Jackson et al v. Mercantile Safe Deposit and Trust Company Doc. 181

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

JAMES H. JACKSON, ET AL.	:	
	:	
v.	:	CIVIL NO. CCB-08-3048
	:	
MERCANTILE SAFE DEPOSIT & TRUST COMPANY	:	
	:	

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MEMORANDUM

In 1935, Felix Walton Jackson established the Felix Walton Jackson Trust ("Jackson Trust") funded by $100,000 from his father Felix P. Jackson, a wealthy businessman and owner of a Philadelphia steamship company.[1] Net income was to be paid to the father during his lifetime and thereafter to Felix Walton Jackson's children, during their lifetime. Termination and distribution of principal was not to occur until 21 years after the death of the last surviving child. Mercantile Safe Deposit and Trust Company ("Mercantile") was appointed as trustee.[2] When Mercantile sought to resign as trustee in 2007, over 70 years later, the trust had paid income of over $500,000; but the corpus was worth approximately $300,000, although the 2008 value of $100,000 in 1935, adjusted for inflation, was over $1.5 million. (Plfs.' Ex. 7). The Trust's annual income of $3,012 in 1941 had the buying power of over $44,000 in 2008 dollars, *id.*, yet the annual income stream was only $6,088 in 2007 (Plfs.' Ex. 5).[3] One of the income beneficiaries, Felix Walton Jackson's son James, and a remainder beneficiary, James's daughter Felicia Freeman, sued Mercantile in South Carolina state court in June 2007 for mismanagement

[1] Felix P. Jackson also funded similar trusts for his other two sons, Milton and Edward. This suit involves only the Felix Walton Jackson trust.

[2] The initial trustee was Safe Deposit and Trust Company, Mercantile's predecessor. Mercantile was taken over by PNC prior to trial.

[3] It had been higher from 1981 to 2001, but never more than $16,000. (Plfs.' Ex 5).

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of the trust.[4] After removal to federal court, various counts were dismissed, the case was transferred to Maryland, and thereafter transferred to the undersigned for trial, which proceeded in February and March 2011.[5] What follows constitutes the court's findings of fact and conclusions of law under Fed. R. Civ. P. 52. For reasons explained below, a judgment will be rendered in favor of the plaintiffs in an amount to be calculated consistent with this opinion.

Preliminarily, the court will outline the legal standard applicable to the remaining claim, breach of fiduciary duty. As initially determined by the U.S. District Court in South Carolina, Maryland law applies to this case.[6] Under *Kann v. Kann*, 690 A.2d 509 (Md. 1997), a beneficiary's claim against a trustee for breach of fiduciary duty in the administration of the trust arises only in equity; punitive damages and a jury trial are not available. *Id*. at 520-21.

Mercantile suggests that the standard for evaluating its performance as a fiduciary changed in 1994, when Maryland adopted the "Prudent Investor" rule in place of the "Prudent Person" rule. Mercantile refers to the enactment of statutory provisions effective October 1, 1994; most relevant are Md. Code. Ann. § 14-405(c), which provides that:

> In administering trust property, a trustee shall observe the standard of care that would be observed by a prudent person dealing with property of another and is not limited by any other statute restricting investments by fiduciaries;

and § 15-114(b)(1), stating that:

> A fiduciary shall: Invest and manage fiduciary assets as a prudent investor would, considering the purposes, terms, distribution requirements, and other circumstances of the governing instrument and the nature of the fiduciary appointment.

[4] The suit originally filed in South Carolina asserted claims for professional negligence, breach of contract, and failure to supervise, as well as breach of fiduciary duty and accounting. The other income beneficiaries, Felix Walton Jackson, Jr., and Felicia Jackson Burns did not join the lawsuit.
[5] The Maryland state court granted Mercantile's petition for resignation in December 2008 but Mercantile did not actually turn over the account until August 2009 after the fee structure was changed. (Tr. 2/1/11 at 166-67).
[6] See "Order on Motion for Judgment on the Pleadings," filed June 24, 2008 (ECF No. 54).

