RENDERED: SEPTEMBER 14, 2007; 2:00 P.M.
NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2006-CA-000546-MR

SANDRA T. ELLIOTT AND
PAUL H. ELLIOTT, CO-TRUSTEES FOR THE BENEFIT OF LINDSEY TOMES ELLIOT — APPELLANTS

v.

APPEAL FROM FAYETTE CIRCUIT COURT
HONORABLE PAMELA R. GOODWINE , JUDGE
ACTION NOS. 00-CI-01070 & 00-CI-01071

J.C. BRADFORD & CO., LLC;
UBS/PAINE WEBBER, INC.; AND
MORGAN, KEEGAN & COMPANY, INC. — APPELLEES

AND: NO. 2006-CA-001850-MR

SANDRA T. ELLIOTT AND PAUL H.
ELLIOTT, CO-TRUSTEES UNDER AN
IRREVOCABLE TRUST AGREEMENT — APPELLANTS

v.

APPEAL FROM FAYETTE CIRCUIT COURT
HONORABLE PAMELA R. GOODWINE , JUDGE
ACTION NOS. 00-CI-01070 & 00-CI-01071

JOHN D. ELLIOTT, EXECUTOR OF THE
ESTATE OF WILLIAM E. ELLIOTT, JR. — APPELLEES

OPINION
AFFIRMING

** ** ** ** **

BEFORE: KELLER AND VANMETER,[1] JUDGES; GUIDUGLI,[2] SENIOR JUDGE.

GUIDUGLI, SENIOR JUDGE: These appeals stem from the entry of separate summary judgments in consolidated actions involving irrevocable trusts established for the benefit of Lindsey Tomes Elliott and Paul Andrew Elliott by their great-grandfather William E. Elliott, Sr. Appellants Sandra and Paul Elliott, who are the parents of the beneficiaries, sought an accounting and damages from the estate of Paul's father, William E. Elliott, Jr., whom they allege was a usurper trustee, as well as seeking an accounting and damages from the appellee stock brokerage firms whom they allege acted at his direction. We affirm the entry of summary judgment in both appeals.

The facts are somewhat complex, but not in dispute. William Sr. created several separate irrevocable trusts for his great grandchildren. Two of those trusts are the subject of these appeals: a trust created in 1983 for Lindsey and an almost identical trust created in 1988 for Paul Andrew. The initial trustee for both trusts was the First National

[1]At the time the complaint in this action was filed, Judge VanMeter was serving as Judge of the First Division of the Fayette Circuit Court. Review of the record reveals that Judge VanMeter signed orders on two non-substantive motions in the early stages of this litigation. Pursuant to standard Court of Appeals' policy, prior to oral argument the identity of the panel members assigned to hear this appeal was provided to the parties with directions to file a motion for recusal within ten (10) days of the notice if any basis for a such motion is known to the parties. No such motion was filed in this appeal and no objection to Judge VanMeter's participation in the resolution of this appeal was voiced at oral argument.

[2]Senior Judge Daniel T. Guidugli sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

Bank of Pikeville, Kentucky; that institution has undergone name changes and mergers and has not been named a party to this litigation.

William Sr. gave his son William Jr. certain rights under the trust instruments:

> 4.4 Settlor's son may at any time, and from time to time, by a prior written notice delivered to the trustee, remove the trustee and appoint another corporate trustee having a capital and surplus of no less than $1,000,000 and authorized to administer trusts.

William Jr. had four sons: Robert; John D.; William E., III; and Paul, who is married to Sandra. In 1985, Robert was hired by appellee J.C. Bradford and received training as a stockbroker. Thereafter, William Jr. and Robert offered First National investment advice for the trusts of the various great-grandchildren. A disagreement arose and First National resigned as trustee in 1988. The trust agreement provided for that contingency in the following paragraph:

> 3. Any trustee of any trust established hereunder may resign at any time by giving 60 days prior written notice of its intention to do so to the income beneficiary of this trust estate. If that income beneficiary is then a minor, notice to that income beneficiary shall be directed that that income beneficiary's statutory guardian, or if a statutory guardian has not been appointed, notice shall be directed to the person or persons then having that income beneficiary's care, custody, nurture and control. If a trustee ceases to act, that income beneficiary may appoint another trustee and if that income beneficiary is a minor when a trustee ceases to act, that income beneficiary's statutory guardian, or if one has not been appointed, that income beneficiary shall act through the person or persons then having that income beneficiary's care, custody, nurture and control.

