor should not hesitate to refer to available financial publications in verifying the account. Such caution on his part would avoid his being misled by an account such as was involved in a Massachusetts case where the trustee had failed to disclose that he had purchased certain corporate stock with cash dividends which he had not reported. Unless the successor knows what dividends should be accounted for, he cannot hope to uncover an item like that. Although the life tenant had approved the account submitted by the trustee, she was not estopped from demanding a full accounting on the grounds that she had been misled. That was not a successor trustee case, but it shows the need for care. The same type of thing can easily happen where there has been a reorganization. I would certainly want to know whether all cash and reorganization securities had been received and accounted for.

All disbursements should be checked against vouchers. The reasonableness and propriety of each expenditure should be checked and determined in the light of the provisions of the trust instrument, including distributions of income and principal, compensation paid to the predecessor and others and expenses of administration.

In checking disbursements, the subject of taxes should be given careful consideration. The successor should see that all personal property, real estate

and other property taxes have been paid and on time. If the predecessor was negligent in the payment of taxes so that penalties were incurred, the facts should be investigated to determine whether there should be a surcharge against him.

From the dollars and cents standpoint, the federal taxes usually give the successor most concern. All income tax returns should be reviewed and possible liability for gift or estate taxes should be checked. If the predecessor has failed to file timely claims for refund where refunds were due, the successor should know the facts and determine to his own satisfaction whether the predecessor was negligent. The successor's investigation concerning tax liabilities will frequently lead him into many interesting problems of procedure and substantive tax law.

In checking the accounts, the successor should not be surprised to find some errors if not technical breaches of trust due to inadequate bookkeeping. In my experience, many if not most of the problems of the average individual trustee will be due in great measure to improper records or a complete lack of them. If he could only understand the need for keeping proper books, files and records for his own protection, I feel sure he would willingly spend more time on them. There is one individual trustee who particularly needs special caution, and that is the donor who acts as sole trustee of his own trust. He can't quite seem to remember that he is no longer the owner of the trust corpus and free to act as he wishes.

### Principal and Income

Improper encroachments on principal are frequently made by the careless trustee and must be watched for by the successor if he seeks immunity from his remaindermen. Sometimes these encroachments are unintentional and due to the trustee's failure to know his principal and income cash balances. I have known of several cases where encroachments were made intentionally but without authority in the instrument where the donor's widow who was the life tenant was in dire need of assistance. It may be difficult to think of surcharging in cases of that kind but in the absence of exoneration by a court decree the successor should attempt to restore the capital account from the predecessor or the life tenant.

In checking receipts and disbursements, the successor must be familiar with the provisions of the instrument and all applicable statutes dealing with allocation and apportionment. He must know, for instance, whether his predecessor was granted discretionary authority and whether the discretion was properly exercised. He must know whether all bond premium should have been amortized and whether the predecessor properly credited stock, extraordinary or liquidating dividends.

One item which is becoming more important in this state is the proper treatment of oil royalties. Although we have had similar problems with other natural resources in the past, the development of the Illinois oil field has presented the problem to many for the first time. When you find an estate

or trust that has some oil interests, you frequently find those interests scattered among fields located in more than one state, making it necessary to check the laws of each state for possible variances. The Uniform Principal and Income Act has done much to settle and clarify the treatment of receipts from natural reources but such acts vary considerably. In Pennsylvania and Illinois, for instance, proceeds received in consideration of permanent severance of natural resources are to be deemed principal unless otherwise provided. Other states provide for apportionment, and you will find statutes like the one in effect in Oklahoma which provides that corpus shall be credited with such percentage as is allowed for depletion for federal income tax purposes, or if no such depletion deduction is allowed then twenty per cent. Where no statute is in effect and the instrument is silent on the subject, as it usually is, the intention of the grantor or testator will prevail, and it is possible under varying circumstances to have all royalties credited to income or all to principal. That is quite a margin for error.

**Investments**

The successor will also want to make an exhaustive review of the investments tendered to him in order to formulate his own investment recommendations and also to determine the propriety of his predecessor's investment program. To determine whether the predecessor should be surcharged, the history of each asset should be checked, particularly those which have depreciated in value or which have been disposed of at a loss. Has the predecessor retained improper or depreciating assets which should have been disposed of? Were those purchased by him authorized investments at the time of acquisition? Are any losses real losses or have they been realized only in a switch of investments for income tax purposes?

The successor should also check to see whether all assets sold by the predecessor were disposed of at fair prices. This may require, in the case of unlisted securities, collateral investigation as to value and marketability. If there is any evidence of sales being made either directly or indirectly for the benefit of the trustee, a complete invstigation should be made. As a matter of fact, that is true as to any indication of self-dealing on the part of the predecessor.

Each parcel of real estate should be examined to determine its location, surroundings, condition, value and the desirability of continued retention.

The same investigation should be made with respect to the real estate underlying each mortgage in the trust. If the real estate was inadequate security at the time the loan was made or has since depreciated to a point where it is no longer adequate security, the successor must investigate the facts to determine whether a surcharge is in order. If the predecessor should have foreclosed but didn't, the successor should act promptly to institute foreclosure proceedings and hold the predecessor responsible for any loss due to his neglect.

The collectability of any notes held by the trust should be determined and the adequacy of any collateral should be investigated.

Any claims by or against the trust estate should be investigated and proper action planned. If the predecessor has permitted the statute of limitations to run on a claim which he should have pursued, a basis for surcharge might exist.

Where the predecessor has administered the controlling interest in a corporation or has formed a corporation for some legitimate purpose of the trust, the successor should look through the corporate form and make investigation of the corporate activities. No fiduciary should be able to hide behind a corporate shell and claim immunity for activities which would otherwise constitute breaches of trust. For instance, purchases and sales made by the corporation which would otherwise constitute self dealings should be reviewed.

