Commonwealth Of Kentucky

Court Of Appeals

NO. 2001-CA-000803-MR

KATHY GORTNEY APPELLANT

v. APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE WILLIAM L. GRAHAM, JUDGE
ACTION NO. 99-CI-00070

KAREN SUE ROGERS APPELLEE

OPINION
REVERSING
AND
REMANDING
** ** ** ** **

BEFORE: BUCKINGHAM, KNOPF, SCHRODER, JUDGES.

BUCKINGHAM, JUDGE: Kathy Gortney appeals from a partial summary judgment of the Franklin Circuit Court which determined that she had breached her fiduciary duties as trustee by failing to provide an accounting of trust funds and which awarded Karen Sue Rogers a judgment for her share of the purported trust, plus prejudgment interest and attorney fees. On appeal, Kathy contends that a fiduciary duty to Karen never arose because a valid trust was never established due to the failure of the trust settlor to properly transfer a trust corpus into the trust. Viewing the evidence in the light most favorable to the

appellant, we conclude there was a genuine issue of material fact concerning whether the trust actually came into existence. Accordingly, we reverse and remand.

Robert D. Rogers is the father of Kathy Gortney, Karen Sue Rogers, and Kenneth Smith Rogers. Robert's first wife, the mother of Kathy, Karen, and Kenneth, is deceased. Kenneth is also deceased but has surviving children. It appears that in approximately 1986, Robert named Kathy as his attorney-in-fact, conferring her with general power of attorney authority. At some point before 1990, Robert married Mattie D. Rogers.

On July 1, 1990, Robert D. Rogers and Mattie D. Rogers created and executed a trust agreement. The trust agreement stated, in part, as follows:

> THIS AGREEMENT made this 1st day of July, 1990, by and between ROBERT D. ROGERS and MATTIE D. ROGERS, of Frankfort, Franklin County, Kentucky, hereinafter called the GRANTORS, and KATHY R. GORTNEY, of Frankfort, Franklin County, Kentucky, hereinafter called the TRUSTEE,
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> W I T N E S S E T H:
>
> The Grantors have this day assigned, transferred, and conveyed to the Trustee, the property described in Schedule A which is attached hereto and made a part hereof. The Grantors and the Trustee agree that the Trustee shall hold said property and all other property that may be added hereto as hereinafter provided, together with all its increments, proceeds, additions, investments and reinvestments, in Trust, for the use and purposes and upon the terms and conditions hereinafter set forth.
>
> The Trust property shall be held by the Trustee for the benefit of Karen Sue Rogers, Kenneth Smith Rogers, and Kathy R. Gortney. The Trustee shall hold the principle and income from the property designated in

> Schedule A hereof until such time as the mortgage notes mature. Upon maturity, the corpus of the Trust shall be divided between the three (3) children, Karen Sue Rogers, Kenneth Smith Rogers, and Kathy R. Gortney. . . .
>
> When the mortgage notes mentioned in Schedule A hereof mature, all property held hereinunder including both principal and undistributed income shall be distributed by the Trustee to her and to her brother and sister, Kenneth Smith Robert and Karen Sue Rogers, and thereupon this Trust shall terminate.
>
> The Trust created by this instrument shall be irrevocable. Nothing contained in this instrument shall be deemed to authorize or permit the Grantors to borrow, any Trust funds or to directly or indirectly deal with or in any manner benefit from the principle of or income from any of the Trust property. . . .

Schedule A listed as the trust corpus: "(1) Mortgage and note from Howell Construction, Inc." and "(2) Mortgage and note from Glenn and Connie Sewell." The Trust Agreement was signed by Robert and Mattie Rogers as Grantors and by Kathy Gortney as Trustee.

Following the execution of the Trust Agreement, Kathy commenced receiving and controlling the mortgage payment checks received on the Howell Construction and Sewell notes. It appears that the monthly payment on the Sewell note was $1,034.66 and that the monthly payment on the Howell Construction note was $3,067.00. The checks were endorsed in various ways;[1] however, it is undisputed that Kathy received the notes proceeds.

[1] Some checks were endorsed "Bob Rogers," some were endorsed "Bob Rogers by Mattie Rogers," and some were endorsed "Bob Rogers by Kathy Gortney."

It is also undisputed that the proceeds were not deposited into a separate trust fund or account. Kathy contends that she received the funds in conjunction with her attorney-in-fact powers and that, at Robert's direction, the proceeds were spent in support of Robert. Karen contends that Kathy received the proceeds as trustee of the July 1990 trust and that the funds were diverted by Kathy to her own personal use. Kathy's power of attorney was revoked sometime in 1996, and after that Kathy no longer controlled the proceeds on the notes, either as trustee or as attorney-in-fact.

