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IN THE
ARIZONA COURT OF APPEALS
DIVISION ONE

In the Matter of:

OAKLAND LIVING TRUST.

CATHERINE S. FELLERS and GARY D. BAILEY, Beneficiaries of the
Oakland Living Trust, *Petitioners/Appellants*,

v.

JAMES E. BAILEY, Successor Trustee of the Oakland Living Trust; and
VICTORIA NORRIS, Beneficiary of the Oakland Living Trust,
Respondents/Appellees.

No. 1 CA-CV 16-0073
FILED 6-13-2017

Appeal from the Superior Court in Maricopa County
No. PB2014-000972
The Honorable Edward W. Bassett, Judge

AFFIRMED

COUNSEL

Margaret Frank Schweitzer Law PLLC, Scottsdale
By Margaret Schweitzer
Counsel for Petitioners/Appellants

Sacks Tierney PA, Scottsdale
By Andre H. Merrett
Counsel for Respondent/Appellee

MEMORANDUM DECISION

Judge Kent E. Cattani delivered the decision of the Court, in which Presiding Judge Peter B. Swann and Judge Donn Kessler joined.

C A T T A N I, Judge:

¶1 Trust beneficiaries Catherine Fellers and Gary Bailey appeal from the superior court’s ruling denying their petition to remove James Bailey as trustee of the Oakland Living Trust (the “Trust”).¹ For reasons that follow, we affirm.

FACTS AND PROCEDURAL BACKGROUND

¶2 Patricia Oakland established the Oakland Living Trust, naming her four children—Catherine, Gary, James, and Victoria Norris—as beneficiaries, each entitled to a 25% share after her death. The Trust named James as successor trustee, and he assumed that role when Oakland died on November 28, 2011. In December 2011, after consulting with the beneficiaries, James hired a Missouri attorney, Robert Reams, as counsel for the Trust.

¶3 Early on, all four siblings met to divide Oakland’s personal property, and they decided not to charge the value of the property against each beneficiary’s pro rata share. The beneficiaries took some of the property immediately, and James stored other property at a facility near his home in Missouri.

¶4 In early 2012, the Trust collected Oakland’s Hallmark group life insurance benefits (~\$11,000) and funds from a Waddell and Reed money market account (~\$112,000) and distributed most, but not all, of the proceeds to the beneficiaries. James offset the distributions to himself and to Gary to account for debts each owed to Oakland before her death, although Gary disputed the amount of his debt and asserted that Oakland had forgiven the remainder owing. By that time, the Trust had also arranged for Oakland’s Waddell and Reed IRA (~\$475,000) to be rolled over into four separate IRAs, one for each beneficiary.

¹ To avoid confusion, we refer to the parties by first name.

FELLERS, et al. v. BAILEY, et al.
Decision of the Court

¶5 In April 2012, James elected to have the Trust receive death benefits from Oakland's Protective Life IRA (~\$180,000) in a lump sum payment, triggering immediate tax liability of approximately \$50,000. Over the rest of that year, Reams, James, and Catherine attempted to convince Protective Life to roll the proceeds over into individual IRAs for the beneficiaries instead, but, according to Reams, the company simply "declined to follow [their] theory." The Trust received the Protective Life funds and paid the taxes required, but James did not distribute the proceeds.

¶6 The Trust's other major initial asset was Oakland's house in Phoenix, which the Trust leased to a tenant beginning in June 2012.

¶7 The siblings' relationship soured over the first years after Oakland's death, and by mid-2012 Catherine and Gary had stopped speaking with James and Victoria altogether. And despite the siblings' agreement regarding distribution of the personal property, James requested appraisals of a car received by Catherine and jewelry received by Catherine and Victoria and apparently subtracted the value of those assets from their shares of the Trust. James at one point also prevented Gary from retrieving his share of the personal property from storage due to friction with Gary and Catherine.

¶8 When Reams provided an inventory of Trust assets and Trust tax documents in April 2013, Catherine and Gary were not satisfied that James had accounted for all Trust assets, and further noted that the inventory lacked even basic detail of funds received and did not include certain income or expenses (e.g., rent and maintenance costs from the Phoenix house) at all. Reams issued an updated first-year inventory in September 2013, addressing some but not all of the issues raised.