Even though the successor may have a duty to institute suit against his predecessor or third parties in order to properly discharge his own responsibility, the successor can at least be assured that he will not have to advance his own funds for such purpose. If the trust estate does not have the funds enabling his successor to take proper action and employ counsel, demand should be made upon the beneficiaries to advance the necessary funds, and in the event they fail to make such advancements, the successor will be exonerated.

One other point that the successor should remember is that he is not required to take action where such action would be fruitless. Before the beneficiary can hold the successor liable, he must show that the successor could have recovered had he taken proper action. Consequently before taking any action, the successor should investigate the probability of recovery.

### Court Approval

Although in this jurisdiction the successor normally does not have the benefit of court approval of his predecessor's accounts, there may be instances where he should refuse to accept office unless the accounts are submitted to the court. In fact, there are many instances where the predecessor himself should insist upon approval of his accounts by a court to settle once and for all the question of his liability.

Regardless of the reason for the court action, the question in the successor's mind should be whether he is fully protected in relying upon the decree for all matters reflected in the accounts approved. Generally speaking the decree, whether it applies to an interim or a final accounting, will afford protection as to the matters covered thereby.

If the successor trustee is a party to the accounting suit, he should make as thorough an investigation of the accounts and raise the same objections as he would if he were checking into his predecessor's accounts without the benefit of court action. If the successor is not a party to the action, as is the usual case with an interim accounting, the question in his mind is whether he can accept the decree without some investigation.

Recently I had occasion to engage in considerable research as to the extent of the successor's responsibility to go behind a decree in a proceeding in which he was not a party. In the absence of clear cut authority on the subject, I concluded that for his own protection the successor should make a reasonable examination of the proceedings to determine whether the decree is valid and the extent to which it affords protection against any claims in the future.

A void decree is of no protection to anyone. Therefore, in the exercise of reasonable diligence and in face of his obligation to pursue claims against his predecessor, it seems to me that the successor should examine the record in the accounting proceedings and determine whether all formal requisites for validity have been complied with.

He should give consideration to the court's jurisdiction over the subject matter. In some situations, this may be a real problem. If the trust, for instance, is a testamentary trust created by a will of a California decedent and the trustees reside in Illinois and the beneficiaries in various other states, the question of jurisdiction would be a serious one. Jurisdiction of the parties, as well as jurisdiction of the subject matter, should be examined into. Has there been proper service on all parties? Have all necessary parties been brought into the proceedings so that they will be bound by the decree? I think I would want to know such facts to avoid the situation which existed in one case in which certain annuitants under the instrument were not made parties to the accounting case in which the successor trustee was also appointed. The annuitants subsequently sued the predecessor and the successor and the former decree, of course, did not bar the right of recovery for income from certain assets which had been improperly scheduled by the original trustee. Had the successor been on his toes, he would have observed that material parties had been omitted, and that there was a variance between the schedule of assets incorporated in the decree and that submitted by the predecessor. The successor could well have avoided personal liability had he been alert.

Not only would I like to check for formal requisites of validity, but I would also like to examine the various pleadings to know the extent and character of the issues raised, particularly if I had knowledge of questionable transactions which did not appear on the face of the account.

Here you are concerned with the extent of the plaintiff's duty to disclose matters which should be the subject of objection. If there has been such proper disclosure and no objection raised, those issues should be considered settled by the decree. Since the decree, as with any decree, is subject to vacation for fraud, I would want to know whether issues were raised about which I had knowledge and which were not clearly apparent from the face of the record.

It is questionable how far the successor trustee must go, but I don't think it is profitable to quibble over what will constitute reasonable action.

I would much rather see the successor do more than might be required than to stop short and have the sufficiency of his investigation questioned by the beneficiaries. It would be far better to settle all questionable matters at the time the successor takes office than to play ostrich and learn at a later date that the accounting decree is not binding in whole or in part.

No attempt has been made to deal with the special problems existing with respect to specific relationships. For instance, the testamentary trustee in taking over from the executor has some problems slightly different than the successor trustee under an agreement. Fundamentally, however, all successors, regardless of relationship, will have substantially the same duties.

There are, of course, many other duties and problems facing a successor which I have not touched upon. The successor will frequently have a question as to whether the vacancy in office legally exists or whether he will inherit the powers granted to his predecessor. He also may have questions of construction or interpretation of the trust instrument or be required to pass on the validity of the trust created.

## The Time to Consult With Your Trial Lawyer Is Before Your Decision to Go Into Court

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The important service that can be rendered by the jury trial lawyer as a pre-trial counsel in helping his client select the cases that can be litigated with safety, as well as with some degree of success, is often not fully understood or appreciated. My remarks on this topic find their source in my many years of courtroom experience and the impressions and conclusions that have come out of that work. My trial experience has been varied and extensive and much of it in the defense of railroads and insurance companies, yet I have emerged with confidence in the jury system as the best method for the determination of fact issues.

This discussion will be concerned primarily with the thought that most corporations, confronted with the usual volume of lawsuits, do not make wise use of the valuable service that a safe trial counsel can render to them in making the important decision whether a serious controversy shall or shall not be litigated. Life insurance companies are no exception and perhaps suffer more from such neglect. Company personnel are prone to feel that the trial lawyer has no value outside the courtroom. On the contrary his greatest service to your company may be rendered long before the day of the trial.

What are the qualifications of a safe trial counsel? Immediately we think of two. First, he must be an educator. Second, he must be a salesman. I have not overlooked the fact that he must also be a good lawyer but we are concerned here with the added qualifications he must attain before he