In April 1996, incongruent with the existence of the 1990 trust, Robert executed a Last Will and Testament wherein he bequeathed and devised "all of my right, title and interest in two certain Notes and Mortgages which I hold on the Glen Sewell property and the Howell Construction property" to Karen and Mattie. Kathy was disinherited under the Will. Robert died in 1998. On June 18, 1998, Kathy, by counsel, assuming a position diametrically at odds with her present position, sent a letter to the attorney for the Estate of Robert Rogers and demanded that the future proceeds of the Sewell note[2] be remitted to her on the basis that she was entitled to the proceeds as trustee of the 1990 trust.

On January 21, 1999, Karen filed a complaint in Franklin Circuit Court alleging (1) that Kathy had breached her fiduciary duties as a trustee by transferring and illegally

[2] The Howell Construction note had been paid in full by this time.

converting assets of the trust solely into her name; (2) that Kathy had converted property of the trust to her own use; (3) that Kathy committed fraud by falsely representing that she would abide by the terms and conditions of the trust; and (4) that, following Karen's request, Kathy had failed to provide an accounting of the trust fund.

On September 21, 1999, Karen filed a motion for partial summary judgment upon the issue of Kathy's failure to provide an accounting. Kathy responded to the motion with arguments that a trust was never created because the intended corpus of the trust, the mortgage notes, was never transferred to her, the intended trustee.

On January 20, 2000, the circuit court entered an opinion and order granting partial summary judgment on the issue of whether a valid trust had been created. The order determined that the trust corpus was created by the trust agreement and that a valid trust existed with Kathy as the trustee. The order further directed Kathy to provide an appropriate accounting to the beneficiaries of the trust for all funds she received as trustee.

On June 26, 2000, the circuit court again issued an order directing Kathy to provide an accounting of the trust fund receipts and disbursements. On July 11, 2000, Kathy filed a document captioned "Accounting." The document stated as follows:

Assets Received	None
Assets Distributed	None
Ending Balance	None

On September 12, 2000, an evidentiary hearing was held concerning the funds. On January 22, 2001, the trial court entered a judgment determining that Kathy had breached her fiduciary duty to provide a proper accounting with respect to funds she received as trustee. On March 20, 2001, the trial court entered a final judgment against Kathy for $98,817.18 plus interest and attorney fees. This appeal followed.

Kathy contends that a trust was never properly created because the Sewell and Howell Construction notes were never transferred to her as trustee, and, therefore, the trust was never funded with a corpus. This argument relates back to the January 20, 2000, opinion and order which granted Karen partial summary judgment on the issue of whether a trust had been created. We accordingly review this argument under the standards applicable to summary judgments.

The standard of review on appeal of a summary judgment is "whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law." Scifres v. Kraft, Ky. App., 916 S.W.2d 779, 781 (1996). "The record must be viewed in a light most favorable to the party opposing the motion for summary judgment and all doubts are to be resolved in his favor." Steelvest, Inc. v. Scansteel Service Ctr., Inc., Ky., 807 S.W.2d 476, 480 (1991).

"A trust . . . is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property

for the benefit of another person, which arises as a result of a manifestation of an intention to create it." Restatement (Second) of Trusts § 2 (1959). "To constitute a trust, there must be (1) some subject matter [the res or corpus], (2) a trustee who has the legal but not the equitable title to this subject matter, and (3) a *cestui que trust* [beneficiary] who has the equitable but not the legal title to this subject matter." Lossie v. Central Trust Co. of Owensboro, 219 Ky. 1, 8, 292 S.W. 338, 340 (1926).

A trust cannot be created unless there is trust property. Restatement (Second) of Trusts § 74 (1959). "In order to create a trust, legal title to the res must be transferred to the trustee." Strode v. Spoden, Ky., 284 S.W.2d 663, 665 (1955). Any property which can be voluntarily transferred by the owner can be held in trust. Restatement (Second) of Trusts § 72 (1959). However, "if the owner of property makes a conveyance *inter vivos* of the property to another person to be held by him in trust for a third person and the conveyance is not effective to transfer the property, no trust of the property is created." Id. at § 32.[3]

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[3] Furthermore, it has been stated that:

> Transfer of title to a trustee for the benefit of the trust of an identifiable res is the event that brings a trust into existence. Thus, in order to create a valid trust, there must be an actual conveyance or transfer of property; the trust must be funded by an assignment of property from the settlor to the trustee. With respect to an *inter vivos trust*, a settlor must convey the

(continued...)

The purported trust in this case was initiated by the trust agreement dated July 1, 1990. This agreement specifically provided that Robert and Mattie Rogers "assigned, transferred, and conveyed" the Howell Construction and Sewell notes to Kathy in her capacity as the trustee of the trust. The agreement was duly executed and notarized. However, for purposes of summary judgment, we accept as true Kathy's contentions that the notes were neither endorsed over to her nor delivered to her. Notwithstanding the explicit language in the trust agreement purportedly assigning, transferring, and conveying the notes to Kathy, because there was evidence that neither an endorsement or negotiation of the notes nor a transfer of physical possession of the notes occurred, we are persuaded that there was a fact issue as to whether the trust ever came into existence.