Although First National sent the notice required by this paragraph to William Jr. and Robert, Paul and Sandra each testified that no such notice was sent to them.

William Jr. subsequently designated himself as trustee and opened brokerage accounts for the trusts at J.C. Bradford, naming Robert as the originating agent. In May, 1993, Robert accepted employment with Morgan Keegan and the trust assets were transferred from J.C. Bradford to Morgan Keegan, again with Robert as the originating agent. With the assistance of an attorney, Paul and Sandra obtained copies of the trust agreements in 1997. Later that year, Paul suffered a heart attack and stroke and did not further pursue any trust related issues until his health conditions stabilized in 1999.

Prior to initiating this litigation, Paul and Sandra exercised their rights under paragraph 3.3 and appointed Sandra as trustee of both trusts. Notices were sent to J.C. Bradford, Morgan Keegan and William Jr. who exercised his rights under paragraph 4.4 by removing Sandra as trustee and requested a recommendation from Paul and Sandra as to a successor corporate trustee. This litigation commenced in March 2000, with the filing of separate, but substantially identical complaints for each of the two trusts which sought: 1) a declaratory judgment that Sandra was duly authorized to serve as trustee; 2) an accounting from William Jr, as well as damages for any losses, costs and attorneys fees incurred by the trusts by reason the action against William Jr.; and 3) separate accountings from J.C. Bradford and Morgan Keegan, as well as damages for any loss and

reasonable attorneys fees incurred by the trusts due to the actions of the applicable firm. On May 11, 2004, Paul and Sandra executed a written agreement under which they would be authorized to serve as co-trustees. Thereafter, Morgan Keegan transferred the trust assets to a financial institution designated by Paul and Sandra.

William Jr. died during the pendency of the litigation in the trial court and his estate, by and through his son and executor John D. Elliott, was substituted as a defendant in the action. By order entered on February 15, 2006, the trial court granted both J.C. Bradford and Morgan Keegan judgment as a matter of law on the basis of laches and the insulating language of KRS 386.830. The trial court thereafter granted the estate's motion for summary judgment.

Turning first to the dismissal of J.C. Bradford and Morgan Keegan, Paul and Sandra argue that genuine issues of material fact preclude summary disposition and that the legal issues which were ripe for judgment should have been decided in their favor. We disagree.

The trial court's judgment in favor of J.C. Bradford and Morgan Keegan was predicated both on laches and the protections afforded by KRS 386.330 which provides:

> With respect to a third person dealing with a trustee or assisting a trustee in the conduct of a transaction, **the existence of trust powers and their proper exercise by the trustee may be assumed without inquiry**. **The third person is not bound to inquire whether the trustee has power to act or is properly exercising the power; and a third person, without actual knowledge that the trustee is exceeding his powers or improperly exercising them, is**

> **fully protected in dealing with the trustee as if the trustee possessed and properly exercised the powers he purports to exercise.** A third person is not bound to assure the proper application of trust assets paid or delivered to the trustee. [Emphasis added.]

The trial court concluded that the statute insulated the brokerage firms from liability absent a showing that they had actual knowledge that William Jr. was exceeding the powers given him under the trust document on the basis of the following rationale:

> Plaintiffs have provided no evidence that either J.C. Bradford nor Morgan Keegan ever possessed actual knowledge that the Trusts' assets were delivered to them in a manner that was inconsistent with the Trust Agreements.
>
> Plaintiffs contend that at the very least both entities should have read the trust documents. Upon further questioning, counsel for Plaintiffs conceded that reading the Trust Agreements would in no way have alerted either entity that William Jr. was acting without authority. In his deposition, Paul acknowledged that he became aware that William Jr. began acting as trustee in 1988.
>
> Plaintiffs did not challenge William Jr.'s appointment as trustee until over a decade later. Until that time, Plaintiff's acquiesced to William Jr.'s role as trustee. At the time the Trust's assets were transferred, initially to J.C. Bradford and subsequently to Morgan Keegan, there was no reason for either entity to suspect that William Jr. was not authorized to act as trustee, let alone have "actual knowledge" that he was acting inappropriately. Therefore, the Court finds that both J.C. Bradford and Morgan Keegan are insulated from liability under KRS 386.830 and both are entitled to summary judgment as a matter of law.

