

# **How to Close an Estate: Court Accountings and Family Agreements**

## **FORMAL ACCOUNTING**

Thomas A. Boulden, Esquire  
Timoney Knox, LLP

# Terminating Estate – General Comments

- Attorney should keep their clients informed. Always have a detailed engagement letter which outlines the nature of the services to be provided, the scope of representation and what is and what is not included in the representation and/or fee arrangement.
- This includes whether or not the estate is to be terminated informally by agreement or formally with a court filed accounting.

# Goal of Estate Administration

- Properly administer estate, file all returns, make all distributions and end personal representative's fiduciary obligations, get Personal Representative (PR), out of office and released from liability
  - Formal Account: Discharge – Account approved by Court
  - Informal account: Release – Administration approved by beneficiaries
  - In either case, concluding the Estate Administration and providing clear information to the beneficiaries is important for proper conclusion.

# Type of Letters Issued and Fiduciary Appointed

- Letters Testamentary – Will probated – Executor qualifies
- Letters of Administration – No Will, or Qualified Fiduciary – Administrator qualifies

# Have There Been Any Threats of Litigation During the Administration?

- Was the production of a will or establishment of an estate compelled?
- If an intestacy, did the class of persons eligible to be appointed Administrator agree on a person or was it contentious?
- Have there been disputed claims filed against the estate?
- Have beneficiaries or fiduciaries been at odds?
- In essence, does the administration pass the gut test of whether it should be concluded informally or formally.

# Have All Aspects of Administration Been Timely Concluded?

- Has proper notice been given to all individuals?
- Has proper notice been given to all known creditors?
- Was the Pennsylvania inheritance tax return accepted as filed?
- Has the Pennsylvania notice and appraisement been received?
- Was there any federal estate tax liability?
- If any of these are questionable then the fiduciary must determine whether the risks warrant a formal accounting and discharge by the court.

# Benefits of Closing an Estate Informally

- Can be handled by a contemporaneous accounting sent to all beneficiaries with a letter and Receipt, Release, Refunding Bond, Waiver of Audit and Indemnification Agreement.
- Usually less time involved and estate concluded more promptly with less expense.
- If all aspects of the administration have been properly handled and there are no known creditor issues comprehensive receipt and release or non-judicial settlement agreement can have a substantially similar effect of discharging a fiduciary as a discharge by the court.

# Closing the Estate by Formal Court Accounting

- Contemporaneous accounting should be maintained throughout the estate administration.
- The fiduciary must sign a verification attached to the account as well as the account itself.
- Accounts are to be filed in time for designated or scheduled audit dates.
- The filing of the account can delay the termination of the estate.
- There are additional costs associated with the notice requirements, the filings, the preparation of filing of the petition for adjudication and, but not limited to, the appearance by counsel at the call of the audit.
- However, once the account has been audited, absent objections, the fiduciary will be discharged by court order.

# Notice to Proper Individuals

- Supreme Court Orphans' Court Rule 10.5\* sets forth who should receive notice of the grant of letters.
  - Send notice within 3 months of grant of letters to:
    - “(1) every person, corporation, association, entity or other party named in decedent’s Will as an outright beneficiary whether individually or as a class member;
    - (2) the decedent’s spouse and children, whether or not they are named in, or have an interest under, the Will;
    - (3) where there is an intestacy in whole or in part, to every person entitled to inherit as an intestate heir under Chapter 21 of the Probate, Estate and Fiduciaries Code;
    - (4) the appointed guardian of the estate, parent or legal custodian of any beneficiary who is a minor child under the age of eighteen years;

\* This Rule is substantially similar to old Rule 5.6.

# Notice to Proper Individuals – Cont'd

- (5) the appointed guardian of the estate or, in the absence of such appointment, the institution or person with custody of any beneficiary who is an adjudicated incapacitated person;
  - (6) the Attorney General on behalf of any charitable beneficiary with an interest above \$25,000 or which will not be paid in full;
  - (7) the Attorney General on behalf of any governmental beneficiary;
  - (8) the trustee of any trust which is a beneficiary; and
  - (9) such other persons and in such manner as may be required by any local rule of court.”
- Although not required, it is a good practice to send out the required notices with a cover letter and a copy of the Will to reduce questions that arise when such notices are received without any foundation. Not sending the Will to all beneficiaries can promote ill feelings and create suspicions in the beneficiaries who did not receive the Will.

