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T&E Litigation Newsletter – 8/8/14

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Marshall D. Senterfitt, Mark E. Swirbalus

After a quiet start to the summer for probate litigation cases, the Supreme Judicial Court recently issued its much-anticipated decision in The Woodward School for Girls, Inc. v. City of Quincy, Case No. SJC-11390, 2014 Mass. LEXIS 584 (July 23, 2014), addressing issues involving the investment management of trust assets under the prudent investor rule.

The dispute, which was transferred to the Court on its own motion, concerns assets of a trust originally established in 1822 by President John Quincy Adams and later supplemented by the bequest of his grandson, Charles Francis Adams, in 1886. In 1953, The Woodward School for Girls became the sole income beneficiary of the trust. Under the terms of the trust, the remainder beneficiary is only entitled to take the principal upon "gross corruption or mismanagement . . . notorious negligence, or any waste knowingly permitted." Accordingly, as noted by the Court, Woodward was intended to benefit from the trust indefinitely and the Town of Quincy, as trustee, was required to devote "complete attention" to the interests of Woodward in its management of the trust property. Woodward initiated suit against Quincy seeking an accounting and asserting, among other things, that it breached its fiduciary duties by failing to keep adequate records and invest the trust assets properly.

Quincy and Woodward cross-appealed from a decision of the probate court awarding $3,000,000 to Woodward, including more than $1,000,000 attributable to allegedly unrealized investment portfolio gains as well as approximately $1,600,000 in pre-judgment interest.

In reversing the probate court's ruling on damages, but upholding the ruling that Quincy was liable for mismanaging the trust assets, the Court focused its decision primarily on whether Quincy satisfied its duties as trustee under the prudent investor rule. More specifically, the Court focused on whether Quincy breached its fiduciary duties by failing to follow advice that the trust assets be invested in a diversified manner. Central to the Court's decision was the question of whether a trustee of a trust for the benefit of a charitable income beneficiary (with a remainder beneficiary who takes the principal only upon the gross mismanagement by the trustee) may prioritize income generation over portfolio growth when making investment decisions.

Ultimately, the Court held that a trustee is not required to follow investment advice simply because the trustee had solicited such advice. Although the failure to follow sound advice may be evidence of imprudent asset management, the decision to follow or not follow investment advice is not, in and of itself, enough to determine the satisfaction of a trustee's duties under the prudent investor rule. In so ruling, the Court held that it was error for the probate court to rule that Quincy had breached its duties as trustee solely on the basis that it failed to implement a specific recommendation for portfolio diversification.

The Court did, however, uphold the probate court's ruling that Quincy breached its fiduciary duties by failing to balance its approach to portfolio management in order to maximize both growth and income, and not only income. Although the Court noted that other jurisdictions have held that it is not a breach of fiduciary duty for a trustee of a trust for the benefit of a lifetime income beneficiary to prioritize income over growth, the Court distinguished the case at bar because Woodward is a charitable beneficiary for which the trust was designed to benefit in perpetuity. In support of its holding, the Court cited the Restatement (Third) of Trusts for the proposition that the trustee of a charitable trust "must necessarily consider both the generation of income and the growth and maintenance of the principal in order to provide income funds to the beneficiary indefinitely." The Court stated further that "[i]n effect, Woodward is equivalent to both the lifetime income beneficiary and all subsequent beneficiaries."

The Court reversed the probate court's award of more than one million dollars in unrealized portfolio gains, ruling that it was erroneous for the judge to calculate damages based on a single investment theory that Quincy failed to adopt. The Court did, however, confirm that unrealized portfolio gains is an appropriate measure of damages for breach of a trustee's duties to prudently invest trust assets so long as the trial court considers evidence of all available strategies and factors that a prudent investor would have considered under the particular circumstances at issue.

The Court also affirmed the probate court's determination that Quincy must pay prejudgment interest dating back to the last date of breach, but concluded that interest had to be recalculated based on the amount of overall damages to be determined on remand.

This update was authored by Mark Swirbalus and Marshall Senterfitt, attorneys in the firm's Probate & Fiduciary Litigation group. For questions or additional information on this topic, please contact Mark at mswirbalus@goulstonstorrs.com, Marshall at msenterfitt@goulstonstorrs.com, or any member of the Probate & Fiduciary Litigation group.

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