¶9 Catherine and Gary contended that Oakland's Bank of America and AmTrust bank accounts and certificates of deposit should also have been included as Trust assets. Victoria had been added to each account as a joint owner before Oakland's death, and although she gave each sibling \$13,000 from one of the CDs, she later decided not to distribute the remaining funds. Catherine and Gary contended that Victoria had been added to the accounts for the limited purpose of paying bills immediately upon Oakland's death, that the Trust specified that all Oakland's bank accounts were Trust assets, and that Oakland had told the siblings that the

FELLERS, et al. v. BAILEY, et al.
Decision of the Court

accounts should be distributed. Reams, however, concluded that these accounts belonged to Victoria, not the Trust.²

¶10 Then, in September 2013, Catherine and Gary learned that James, Victoria, and her husband had purchased the Phoenix house from the Trust two months earlier. James had never notified them of the sale and never sought their consent to the transaction. The value of the house was set at \$255,000 by an independent appraisal through a title company, but James and Victoria reduced the purchase price by 6% on the basis that as seller, the Trust would usually pay a 6% commission; James discussed the price reduction with Reams, who approved. Accordingly, James and Victoria received their shares of the house as in-kind distributions, and paid half of the purchase price into the Trust (~\$120,000) to cover Catherine and Gary's shares. The proceeds, however, were never distributed to Catherine and Gary.

¶11 When Catherine and Gary pressed James on these issues – and particularly after Catherine, later joined by Gary, filed a petition for an accounting in a Missouri court – James raised the Trust's no contest clause, under which they would risk forfeiting their interests in the Trust.

¶12 In mid-2014, Catherine and Gary filed the instant petition in Arizona seeking removal of James as trustee, which the Trust opposed. After a three-day evidentiary hearing at which all four siblings testified, the superior court denied the removal petition. After the court denied their

² Additionally, Gary believed James had concealed a life insurance policy owned by Oakland covering Gary's life.

Catherine and Gary also later learned that Oakland had owned an annuity with Fidelity and Guaranty Life ("FGL") that James had not disclosed. James explained, however, that the individual siblings, not the Trust, were beneficiaries of the FGL annuity, and Gary later acknowledged that the Trust was not a beneficiary and that he had received proceeds individually as a beneficiary.

motion for new trial, Catherine and Gary timely appealed.³ We have jurisdiction under Arizona Revised Statutes (“A.R.S.”) § 12-2101(A)(1).⁴

DISCUSSION

¶13 Catherine and Gary contend that the superior court erred by denying their petition to remove James as trustee. We review this ruling for an abuse of discretion. *See* A.R.S. § 14-10706; *In re Estate of Newman*, 219 Ariz. 260, 270–71, ¶¶ 39–40 (App. 2008) (as amended).

¶14 A trustee owes fiduciary duties to trust beneficiaries, and breach of such a duty is a breach of trust. *See* A.R.S. § 14-11001(A); *see also* A.R.S. §§ 14-7402(B), -10801 to -10814. As relevant here, these duties include: the duty of loyalty, A.R.S. § 14-10802, the duty of impartiality, A.R.S. § 14-10803, the duty of prudent administration, A.R.S. § 14-10804, the duty to delegate authority reasonably and responsibly, A.R.S. § 14-10807, the duty to control and protect trust property, A.R.S. § 14-10809, the duty to inform and report to the beneficiaries, A.R.S. § 14-10813, and the duty to administer the trust in good faith, in accordance with its terms, and in the beneficiaries’ interests, A.R.S. § 14-10801.

¶15 The superior court has discretion to remove a trustee in the case of a material breach of trust or (if it finds removal would best serve the beneficiaries’ interests) in the case of persistent failure to administer the trust for the beneficiaries’ benefit. A.R.S. § 14-10706(B)(1), (3). Removal is only one possible remedy for breach of trust, and courts show a measure of deference to the settlor’s choice of trustee, particularly if another remedy would adequately address the breach. *See* A.R.S. § 14-11001(B); *Estate of Newman*, 219 Ariz. at 270, ¶ 39; Restatement (Third) of Trusts (“Restatement”) § 37 cmt. f (2003).

¶16 Catherine and Gary cite to several alleged breaches that they argue warranted removal. But even though the superior court would have

³ The Trust also filed a petition for approval of a final accounting and distribution of Trust assets, which remains pending. After denial of the removal petition, James petitioned to forfeit Catherine and Gary’s interests based on the Trust’s no contest clause, and Catherine and Gary cross-petitioned to forfeit James and Victoria’s interests. The court has since denied the petition regarding Catherine and Gary’s interests, and the other remains pending.

⁴ Absent material revisions after the relevant date, we cite a statute’s current version.

FELLERS, et al. v. BAILEY, et al.
Decision of the Court

been justified in ordering removal based on the evidence presented, we defer to the court's exercise of discretion because removal was not mandatory as a matter of law. As described below, in each instance the superior court heard evidence from which it could find either that no breach had occurred or that the breach of trust did not warrant removal.