Mercantile overstates the significance of the change in Maryland law, at least as applied to the facts in this case. In *MNB v. Cummins*, prior to the 1994 statute, the Court of Appeals explained that: "Maryland follows a prudent person standard for investment by fiduciaries . . . . [The trustee's] duty is not necessarily to maximize the return on investments but rather to secure a 'just' or 'reasonable' return while avoiding undue risk." 588 A.2d 1205, 1209-10 (Md. 1991) (internal quotations and citations omitted). In applying that standard, the court referred to a "prudent investor," as well as a "prudent person," analyzing the question presented in that case as whether a prudent investor would invest trust cash rather than leaving it for several months in a non-interest bearing account. *Id.* at 1210. In finding that the cash should have earned interest, the Court of Appeals cited earlier cases and a treatise dating back to 1960, quoting G. Bogert, *The Law of Trusts and Trustees* § 541 (2d ed. 1960) for the principle that "in all management of the trust a trustee is required to manifest 'the care, skill, prudence, and diligence of an ordinarily prudent [person] engaged in similar business affairs and with objectives similar to those of the trust in question.'" *Id.* In 2001, the Court of Special Appeals applied that standard, referring to a "prudent person," in *Helman v. Mendelson*, 769 A.2d 1025, 1036-37 (Md. App. 2001) in concluding that remainder beneficiaries were "well-cared for" where the trust corpus grew from $420,000 to over $20 million in the course of 24 years, even though the trustees "might have invested more aggressively than they did." *Id.* at 1038. Also in 2001, the Court of Appeals explained that the "linchpin" of its holding in *Cummins* regarding lost investment income was "the duty of a trustee to manifest "the care, skill, prudence, and diligence of an ordinarily prudent [person] engaged in similar business affairs and with

the objectives similar to those of the trust in question." *Buxton*, 770 A.2d 152, 163 (Md. 2001) (internal citations omitted). In the context of this case, it appears to the court that the change in the applicable standard makes little, if any, difference, given the similarity in analysis of Maryland law at least since 1960 illustrated by *Cummins*, *Helman*, and *Buxton*. Further, both experts in this case agreed that Mercantile at all times had a fiduciary duty to earn a reasonable rate of return on trust assets. (Tr. 3/7/11 at 61; Tr. 3/8/11 at 82, 186-87.) Given the long-term expected existence of the trust, and the need to consider interests of both income beneficiaries and remaindermen, *Helman,* 769 A.2d at 1037-38; *York v. Md. Trust Co.*, 131 A. 829, 833 (Md. 1926), it is not reasonable to suggest that merely preserving the initial corpus would be appropriate.

Under Maryland law, the burden is on the plaintiff to establish that Mercantile breached a fiduciary duty and that the Trust suffered loss as a result. Once the plaintiffs proffer such evidence, the burden shifts to the trustee to offer evidence to rebut the allegation. *Cummins*, 588 A.2d at 1210; *Goldman v. Rubin*, 441 A.2d 713, 724 (Md. 1982) (*quoting Lopez v. Lopez*, 243 A.2d 588, 594 (Md. 1968)).[7]

Several terms of the Trust are of particular importance in evaluating Mercantile's performance. One stated that the trustee should "invest and keep invested the principal in such securities as trustee may deem prudent, without restriction to so-called legal investments, provided, however, that no investment shall be made in any securities in the marketing, buying, or selling of which trustee has any interest, direct or indirect." (Jt. Ex. 1 at ¶ 6).[8]

The Trust also included a "spendthrift" provision that stated:

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[7] The Restatement (Second) of Trusts explains that: a trustee is chargeable with: (a) any loss or depreciation in value of the trust estate from breach; (b) any profit made through breach; and (c) any profit which would have accrued to the trust estate if there had been no breach of trust. § 205.

[8] *See also* Jt. Ex. 10, Investment Review form.

> <u>Fifth</u>: All the shares of principal and income hereby given shall be paid and distributed to several beneficiaries upon their own individual receipts only, and shall in no way or manner be subject or liable to their, or any of their, alienation, anticipation, sale, assignment, pledge, debts, contracts, engagements, orders, obligations or liabilities, and shall not be subject to any levy, execution, attachment, sequestration or seizure.

(Jt. Ex. 1 at ¶ 5).

Both sides called experts to testify at trial. The plaintiffs' expert, John Rodgers, has extensive experience in the administration of personal trusts by a bank trust department, including service as head of a trust investment committee and trust advisory committee. (Plfs.' Ex. 138.) He testified at trial that a reasonable allocation of the portfolio, balancing the interests of the income beneficiaries against those of the remainder beneficiaries and considering the likely length of the trust, would have been 75% equity and 25% fixed income, beginning as early as 1940, rebalancing the equity portion when it reached 85%.[9] (Tr. 3/7/11 at 70-72). To calculate a reasonable rate of return, he relied on Ibbotson's reporting of the annual return and annual yield of the S&P 500 and U.S. government bonds.[10] (*Id.* at 62, 66). His initial damage estimate at trial, taking the calculation through 2007, amounted to approximately $4.6 million. (Plfs.' Ex. 140). An alternate start date of 1958 proffered by counsel in response to the court's inquiry yielded a total loss of $2,956,486.[11]

The defendant's expert, Joseph Chadwick, is experienced primarily in fiduciary and investment areas other than personal trusts. (Plfs.' Ex. 159.) At trial he testified to a strategy that included rebalancing every year. (Tr. 3/8/11 at 115-16). In response, Mr. Rodgers persuasively explained that annual rebalancing is not ordinarily justified for a personal trust.