# Legal Advertising

- The grant of letters should be advertised. See 20 Pa.C.S.A. § 3162.
  - Legal Advertising: PEF Code §3162: notice of the grant of letters should be advertised immediately, once a week for 3 successive weeks in the legal publication of the county where letters were granted, and in a newspaper of general circulation, published near where decedent resided.
- **Note:** Obtain proof of publication after notice has been published for inclusion in the petition for adjudication.

# Notice to the Department of Human Services

Begins the running of the 45 day clock on DHS  
to provide a Statement of Claim.

# Early in the Administration

- Check for Unclaimed Property
- Open Safe Deposit Boxes
- Have mail forwarded – fiduciary or counsel
- Opening checking account to pay bills – recommend counsel maintain
- Establish proper record keeping practices
- Collection and Valuation of assets
  - Bank Accounts, investment accounts, life insurance policies, Veteran's benefits, social security benefits
  - Real Estate – obtain valuations
  - Business interests – obtain valuations

# Inventory

An inventory is required to be filed no later than the filing of the Pennsylvania Inheritance Tax Returns under 20 Pa.C.S.A. § 3301 beneficiaries may request the filing of an inventory prior to the filing of Inheritance Tax Return.

# Payment of Debts

- Determine if there are sufficient assets to pay all known and possible debts of the decedent.
- Begin to make payments keeping accurate records of what was paid, with descriptions.
- Claims
  - There may be claims made against the estate. The executor has the duty to accurately determine the debts and not just deny proper payments.
- Beware of the Dead Man's statute which may preclude testimony by individuals. **Do not inadvertently waive the Dead Man's statute.** 42 Pa.C.S.A. § 5930.

# Taxes

- PA Inheritance Taxes

- PA inheritance tax return must be filed with Register of Wills within 9 months of date of death.

- May also apply for a 6 month extension of time for filing. Often used if real estate in the estate has not been sold.
- Determine who is to pay the tax. PEF Code Chapter 37: Apportionment of Death Taxes and 72 P.S. §§ 9136-9154 need to be read in conjunction with the tax clause (if any).

- Discount

- If Executor makes a payment on account of the PA inheritance tax within 3 months after the date of death, the estate will receive a 5% discount based on the amount paid.
  - Balance must be paid within 9 months of death to avoid interest charge.
  - While not common, in larger estates, make sure there is no Pennsylvania Estate Tax liability.

- Federal Estate Taxes

- If a federal estate tax return is required, taxes must be paid and returns filed within 9 months of date of death. Also can obtain a 6 month extension.

- Will 6 months alternate valuation benefit estate?

- If gross estate exceeds Federal estate tax credit of \$11,180,000.00 for 2019 a return must be filed.

- Protective federal estate tax return for Portability of unused federal estate tax credit to surviving spouse.

- Closing letter – No longer issued by the IRS but you can request one.

# Formal Settlement

- Filing of the accounting with the Court for approval of the administration and proposed distribution
- Pros/Benefits
  - The certainty of the administration is approved by the Court and discharge granted to the fiduciary.
  - Established methodology for reporting of information.
  - Fiduciary has some control over the timing.
    - Account is presumed correct
    - Objectants have the burden of proof for claims raised, except for fees and commissions
    - If objections are not timely filed they are usually not considered.

- Cons

- More costly and time consuming.

- Requires appropriate skill and proper form to be used.

- Most accounts are prepared using programs which can be expensive but greatly assist in general estate administration.

- Incorrect form may be rejected by the Court or objected to. See Pennsylvania Supreme Court Orphans' Court Rule 2.1 (any local variations)

- All aspects of the accounting are subject to Court review and the Court may sua sponte raise objections not raised by beneficiaries.

- Objections may be filed raising issues requiring litigation causing a delay in distribution.