A. Loyalty.

¶17 Catherine and Gary argue that James breached his duty of loyalty by selling the Phoenix house to himself and Victoria, and particularly by doing so without notice to Catherine and Gary. Despite James's protestations to the contrary, this transaction clearly constituted self-dealing, which created a conflict between his personal interests and his fiduciary duty of loyalty. See A.R.S. § 14-10802(B) (restricting a trustee's ability to enter a sale "for the trustee's own personal account or that is otherwise affected by a conflict between the trustee's fiduciary and personal interests"); *Lane Title & Tr. Co. v. Brannan*, 103 Ariz. 272, 278 (1968) (noting a trustee's duty of "undivided loyalty" to beneficiaries); Restatement § 78(2) (2007) ("Except in discrete circumstances, the trustee is strictly prohibited from engaging in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests.").

¶18 Nevertheless, the court could reasonably conclude that James's sale and purchase of the Phoenix house did not require his removal as trustee. Although James admittedly did not seek Catherine and Gary's consent to the sale, see Restatement § 78 cmt. c(3), there was evidence (albeit disputed) that Catherine and Gary knew or should have known of James and Victoria's interest in purchasing the house by April 2013. Moreover, although James did not appoint a special co-trustee to render an independent valuation of the property (as authorized, but not required, under the terms of the Trust), the appraisal was conducted through the title company independent of James's control, and there is no indication that the appraisal did not accurately represent fair market value. While discounting the price by 6% for an imputed seller's commission would understate the value of property received by James and Victoria as an in-kind distribution, the superior court could—and later did—correct this imbalance by adjusting the Trust's accounting rather than removing Oakland's chosen trustee. And throughout the transaction, James consulted and relied on advice of counsel, a factor weighing against a finding of bad faith.

B. Impartiality.

¶19 Catherine and Gary argue James violated his duty of impartiality through disparate treatment of the beneficiaries. A trustee is required to “act impartially in investing, managing and distributing the trust property, giving due regard to the beneficiaries’ respective interests.” A.R.S. § 14-10803. As Catherine and Gary note, James and Victoria received an in-kind distribution of their shares of the real property by purchasing the house, but their payment to the Trust to cover Catherine and Gary’s shares was never distributed. But the court could conclude that, while this resulted in disparate treatment, James’s decision not to distribute the cash proceeds in order to retain sufficient funds for litigation and other expenses did not warrant removal. And, without resorting to removal, the court could—and has begun to—balance the distributions as part of its supervision of the final accounting.⁵

¶20 Catherine and Gary further argue that James breached this duty by accepting his own calculation (without documentation) of his debt to Oakland while concurrently failing to accept Gary’s word regarding Gary’s debt. The evidence showed, however, different circumstances underlying the two debts: while there was no evidence of any written documents regarding James’s debt, James presented handwritten documentation (albeit disputed) of Gary’s debt. And although the court later calculated Gary’s debt differently, that alone does not establish disparate treatment warranting removal.

C. Prudent Administration.

¶21 Catherine and Gary further contend that, by failing to promptly distribute funds and by taking a lump sum payment of the Protective Life IRA, James breached his duty to prudently administer the trust according to its terms. A trustee must use reasonable care, skill, and caution to administer the trust “as a prudent person would” in light of the trust’s particular terms. A.R.S. § 14-10804; *see also* A.R.S. § 14-10902(A).

¶22 Despite collecting proceeds from the Protective Life IRA in December 2012 and later from the sale of the house in July 2013, James made no cash distributions after the initial distributions in early 2012. But the Trust does not provide beneficiaries an entitlement to any particular

⁵ As part of that balancing of distributions, the superior court may consider awarding Catherine and Gary interest on the funds owed to them to account for the earlier distribution of assets to James and Victoria.

distributions of their trust share. While Catherine and Gary rely on the Trust's criteria for postponing a distribution to a single beneficiary under certain circumstances, the Trust further provides the trustee wide discretion to distribute to each beneficiary "as [the] Trustee determines is necessary," considering the beneficiary's reasonable needs and other resources. Particularly given the risk of and, as of mid-2013, active litigation, the superior court could conclude that James's decision to retain funds to account for Trust expenses was not imprudent.

¶23 Catherine and Gary argue that James's decision to receive a lump sum payment of death benefits from Oakland's Protective Life IRA — with its adverse tax consequences — was imprudent and contrary to the Trust's terms allowing alternative methods for tax minimization. *See also* A.R.S. § 14-10902(C)(3) (expressly noting tax consequences as a consideration relevant to prudent asset management). But the evidence presented supports the conclusion that, despite efforts by James (and Catherine and Reams) to effectuate a roll over into individual IRAs for the beneficiaries, the annuity company declined to do so. Accordingly, the court could reasonably conclude that James's treatment of the Protective Life IRA funds did not show a breach of his duty to administer the trust prudently.

D. Delegation.

¶24 Catherine and Gary assert that James improperly delegated authority to Victoria and to Reams. "A trustee may delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances," but must exercise reasonable care in selecting, managing, and supervising the agent. A.R.S. § 14-10807(A).