Although in their brief Paul and Sandra challenge these conclusions primarily on the basis of a duty to make reasonable inquiry, at oral argument a question was raised as to whether Robert's knowledge concerning his father's lack of authority to

act as trustee could be imputed to his employers, J.C. Bradford and Morgan Keegan. We are convinced that under either theory, the decision of the trial court must be upheld.

A reading of the statute makes clear that as far as the brokerage firms are concerned, "the existence of trust powers and their proper exercise by the trustee may be assumed without inquiry." Absent actual knowledge that the trustee is exceeding his authority, the brokerage firms are insulated from liability for the trustee's actions. As stated in the opinion of the trial court, it was conceded that a simple reading of the trust documents would not have provided the firms with actual knowledge concerning any defect in William Jr.'s authority as trustee. In fact, the trust documents plainly give William Jr. specific authority to remove trustees and appoint a successor trustee. More importantly, however, until actual knowledge is established, no duty to make any inquiry into the trustee's authority arises.

Thus, Paul and Sandra's contention that the brokerage firms had a duty to investigate is predicated upon their assertion that Robert had actual knowledge that his father was a usurper and that that knowledge must be imputed to his employers, the brokerage firms. The only hint as to Robert's knowledge concerning his father's authority is contained in the following excerpt from his deposition, which Paul and Sandra offered in their response to the brokerage firms' motions for summary judgment:

> Q. Do you know what mechanism W.E. Elliott, Jr. used to make himself trustee?
> A. Well, again, I assume that my father, based on the fact that he, himself, was responsible for convincing my grandfather in establishing these trusts, that the trust agreement that was designed gave him very liberal powers of

> authority, and he had the right to name himself as trustee, and had requested it.

The only knowledge which could have been imputed to the brokerage firms is set out in Robert's deposition and that undisputed testimony supports the trial court's interpretation and application of KRS 386.330.

Finally in this regard, we find no error in the trial court's invocation of the doctrine of equitable laches. By his own admission, Paul knew as early as 1988 that his father was acting as trustee and, despite having concerns about the way the trusts were being handled, did not even ask for a copy of the trust agreements until 1997. Paul also admitted in his deposition that regular statements for the accounts were mailed to him by the brokerage firms and that he had access any time he requested it to the trust records his father maintained at his office. On these undisputed facts, we find no error in the trial court's conclusion that Paul and Sandra acquiesced in William Jr.'s actions as trustee until 1997, thus obviating any claim that their loss, if any, was attributable to a breach of duty by the brokerage firms. Whether viewed as acquiescence in William Jr.'s actions or as laches, the result is the same. Paul and Sandra chose not to act despite admitted concern over the manner in which the brokerage accounts were being handled.

With respect to the dismissal of the claims against William Jr.'s estate, we are convinced that the trial court correctly analyzed the undisputed facts in concluding that William Jr.'s usurpation of the position of trustee constituted a single breach of the trust agreement. Paul and Sandra acknowledged this fact in their memorandum opposing William Jr.'s motion for summary judgment:

> Instead, William, Jr., decided . . . to designate himself as the successor trustee of the Trusts. Under paragraph 4.4 of the Trust Agreements, William, Jr. only had authority "to remove the trustee and appoint another corporate trustee having capital and surplus of no less value than $1,000,000 and authorized to administer trusts." **It is this wrongful act by William, Jr., for which the Plaintiff's seek recovery.** [Emphasis original.]

It logically follows that if William Jr. was not the duly authorized trustee, all of his acts with respect to management of the trusts were unauthorized, a single continuing course of conduct with respect to his management of the trust assets. Thus, the trial court's decision conforms to the general rule set forth in the *Restatement (Second) of Trusts,* §213:

> A trustee who is liable for a loss occasioned by one breach of trust cannot reduce the amount of his liability by deducting the amount of a gain which has accrued through another and distinct breach of trust; but **if the two breaches of trust are not distinct, the trustee is accountable only for the net gain or chargeable only with the net loss resulting therefrom.** [Emphasis added.]