# When Can an Account be Filed?

- Under Probate, Estates and Fiduciaries Code §3501.1, executor can file account at any time after 4 months after legal advertising.
- May be cited to file an accounting after the expiration of 6 months from the first complete advertisement of the original grant of letters (this can cause trouble sometime).
- The Court may direct the filing of an account **at any time**.
- Party must have standing or be an interested party or creditor to require an accounting (specific legatees paid in full have no standing).

## § 3501.1. Accounting by personal representative

- A personal representative may file his account at any time after four months from the first complete advertisement of the original grant of letters, but shall not file it earlier unless directed to do so by the court. A personal representative may be cited to file an account at any time after the expiration of six months from the first complete advertisement of the original grant of letters. A personal representative may be directed by the court to file an account of his administration at any time.

# § 3301. Duty of personal representative

## Subchapter A of Chapter 33 - Inventory

(a) **General assets.**--Every personal representative shall file with the register a verified inventory of all real and personal estate of the decedent, except real estate outside of this Commonwealth. An ancillary personal representative shall include in the inventory only assets for which he is responsible.

(b) **Real estate outside of Commonwealth.**--The inventory shall include at the end a memorandum of real estate outside of this Commonwealth. The memorandum, at the election of the personal representative, may indicate the value of each item of real estate included therein, but the values so fixed shall not be extended into the total of the inventory or included as real estate in subsequent accountings.

(c) **Time for filing.**--The personal representative shall file his inventory no later than the date he files his account or the due date, including any extension, for the filing of the inheritance tax return for the estate, whichever is earlier. Any party in interest in the estate may request the filing of an inventory at an earlier date by writing delivered to the personal representative or his attorney in which event **an inventory shall be filed within three months after the appointment of the personal representative or within 30 days after the request, whichever is later.** The court may direct the personal representative to file an inventory of estate assets at any time.

# Preparation of Accounting

- First step in preparing an accounting is to properly set up the recordkeeping process at the beginning. This will help the preparation of an accounting.
  - If possible have the checkbook, bank statements and other statements sent to and maintained by the law firm.
  - If using a program update the information on a regular basis to ease in the account preparation.
- Must list all transaction which occurred during the administration of the estate.
  - Showing initial values of assets, increases or decreases in values and how the money has been expended.
- Distributions made to the beneficiaries and proposed distributions are to be included.
- **Note:** Omitted assets or transactions not disclosed in the accounting are not covered by any adjudication approving the account.

# Preparation of Accounting

- When the estate is finally ready to wind up, the executor may prepare a fiduciary accounting in the form required by Supreme Court Orphans' Court Rule 2.1.
  1. This lists all transactions, including assets of value that have come into the estate, how much they were valued at, and how the money has gone out.
  2. It shows any distributions which have been made to the beneficiaries, and proposed distributions that are to be made to finalize the estate.
  3. Omitted assets or transactions are not covered by the Adjudication of the Account only included transactions are covered.

# The Requirements for a Model Account

## National Fiduciary Accounting Standards

- An account filed in Pennsylvania:
  - Accounts should be stated in a manner that is understandable by all persons who are not familiar with practices and terminology peculiar to the administration of estates and trusts.
  - A fiduciary account shall begin with a concise summary of its purpose and content.
  - A fiduciary account shall contain sufficient information to put the interested parties on notice to all significant transactions effecting the administration during the accounting.
  - A fiduciary account shall include both carrying values – representing the value of assets as acquisitioned by the fiduciaries – and current values at the beginning and end of the accounting period.
  - Gains and losses incurred during the accounting shall be shown separately in the same schedule.
  - The account shall show all significant transactions that do not affect the amount for which the fiduciary is accountable (investment accounts need to be identified and information shown).

NATIONAL FIDUCIARY  
ACCOUNTING STANDARDS  
PROJECT

1983 REPORT OF FIDUCIARY  
ACCOUNTING STANDARDS  
COMMITTEE

# Fiduciary Accounting

- **“Fiduciary Accounting”** does not have one commonly understood meaning. In a broad sense, it can mean the entire process whereby a fiduciary – normally a personal representative, trustee or guardian – communicates information on an on-going basis regarding his administration of a fund and periodically justifies his administration to the parties in interest and, perhaps, to a court. In another sense, it may be the process whereby a fiduciary – here more often a trustee – periodically keeps parties in interest currently informed of transactions and investment policies being followed.