¶25 Catherine and Gary argue that James impermissibly listed Victoria as co-trustee on the Trust's bank account and authorized Victoria to receive Oakland's mail and pay household bills. But James testified that the co-trustee designation on the bank account was the result of an error by the bank (he had requested she be included as successor trustee, per the Trust's terms), that there was no indication she had ever actually accessed the account, and that he corrected the mistake as soon as Catherine and Gary brought it to his attention. And the record reflects that James supervised and directed Victoria's other actions on behalf of the Trust.

¶26 Catherine and Gary further contend that James impermissibly delegated authority to Reams, the Trust's attorney. But, as they acknowledge, a trustee may properly consult with legal counsel. *See*

FELLERS, et al. v. BAILEY, et al.
Decision of the Court

Restatement § 80 cmt. b (2007). And James testified that, although he relied on advice of counsel regarding legal questions, as trustee he retained the independent responsibility and authority to make the ultimate decision. Accordingly, the court could reasonably conclude that James had not impermissibly delegated his authority as trustee.

E. Control and Protect Trust Property.

¶27 Catherine and Gary argue that James improperly failed to marshal all Trust assets, including Oakland's bank accounts and certificates of deposit, the FGL annuity, and various bonds. A trustee must "take reasonable steps to take control of and protect the trust property." A.R.S. § 14-10809.

¶28 Catherine and Gary assert that Oakland intended her checking and savings accounts and certificates of deposit to be Trust assets, and that James and the other beneficiaries had so agreed until Victoria changed course and kept the funds for herself. The only evidence presented, however, was that Victoria and Oakland were joint owners of these accounts, and "on the death of a party, sums on deposit in a multiple party account belong to the surviving party or parties." A.R.S. § 14-6212(A). While Catherine and Gary contended that Oakland added Victoria's name to the accounts for a limited purpose, there was no evidence that the accounts were actually titled in that manner. Nor did they present any evidence that Reams, who opined that the accounts legally belonged to Victoria, failed to adequately investigate before rendering that opinion.

¶29 Catherine and Gary also assert that James concealed the existence of Oakland's FGL annuity. But, as Gary acknowledged, the individual siblings, not the Trust, were named as beneficiaries of the FGL annuity, which supports the conclusion that this was not a Trust asset at all. And although Catherine and Gary now assert that James failed to timely discover several treasury bonds, no such evidence was presented to the superior court. Under the circumstances, the court could conclude that James had not breached this duty because the allegedly missing assets were not in fact Trust assets.

F. Inform and Report to Beneficiaries.

¶30 Catherine and Gary argue that James breached his duty to provide timely and complete accountings and inventories. By the terms of the Trust and under Arizona law, the trustee has a duty to "keep the qualified beneficiaries of the trust reasonably informed," to "promptly respond to a beneficiary's request for information," and to provide annual

FELLERS, et al. v. BAILEY, et al.
Decision of the Court

reports delineating, among other things, trust assets, liabilities, distributions, and expenses. A.R.S. § 14-10813(A), (C).

¶31 Catherine and Gary’s arguments regarding the adequacy of the inventories and accountings provided largely depend on their other arguments—for instance, overstating Gary’s debt or omitting Oakland’s bank accounts and certificates of deposit from Trust assets—that we have rejected. And although the proposed final accounting has required multiple modifications and has not yet been approved, the existence of such mistakes does not, in itself, mandate removal.

G. Administer in Good Faith.

¶32 Finally, Catherine and Gary assert that the hostility and lack of communication between James and the beneficiaries represented a breach of his duty to administer the trust in good faith. A trustee must “administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries.” A.R.S. § 14-10801. Hostility between trustee and beneficiary is not generally sufficient by itself to justify removal of the trustee, although such hostility does not relieve the trustee of his duty to administer the trust properly and in good faith. *See* Restatement § 37 cmt. e(1).

¶33 Although there is no doubt that the parties’ relationship became strained, the superior court nevertheless retained discretion to conclude that removal was not warranted. While James eventually stopped speaking with Catherine and Gary, Catherine and Gary nevertheless continued to receive Trust communications through counsel. And, as described above, the court reasonably concluded that the alleged breaches of trust did not warrant removal. Under these circumstances, the court could reasonably conclude that the inchoate hostility alleged could be otherwise managed and did not represent a material breach justifying removal.

FELLERS, et al. v. BAILEY, et al.
Decision of the Court

CONCLUSION

¶34 We affirm the superior court's denial of the petition to remove James as trustee. In an exercise of our discretion, we deny Catherine and Gary's request for an award of attorney's fees under A.R.S. § 14-11004(B).



AMY M. WOOD • Clerk of the Court
FILED: JT