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[9] In a preliminary version of his damages calculation, however, Mr. Rodgers selected a 70%/30% allocation. (Def.'s Ex. 213, Tr. 3/7/11 at 79.)

[10] This reliance on Ibbotson's is consistent with the evidence that Mercantile also compared its performance to the S&P 500 and a fixed income fund. (Tr. 1/31/11 at 144; Jt. Ex. 27 at 2816.) Further, Mr. Chadwick apparently used the S&P 500 as a "proxy" in calculating damages in a different case. (Tr. 3/8/11 at 152-53).

[11] In addition to the loss in not achieving a reasonable rate of return, the plaintiffs also seek the $27,673 in attorneys' fees charged to the trust by Mercantile in connection with its petition to resign.

Further, Mr. Chadwick began his calculations as to rate of return only in 1994, apparently based on his interpretation of the "prudent person" versus "prudent investor" standard. (Tr. 3/8/11 at 98).

The plaintiffs identified a number of alleged breaches of fiduciary duty over the course of the Trust's 70-plus years from 1935 through 2007. The first, which will be rejected, is the failure to grow the corpus by investing more heavily in stock in the 1940's and 1950's. When the trust was funded in 1935, the settlor and his father, who provided the funds, had control over the assets and chose to purchase bonds. Given the recent market crash, the risks, and the public's relative unfamiliarity with the stock market, it was not an unreasonable choice. *See Ridgely v. Pfingstag*, 50 A.2d 578, 591 (Md. 1946). Indeed, the trustee did not have sole discretion over the investments until 1947, and the settlor had made his preference for conservative investments clear. Further, after Felix P. Jackson died in 1940, the settlor, Felix Walton Jackson, conveyed his choice to Mercantile to have the income paid out to meet the needs of his minor children. The youngest child, Jesse Jackson, did not reach the age of maturity until 1957. Contrary to the plaintiffs' suggestion, the evidence did not support a finding that the trustee ceded its discretion on this issue to another family member, brother Milton Jackson. Rather, the evidence showed that Milton merely conveyed his brother's decision after consultation and after Felix received advice concerning the tax consequences of his decision from the bank. (Tr. 2/1/11 at 100-109, 137-43; Def.'s Ex. 16-20, Def.'s Ex. 23, 25, 27). The trustee's own decision to accede to the request of the settlor was well within the terms of the trust and not a breach of duty.

By 1960, with a market value of $142,025, the trust was invested at a 70% stock 30% fixed income allocation. (Jt. Ex. 4). It remained under the management of Mr. Peterman, who handled the Trust continuously from 1944 to 1967. (Tr. 2/1/11 at 153-54). Records confirm that

annual reviews took place regularly. Further, until the mid-1970's, the market value of the equities in the Jackson Trust kept a reasonably close relationship to that of the S&P 500.[12] (Plfs.' Ex. 148 .)[13]

Beginning in the mid-1970's, however, in approximately 1975, the S&P 500 returns significantly, even dramatically, outpaced the Jackson Trust through 2007. The evidence demonstrated that several causes for which Mercantile is responsible coincided over at least three decades to unreasonably lower the rate of return. First appears to be the decision to sell the remaining stocks and bonds and to invest almost exclusively in Mercantile-created common investment funds, which occurred in 1975, followed by a switch to various Mercantile mutual funds in 1998, followed by another liquidation only three years later when Mercantile determined that investment in its own funds might be contrary to the terms of the Trust. (Plfs.' Ex. 1 and 2, Tr. 1/31/11 at 253-257). Second was the failure to maintain any consistent balancing of the allocation of the Trust assets, with no good reason apparent from the records as to why the percentage of stock fairly steadily declined from 70% in 1981 to a low of 48.91% in 2000. (Jt. Ex. 4; Plfs.' 146) The income beneficiaries' differing and inconsistent statements of objectives, on the occasions these were obtained by Mercantile, do not justify a strategy resulting in such low returns for the Trust. These major deficiencies may be explained by a third factor, the frequent turnover of Mercantile personnel handling the account; as it became a "smaller" account, it was passed to the next least experienced officer to manage. (*See, e.g.* Tr. 1/31/11 at 197-98, 250-52). Further, while the account in theory was subject to an annual review by the Trust Investment Committee, the records do not reflect that such a review took place on any regular basis during the later years. (Plfs.' Ex. 146; Tr. 1/31/11 at 204-205).