# Advantages to Be Gained from Uniformity

- The manner in which a fiduciary records receipts and disbursements and gains and losses from investment during the course of administration is commonly dictated by local practice, court rule or statute. In many jurisdictions there is a lack of clarity or consistency regarding the form and content of such an accounting. A uniform form of account and the creation of guiding principles of accounting would be a most helpful development.

# Basic Objectives and General Standards of Fiduciary Accounting

- The fundamental objective of an account should be to provide essential and useful information in a meaningful form to the parties interested in the accounting process. It is also important that the account should be sufficiently simple to enable its preparation without unreasonable expense to the fund, or undue distraction from the on-going administration of the estate. Finally, although the parties should understand the nature of the accounting process and the need to protect their interests, the relationship of trust and confidence existing between the fiduciary and the beneficiaries is itself important and the account should not be presented in an adversary format that will unnecessarily impair this relationship.

# Competing Goals

- Maximum clarity, full disclosure and complete description and explanation of all events to be disclosed appear to be standards that all would accept. But, in combination, they may present many difficulties. For example, clarity may be obscured by the detail that is required for a disclosure that omits nothing. Full explanation of all investment decisions might produce a massive document that few beneficiaries would read. On balance, a set of flexible principles keyed to the standard of good faith supports the utmost protection of the parties and permits accounting standards to change and mature as circumstances require.

# Competing Goals (Cont'd)

- Fiduciary accounts rarely will be identical. In addition to the predictable variables of the size and composition of the assets, the period covered and the position of those interested, the significance of particular issues in a controversy may be illuminated by special accounting treatment of some portion of a fund. This suggests that a fiduciary should have enough flexibility to state an account in the manner best adapted to the particular circumstances and discourages any effort to prescribe a totally rigid format. Accordingly, the following principles are suggested as general standards for fiduciary accounting.

# Model Accounts

- Sample Estate is at page 111 of the materials.

# Fiduciary Accounting Principles

- Accounts should be stated in a manner that is understandable by persons who are not familiar with practices and terminology peculiar to the administration of estates and trusts.
- In order for an account to fulfill its basic function of communication, it is essential that it be stated in a manner that recognizes that the interested parties are not usually familiar with fiduciary accounts. It is neither practical nor desirable to require that accounts be tailored to meet individual disabilities of particular parties but any account should be capable of being understood by a person of average intelligence, literate in English, and familiar with basic financial terms who has read it with care and attention.

# A fiduciary account shall begin with a concise summary of its purpose and content

- Very few people can be expected to pay much attention to a document unless they have some understanding of its general purpose and its significance to them. Even with such an understanding, impressions derived from the first page or two will often determine whether the rest is read. The use that is made of these pages is therefore of particular significance.
- The cover page should disclose the nature and function of the account. While a complete explanation of the significance of the account and the effect of its presentation upon the rights of the parties is obviously impractical for inclusion at this point, there should be at least a brief statement identifying the fiduciary and the subject matter, noting the importance of examining the account and giving an address where more information can be obtained.

# A fiduciary account shall begin with a concise summary of its purpose and content

## (Cont'd)

- It is assumed that the parties would also have enough information from other sources to understand the nature of their relationship to the fund (e.g., residuary legatee, life tenant, remainderman), the function of the account, and the obligation of the fiduciary to supply further relevant information upon request.
- A summary of the account shall also be presented at the outset. This summary, organized as a table of contents, shall indicate the order of the details presented in the account and shall show separate totals for the aggregate of the assets on hand at the beginning of the accounting period; transactions during the period; and the assets remaining on hand at the end of the period. Each entry in the summary shall be supported by a schedule in the account that provides the details on which the summary is based.