The commentary to this section provides some guidance in determining whether breaches are "distinct:"

> *Factors determining whether breaches of trust are distinct.* In determining whether two breaches of trust are distinct, the following factors may be of importance: (1) whether the breaches of trust relate to the same or to different parts of the trust property; (2) whether the breaches of trust arise out of successive dealings with the same property or its product; (3) the amount of time elapsing between the breaches of trust; (4) whether there has been an accounting between the breaches of trust; (5) how the trustee has dealt with the property or its product between the breaches of trust; (6) whether the trustee intends to misappropriate trust property; or intends to commit

> a breach of trust, although not intending to misappropriate trust property; or does not intend to commit a breach of trust; (7) whether the breaches of trust are the result of a single policy on the part of the trustee.

Restatement 2d of Trusts § 213, comment e. The commentary goes on to emphasize that there are no hard and fast rules dictating the weight to be ascribed to the various factors. In considering these factors, the trial court noted that there was no evidence that William Jr. engaged in any misappropriation, self-dealing, retention of profits or fraud with respect to the management of the trusts. We therefore find no error in the resulting conclusions that William Jr.'s dealings with the trust property constituted a single or distinct act and that he is therefore chargeable only with the net loss or gain.

Next, the trial court noted that despite Paul and Sandra's contention that they were not seeking punitive damages, they nevertheless alleged that the circumstances of the case present "a serious underlying public policy issue which is reflected in the measure of damages allowed." We agree with the trial court's assessment that by seeking damages for losses which cannot be offset by gains, Paul and Sandra are essentially seeking punitive damages which are not available against William Jr.'s estate:

> In order to recover punitive damages from the Estate, Appellants had to prove that "the defendant from whom such damages are sought"-i.e., *the Estate itself*-"acted toward the plaintiff with oppression, fraud or malice." And, in this case, it is undisputed that Appellants could not produce any evidence that the Estate acted in such a manner.

Stewart v. Estate of Cooper, 102 S.W.3d 913, 916 (Ky. 2003). As was the situation in *Stewart*, the estate was not even in existence at the time of the alleged wrong. In fact, Paul and Sandra had appointed themselves as trustees prior to William Jr.'s death.

We are thus convinced that the trial court correctly concluded that Paul and Sandra failed to show entitlement to any damages by reason of William Jr.'s dealings as trustee. Because William Jr.'s dealings with the respective trusts were properly held to be a single act, any losses must be offset by the profits gained and there is no dispute that the trusts were profitable. Neither were they entitled to punitive damages from William Jr.'s estate and, as previously discussed, the brokerage firms were insulated from liability as a matter of law.

In light of our resolution of these issues, we need only address Paul and Sandra's complaints regarding the application of the doctrine of laches by noting Paul's admission that he had known since 1988 that his father was acting as trustee and yet took no action to obtain the trust documents until 1997, waiting an additional three years before filing these complaints. On these facts, we cannot fault the trial court's application of laches to their claims.

Accordingly, we affirm the well-reasoned judgment of the trial court in each appeal.

ALL CONCUR.

BRIEFS AND ORAL ARGUMENT FOR APPELLANT:

Philip E. Wilson
Lexington, Kentucky

BRIEF FOR APPELLEE JOHN D. ELLIOTT, EXECUTOR:

Brian M. Johnson
Trevor T. Graves
Lexington, Kentucky

ORAL ARGUMENT FOR APPELLEE JOHN D. ELLIOTT, EXECUTOR:

Brian M. Johnson
Lexington, Kentucky

BRIEF FOR APPELLEE J.C. BRADFORD:

Henry E. Kinser
Mickey T. Webster
Lexington, Kentucky

ORAL ARGUMENT FOR APPELLEE J.C. BRADFORD:

Henry E. Kinser
Lexington, Kentucky

BRIEF FOR APPELLEE MORGAN KEEGAN:

Barbara B. Edelman
Christopher M. Parenti
Lexington, Kentucky

ORAL ARGUMENT FOR APPELLEE MORGAN KEEGAN:

Christopher M. Parenti
Lexington, Kentucky