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[12] The settlor, Felix Walton Jackson, died in 1976.

[13] Upon reviewing Plfs.' Ex. 148 and the records supporting it, and considering that the S&P 500 is a publicly-available index rather than a new calculation, I find it is properly admissible as a summary exhibit.

To discuss these factors in more detail, the first was the decision to liquidate the entire Trust in 1975 and place it into Common Trust Funds ("CTF") or Collective Investment Funds ("CIF") for equity and for fixed income. (Jt. Ex. 64; Tr. 1/31/11 at 146-48, 253-54). These are in-house funds used by corporate fiduciaries such as Mercantile to consolidate and manage smaller personal trust accounts. (Tr. 1/31/11 at 151-52, 163). While use of such funds is not necessarily unreasonable, in this instance it appears to have violated the Trust provision against direct or indirect investment in the trustee's own securities;[14] further, there is no sufficient explanation in Mercantile's records of the decision to liquidate, nor any minutes reflecting review of the decision by the Trust Investment Committee; indeed, there are no records of review for most of the 1970's or for 1987-2001. (Def.'s Ex. 218.) Nor is there any indication that the performance of the CTF's, measured against the benchmark S&P 500, was sufficient to achieve a reasonable rate of return in a rising equity market. (Tr. 1/31/11 at 177, 144-45; Plfs.' Ex. 146, 148 ; Jt. Ex. 146.) It appears that the liquidation in 1975 incurred a capital gains tax of $16,700, which was approximately 13% of the corpus. (Jt. Ex. 30 at 2804; Tr. 1/3/11 at 149-51). Further, all of the growth-oriented equity fund was sold off between 1975 and 1989, again incurring significant capital gains. (Tr. 1/31/11 at 170-172; Plfs.' Ex. 1.) In 1998, the CTF's were converted to Mercantile funds. In 2001, when the conflict with the Trust provision was recognized, the entire Trust was liquidated again and individual stocks and bonds finally were restored to the account. (Jt. Ex. 75; Tr. 1/31/11 at 255-56). Failure to maintain a 70%/30% allocation, however, continued, as did failure to keep reasonably close to the S&P 500 benchmark, demonstrating a continuing failure of oversight of the Trust. The income

[14] This issue was acknowledged in Mercantile records. (See Plfs.' Ex. 45, 47; Jt. Ex. 78 at 2239, 2337, 2334, 2314; Tr. 2/1/11 at 31-39.)

beneficiaries' needs and circumstances did not change in any way between 1980 and 2000 sufficient to justify the significant shift away from equities in the Trust portfolio.

Another significant contributing factor to Mercantile's failure to achieve a reasonable rate of return was the discretionary decision to permit a withdrawal of approximately $40,000 in 2001 to pay already-incurred hospital bills for Jesse Jackson.[15] (Tr. 2/1/11 at 111-119). A sympathetic reaction to his request is understandable; given the Trust's spendthrift provision, however, the fact that the withdrawal represented 15% of the entire Trust assets, and that a 2% fee would be taken by Mercantile on the withdrawal, I agree with Mr. Rodgers that the decision was an abuse of the trustee's discretion.[16] Undoubtedly, it contributed to the overall failure to grow the corpus of the trust.

Mercantile challenges Mr. Rodgers's damage model in part because he did not calculate specific losses based on, e.g., the $40,000 withdrawal. Rather, he identified a number of breaches of fiduciary duty contributing to an overall failure to achieve a reasonable rate of return and then calculated that return mathematically, as well as the lost income that should have been paid on the investments. Mr. Rodgers also allowed for a hypothetical 5% administrative fee and the fact that the income was entirely paid out to the beneficiaries rather than reinvested. (Tr. 3/7/11 at 83). This is an acceptable methodology, although the court will set a later starting date and apply the 70%/30% allocation initially chosen by both Mercantile and Mr. Rodgers.

As to counsel fees, Mercantile was not defending the trust or its assets, in which case it might be entitled to charge fees to the trust. *See Saulsbury v. Denton Nat. Bank*, 335 A.2d 199, 200 (Md. App. 1975). Rather, it sought to resign as trustee and obtain a release of liability for its own benefit. The cost of $27,673.64 should have been paid by Mercantile.

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[15] Jesse Jackson died of cancer in 2002.
[16] The plaintiffs do not challenge the smaller, advance payments to Jesse so that he could obtain hearing and dental aids.