A fiduciary account shall contain sufficient information to put the interested parties on notice as to all significant transactions affecting administration during the accounting period

- The presentation of the information in an account shall allow an interested party to follow the progress of the fiduciary's administration of assets during the accounting period without reference to an inventory or earlier accounting that is not included in the current account.
- An account is not complete if it does not itemize assets on hand at the beginning of the accounting period.

A fiduciary account shall include both carrying values—representing the value of assets at acquisition by the fiduciary—and current values at the beginning and end of the accounting period

- In order for transactions to be reported on a consistent basis, an appropriate carrying value for assets must be chosen and employed consistently.
- The carrying value of an asset should reflect its value at the time it is acquired by the fiduciary (or a predecessor fiduciary). When such a value is not precisely determinable, the figure used should reflect a thoughtful decision by the fiduciary. For assets owned by a decedent, inventory values or estate tax values—generally reflective of date of death values— would be appropriate.
- In the Model Account, carrying value is referred to as “fiduciary acquisition value.” The Model Account establishes the initial carrying value of assets as their value at date of death for inventoried assets, date of receipt for subsequent receipts and cost for investments.
- Carrying value would not normally be adjusted for depreciation.

# Gains and losses incurred during the accounting period shall be shown separately in the same schedule

- Each transaction involving the sale or other disposition of securities during the accounting period shall be shown as a separate item in one combined schedule of the account indicating the transaction, date, explanation, and any gain or loss.
- Although gains and losses from the sale of securities can be shown separately in accounts, the preferred method of presentation is to present this information in a single schedule. Such a presentation provides the most meaningful description of investment performance and will tend to clarify relationships between gains and losses that are deliberately realized at the same time.

# The account shall show significant transactions that do not affect the amount for which the fiduciary is accountable

- Transactions such as the purchase of an investment, receipt of a stock split or change of a corporate name do not alter the total fund for which a fiduciary is accountable but must be shown in order to permit analysis and an understanding of the administration of the fund. These can be best shown in information schedules.
- One schedule should list all investments made during the accounting period. It should include those subsequently sold as well as those still on hand. Frequently the same money will be used for a series of investments. Therefore, the schedule should not be totaled in order to avoid giving an exaggerated idea of the size of the fund.
- A second schedule (entitled “Changes in Investment Holdings” in the Model Account) should show all transactions affecting a particular security holding such as purchase of additional shares, partial sales, stock splits, change of corporate name, divestment distributions, etc.

# Distribution of Assets

- During the administration of an estate or trust the partial distribution of assets is a generally accepted practice. See 20 Pa.C.S.A. § 3532. Keep in mind the distribution is a “at risk” distribution and receipt, release and refunding agreements must be obtained.
- Generally during the administration of an estate a first and final account is the only account filed. See 20 Pa.C.S.A. § 762.
- Partial accounts may be filed to raise questions seeking Court guidance or to permit the beneficiaries to understand the status of the administration of the estate.
- Good practice to always prepare an account to share with beneficiaries whether formal or informal.
- Co-fiduciary disagreements may be raised by the filing of an accounting (or partial accounting to resolve the dispute.
  - Co-fiduciaries who are in disagreement should file a single accounting with each fiduciary providing an affidavit or otherwise documenting the entries to which they object or do not agree.

## § 3532. At risk of personal representative

- **(a) Rights of claimants against personal representatives.--**A personal representative, at his own risk and without the filing, audit or confirmation of his account, may distribute real or personal property and such distribution shall be without liability to any claimant against the decedent, unless the claim of such claimant is known to the personal representative within one year after the first complete advertisement of the grant of letters to such personal representative or thereafter but prior to such distribution.

# §3532 Continued

- **(b) Rights of claimants against distributed property.--**
- (1) Personal property.--No claimant shall have any claim against personal property distributed by a personal representative at his own risk pursuant to subsection (a) , unless the claim of such claimant is known to the personal representative within one year after the first complete advertisement of the grant of letters or thereafter but prior to such distribution.
- **(2) Real property.--**No claimant shall have any claim against real property conveyed by a personal representative in distribution at his own risk pursuant to subsection (a) hereof, unless such claimant, within one year after the decedent's death, files a written notice of his claim with the clerk. Such claim against real property shall expire at the end of five years after the decedent's death, unless within that time the personal representative files an account or the claimant files a petition to compel an accounting.
- **(3) Liens and charges existing at death.--**Nothing in this section shall be construed as affecting any lien or charge which existed at the time of the decedent's death on his real or personal property.

# §3532 Continued

- **(b.1) Limitation on rights of claimants.--**A personal representative may make written demand by mail or delivery to any person who may have a claim but who has not previously given written notice of his claim to the personal representative. If the personal representative's demand requests the person to give written notice of his claim within 60 days from the mailing or delivery of the demand or within one year from the first complete advertisement of the grant of letters, whichever is later, and the person fails to do so, the person shall not have any rights with respect to such claim under subsection (a) or (b)(1) and shall not have any right on account of such claim to receive notice of the filing of the personal representative's account and of its call for audit or confirmation. The personal representative shall not be liable to any such person or to any beneficiary, heir or next of kin or creditor of the estate for making or failing to make demand under this subsection.
- **(c) Record of risk distributions.--**The personal representative may file with the clerk receipts, releases and refunding agreements which he may have received from persons to whom he has made a risk distribution, or from other parties in interest. Receipts, releases and refunding agreements so filed shall be indexed under the name of the estate. Their acceptance shall not be construed as court approval of any act of administration or distribution therein reflected.

# Accounts

- An executor usually only files one account “First and Final Account”, however partial accounts of the administration to a date in the administration are advised if final accounts will be delayed because of complexities of an estate or lengthy administration; *See Cassatt Est.*, 105 Pa. Super. 14.
- *McLellan Ap.*, 76 Pa. 231: confirmation of partial accounts is conclusive only as to transactions contained in said account.
- *LaRocca Trust*, 485 Pa. 236: the Court’s direction to file a supplemental account is interlocutory and not appealable.
- Accounts can also be filed for guidance if a disagreement exists among fiduciaries.
- The form for an account is governed by Supreme Court Orphans’ Court Rule 2.1 which is based on old Supreme Court Orphans’ Court Rule 6.1.

## § 762. Accounts

- The orphans' court division may decide or dispose of any question relating to the administration or distribution of an estate or trust and exercise any of its powers in respect thereof upon the filing of an account or in any other appropriate proceeding. The account may be a complete accounting of the estate or trust or of only the transactions which raise the question to be determined.

# Surcharge of Fiduciaries

- The core concept of a surcharge is to put the beneficiaries or harmed parties in the same place as if the improper action or inaction had not occurred.
- **Surcharge** has been **defined** as the "penalty for failure to exercise common prudence, common skill and common caution in the performance of fiduciary duties." In re Estate of Dobson, 490 Pa. 476, 484, 417 A.2d 138 (1980). See also In re Estate of Campbell, 692 A.2d 1098, 1102 (Pa. Super., 1997); In re Estate of Geniviva
- **Surcharge** is **awarded** to compensate beneficiaries for loss occasioned by a fiduciary's breach of one or more of the duties owed to them. Restatement (Second) of Trusts, § 204 (1959); Dobson, *supra*. Surcharge is imposed for fiduciary's failure to fulfill duty of care. In re Estate of Geniviva, 450 Pa. Super. 54, 675 A.2d 306, 311, alloc. den., 546 Pa. 666, 685 A.2d 545 (1996);

# Conflict of Interest or Self-Dealing

- If the breach arises from a **conflict of interest or self-dealing**, a loss to the estate is not required to give the beneficiaries a remedy against the fiduciary. Estate of McCredy, 323 Pa. Super 268, 470 A.2d 585 (1983); Restatement (Second) of Trusts, § 170 (1959); Cunningham Trust, 12 Fiduc. Rep. 2d 94 (O.C. Montg. Co. 1991).
- There must be a loss- In re Mendenhall, 484 Pa. 77, 398 A.2d 951, 954 n. 3 (1979); Estate of Pew, 440 Pa. Super. 195, 655 A.2d 521, 542 (1994).