Mercantile argues that the doctrine of laches applies to bar James Jackson's claim. Maryland courts have explained that "[l]aches is a defense in equity against stale claims." *Buxton*, 770 A.2d at 158, and

> [t]he passage of time, alone, does not constitute laches but is simply "one of the many circumstances from which a determination of what constitutes an unreasonable and unjustifiable delay be made."

*Id. (*quoting *Parker v. Board of Elec. Sup.*, 186 A.2d 195, 197 (Md. 1962). Further,

> "since laches implies negligence in not asserting a right within a reasonable time after its discovery, a party must have had knowledge, or the means of knowledge, of the facts which created his cause of action in order for him to be guilty of laches."

Buxton, 770 A.2d at 159, quoting *Parker*, 186 A.2d at 197). A defendant seeking to invoke laches must demonstrate not only inexcusable delay by the plaintiff but also prejudice to the defendant. *Schaeffer v. Anne Arundel County,* 338 Md. 75, 83 (1995). Further, Maryland law suggests the standard is more stringent where the defendant is in a continuing fiduciary relationship with the plaintiff. *See Cummins*, 588 A.2d at 1220 n.15 ("Trial counsel for MNB, who was not lead counsel on this appeal, undoubtedly was conscious of the Maryland law on the laches defense. '[E]xpress trustees usually are denied the right to plead limitations,' so that '[t]o cause the statute to begin running during the life of the trust there must be some act of repudiation of the trust by the trustee,' for example, a refusal to account or appropriating principal or income." (internal citations omitted)).

In this case, Mercantile sought to resign in 2007; suit was filed the same year. The plaintiffs seek damages dating back to 1940, and Mercantile asserts that laches bars the majority of the claim. Examining the plaintiffs' circumstances, it appears that James Jackson's failure to assert a claim more promptly is likely excusable, and his daughter's is clearly so. While

Mercantile might be prejudiced by having to account for its management of the trust as far back as 1940, it has not shown prejudice in accounting back to 1975.

Regarding plaintiff James Jackson the evidence suggests that he was not particularly sophisticated regarding investments and that he placed his trust in Mercantile. Mr. Jackson testified that his employment included work for a gas and oil pipeline business and the claims department of a life insurance company; at one time he owned a convenience store and later worked for a travel company. He denied employment or particular knowledge, however, related to investments, stocks, and bonds. (Tr. 1/31/11 at 47-49). He was aware of the Trust, and received monthly income checks beginning in 1957, *id.* at 46, but did not have a copy of the trust document until his brother Jesse gave him one "around 2000." (*Id.* at 54). Mr. Jackson agreed that he received letters from Mercantile advising him who would be handling the Trust, but never called to ask any questions or to ask for a copy of the Trust document, because he did not know he had "the right to do anything." (*Id.* at 58, 77). Mr. Jackson also received documents (year-end summary reports) concerning the Common Trust Funds and Collective Investment Funds used by Mercantile, but "didn't know what they were exactly," *id.* at 85, and was "depending on Mercantile." (*Id.* at 88). He also periodically received income distribution statements and principal balance statements. (*Id.* at 94; Def.'s Ex. 131; Def.'s Ex. 201.) He received a lengthy year-end 2001 statement that identified the discretionary distribution of $40,000 to his brother Jesse. (Tr. 1/31/11 at 97-98; Jt. Ex. 54 at MSD 003222). Mr. Jackson accurately described the entry as "buried in there," but agreed that he did not complain about the distribution after the fact. (Tr. 1/31/11 at 98).

Mr. Jackson's failure to recognize that the Trust provisions may have been violated is understandable. Indeed, it appears that Mercantile did not acknowledge internally any issue

regarding investments in its common funds until 2001, and even then did not explain to the beneficiaries the reason for the reinvestment in individual stocks and bonds. And Mr. Jackson's daughter had no reason to know of any problem with the Trust's management until 2007, when she was contacted by Mercantile about its request to resign as trustee. Accordingly, the doctrine of laches will not be applied to bar recovery in this case.

Calculating the appropriate award of damages, however, requires additional assistance from the parties before a final judgment is entered. The plaintiffs' expert will be asked to assume a starting date of January 1, 1975, rather than 1940, and counsel will be asked to suggest what amount should be paid to the Trust, and what amount should be paid to James Jackson directly. The plaintiffs should file their submission within 30 days or advise the court if they need a longer period of time. Mercantile may respond within 21 days if it disagrees with the plaintiffs' position.[17]

November 15, 2012 /s/
Date
Catherine C. Blake
United States District Judge

[17] Failure to disagree will not waive any of Mercantile's already stated objections to any award of damages.