# How to Remedy Self-Dealing

- Even if the fiduciary acted in good faith and paid fair consideration. Estate of Banes, 452 Pa. 388, 305 A.2d 723 (1973);
- Remedy- At the beneficiary's pleasure, affirm the transaction and obtain sum lost; or, disavow the transaction and restore status quo at expense of fiduciary. Tracy v. Central Trust Company, 327 Pa. 77, 192 A. 869 (1937); Restatement (Second) of Trusts, § 206, Comment c (1959).
- Removal - A court of common pleas is authorized to remove an administrator where a conflict of interest is apparent from the circumstances. In re Estate of Gadiparthi, 158 Pa. Commw. 942, 632 A.2d 942, 946 (1993).

# Burden of Proof and of Going Forward

- Generally, those seeking surcharge bear the burden of proving, by a fair preponderance of the evidence, the breach and the loss. Estate of Pew, 440 Pa. Super. 195, 655 A.2d 521, 543 (1994); Federoff Estate (No. 2), 7 Fiduc. Rep. 2d 325, 327 (O.C. Allegh. Co. 1987) and cases cited. See, R.W. Tredinnick, "Presumptions and the Burden of Proof in Orphans' Court Litigation", 7 Fiduc. Rep. 2d 102, 127-131 (1987).
- **EXCEPTION:** Where a fiduciary commits "patent error," the burden shifts to the fiduciary to present evidence to demonstrate prudence; if this burden is not met, breach may be found. In re Estate of Campbell, 692 A.2d 1098, 1104 (Pa. Super., 1997) (failure to timely file inheritance tax return is patent error).
- Other examples of patent error include: In re Estate of Ellis, 460 Pa. 281, 333 A.2d 728 (1975) (payment of unnecessary real estate commissions).
- In re Estate of Lohm, 440 Pa. 268, 269 A.2d 451 (1970) (overpayment of taxes)
- In re Estate of Geniviva, 450 Pa. Super. 54, 675 A.2d 306, 311, alloc. den., 546 Pa. 666, 685 A.2d 545 (1996) (failure to timely file tax returns).

# Exculpatory Provisions

- Exculpatory or immunity provisions can relieve a fiduciary of liability for certain acts in certain circumstances. Markle Estate, 182 Pa. 378, 38 A. 612 (1897). See also, Wanamaker Estate, 105 Montg. Co. 372; Sullivan Trust, 21 Fiduc. Rep.2d 187 (O.C. Berks 2001).
- Such a clause will not protect a fiduciary that misused trust assets or engaged in self-dealing. Abbott Trust, 3 Fiduc. Rep. 2d 243 (O.C. Allegh. Co. 1983).

# Loss is Necessary

- In re Mendenhall, 484 Pa. 77, 82 n.3, 398 A.2d 951, 954 n.3 (1979); Estate of Pew, 440 Pa. Super. 195, 655 A.2d 521, 542 (1994). Can escape liability if sound reasons underpin decision to retain investment producing loss so long as trustee can articulate them for the court. Disston Trust, 3 Fiduc. Rep. 2d 359 (O.C. Phila. Co. 1983).
- No duty to produce greater profits. Where there is no loss (and in fact some gain) from authorized investments, there can be no surcharge even if greater skills not applied: no duty to produce appreciation equal to Dow Jones or other similar indices. Killey Trust, on remand, 29 Fiduc. Rep. 437 (O.C. Phila. Co. 1979). For criticism, see Pennsylvania Law Journal Reporter, April 13, 1981, Vol. IV, No. 4, at 11.

- Overall portfolio evaluation approach, see Hirsch, *supra*; Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U.L. Rev. 52 (1987) (Prudent Man Rule should be updated to include portfolio investment theory). Cf. *Estate of McCredy*, *supra*. (Challenged investments reviewed in overall scheme of individual trustee's investment plan); *Burchfield Trust*, 1 Fiduc. Rep. 2d 248 (O.C. Allegh. Co. 1978) (court noted but did not rely upon "fine performance of the bank").
- Normally, paper losses alone will not support a surcharge. *Smith Trust*, 21 Fiduc. Rep. 312 (O.C. Bucks Co. 1971). However, see *Scharlach Estate*, 809 A.2d 376 (Pa. Super. 2003).

# Pennsylvania's Prudent Investor Rule

- Pennsylvania adopted its own Prudent Investor Rule (“Pa. Rule”) on June 25, 1999, by Act No.28 of 1999 as new Chapter 72 of the Probate Estates and Fiduciaries Code, 20 Pa.C.S. (“PEF Code”). The Pa. Rule is modeled on the Uniform Prudent Investor Act formulated by the Uniform Law Commissioners in 1994, now adopted by a majority of states.
- The Pa. Rule applies to all actions of fiduciaries on or after December 25, 1999, regardless of when the trust was created. For exceptions to this, see §§ 7204 (Diversification), 7206 (Delegation) and 7208 (Life Insurance).
- The general rule (§ 7203): “ A fiduciary shall invest and manage property held in a trust as a prudent investor would, by considering the purposes, terms and other circumstances of the trust and by pursuing an overall investment strategy reasonably suited to the trust.”
- (1) The rule permits the fiduciary to invest in every kind of property and type of investment consistent with Chapter 72;
- (2) The rule provides a nonexclusive list of eight (8 ) considerations to be included in investment decisions, e.g., the size of the trust; tax consequences of the proposed investment; income and resources of beneficiaries.

# Diversification and Delegation

- Diversification (§ 7204): A fiduciary “shall reasonably diversify investments, unless;
  - (1) He reasonably determines that it is in the beneficiaries’ interests not to diversify in light of the requirements of Chapter 72 of the PEF Code;
  - (2) He reasonably elects to retain any asset received in kind (§ 7205).
- Delegation (§ 7206): A fiduciary may delegate “investment and management” that a prudent investor “might delegate under the circumstances.” See Solmssen, Jr., Delegation of Trustee’s Investment Discretion, 19 Fiduc. Rep.2d 398 (1999).
  - (1) Fiduciary exonerated from liability for agent’s acts if he exercises “reasonable care, skill and caution” in selecting the agent; establishing the terms of the delegation; and periodically reviewing the agent’s performance.
  - (2) Agent is liable to trust for failing to comply with the terms of delegation; to exercise reasonable care skill and caution; or to exercise any special investment skills he has claimed to have.
  - (3) A co-fiduciary may delegate to another if he reasonably believes the other has greater investment skills. Delegator is exempt from liability under the fiduciary/agent rule outlined above.
  - (4) Investment in mutual fund is not a delegation.

# Other Provisions

- Uninvested Funds - If the Fiduciary reasonably expects within 90 days to: distribute them as income; disburse them for administration of the trust; or reinvest, or if the amount makes investment unjustifiable. (§7207).
- Life insurance (§ 7208): Trustee may acquire or retain life insurance on settlor and/or
- Spouse. No liability for loss where trustee fails to:
  - determine the propriety of this
  - investment: investigate the issuer; exercise available non-forfeiture provisions; or diversify
  - the contract.

# Mutual Funds - Watch Captive Funds

- Mutual funds (§ 7209): A corporate fiduciary may invest in a mutual fund which it also services for compensation, so long as the portfolio of the fund consists “substantially” of investments not prohibited by the governing instrument.
- The basis of the fiduciary’s compensation for services to the fund must be disclosed by prospectus.
- Corporate fiduciary and its co-fiduciary may invest in its own, or its affiliate’s, common trust funds, and/or in its own mortgage investment fund. (§ 7210).
- Unless the instrument clearly expresses a contrary intent, a corporate fiduciary may invest in its own mutual and common or collective funds if they consist of investments permitted by the governing instrument. (§ 7211).

# Degree of Care and Standard of Conduct

- Degree of Care (§ 7212): “Reasonable care, skill and caution”, or those “special investment skills” it claims to have.
- Standard of conduct (§ 7213) Fiduciary to be judged on conduct, not results. Determination of compliance to be based on circumstances at time of conduct in question.
- A Fiduciary not liable if he acted in substantial compliance with Chapter 72 or in reasonable reliance on the governing instrument.