It is undisputed that the Howell Construction note and the Sewell note were negotiable instruments. See KRS[4] 355.3-104. In its order granting partial summary judgment, the trial court, in concluding that a transfer of the notes to Kathy had occurred, relied on KRS 355.3-203. This statute provides, in relevant part, that:

> (1) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person

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[3](...continued)

> legal title to the trust res to the trustee so that the trustee may hold the property for the benefit of the *cestui que trust*.

76 Am Jur 2d Trusts 82 (1992).

[4] Kentucky Revised Statutes.

> receiving delivery the right to enforce the instrument.
>
> (2) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course . . . .

KRS 355.3-203.

The circuit court correctly phrased this issue for summary judgment as "this Court must determine whether the assignment and transfer clause in the trust itself was sufficient to transfer the notes to Ms. Gortney as trustee." In its January 20, 2000, order granting partial summary judgment, the court concluded that:

> [A] delivery and transfer of the notes occurred when the Trust Agreement was executed. The transfer to Ms. Gortney as Trustee authorized her to enforce the instruments, as was evidenced by the fact that she received payments from the obligors and endorsed their checks for deposit herself. This Court is aware that Robert and Mattie Rogers made no endorsement on the notes to transfer them to Ms. Gortney or the trust. However, an endorsement is not required for mere enforcement of the instrument, only for a negotiation of the instrument. Therefore, endorsement of the notes was not required for Ms. Gortney to be able to enforce the right to receive payments on the notes as Trustee.

We are persuaded that the trial court erroneously relied upon KRS 355.3-203 in concluding that any rights in the notes had passed to Kathy by way of the language of the Trust Agreement. KRS 355.1-201 defines "delivery" with respect to an instrument as the "voluntary transfer of possession." For purposes of summary judgment, we assume that no transfer of

possession of the notes occurred; therefore, delivery of the notes to Kathy did not occur. Since an instrument is "transferred" only when it is "delivered," it follows that a transfer did not occur, and it was error for the circuit court to rely upon KRS 355.3-203 to conclude that any title or other rights in the notes had occurred.

Similarly, Kathy was not a holder of the notes by negotiation of the notes. Negotiation likewise requires a transfer of possession of the notes. KRS 355.3-201. Further, as there was no endorsement of the notes, Kathy acquired no rights in the notes under KRS 355.3-204, KRS 355.3-205, or KRS 355.3-206. In addition, since Kathy was not a holder of the instrument or a nonholder in possession of the instrument, Kathy acquired no rights to enforce the instrument under KRS 355.3-301(1) or KRS 355.3-301(2). Finally, neither of the exceptions for enforcement for a person not in possession under KRS 355.3-301(2) applies.

In summary, under the facts viewed in the light most favorably to Kathy, the notes were not negotiated to Kathy so as to give her rights in the notes, nor were the notes transferred to Kathy so as to give her a right to enforce the notes, nor were the notes endorsed so as to give her rights in the notes. Under these circumstances, despite the trust agreement purporting to transfer the notes to Kathy, we conclude that there was a fact issue concerning the transfer of the notes to the trust so as to create a trust corpus. Absent a trust corpus, a trust never came into existence. Absent a trust, Kathy never became a bona fide trustee, and no fiduciary duty arose to provide an accounting to

Karen. We therefore reverse the judgment of the Franklin Circuit Court and remand for a factual determination in this regard.[5]

In her brief, Karen argues to the effect that Kathy should be estopped from denying the existence of a trust because, following Robert's death, Kathy sent a communication to the estate acknowledging the existence of a trust and demanding that the proceeds from the Sewell note be sent to her in accordance with the trust agreement and, further, because in her deposition Kathy acknowledged that a trust had been created by the 1990 trust document.[6] However, prior to the entry of summary judgment, Kathy repudiated this position and argued that a trust had not been created because no corpus had been created. In our review of a summary judgment, we must view the evidence in the light most favorable to the nonmoving party, i.e., Kathy. Here, that requires us to accept her later, though inconsistent, position. Further, in her deposition Kathy acknowledged only that

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[5] There is evidence indicating that the trust came into existence. For example, the trust agreement states that the notes were actually transferred to Kathy. Also, Kathy acknowledges coming into possession of the notes proceeds (although she states she did so as Robert's power of attorney). Furthermore, Kathy at one time acknowledged the existence of the trust in a letter written by her attorney.

However, there is also evidence that the notes were never transferred and that the trust never came into existence. For example, Kathy testified that the notes were not attached to the trust agreement and were never transferred to her. Further, no trust account was ever set up, and Robert and Mattie Rogers apparently reported income from the notes as income on their personal income tax returns. Also, Robert Rogers' rights in the notes were the subject of a provision in his will (indicative that the notes were not within a trust).

[6] The circuit court did not address this issue in its partial summary judgment.

the letter accurately reflected her position at the time the letter was written. The issue is one of credibility that we leave to the fact finder.

Karen also argues that under Jones v. Chipps, 296 Ky. 245, 176 S.W.2d 408 (1945), the language of the trust agreement accomplishes the transfer of the notes. The Jones case contains the statement, "The transfer of the notes on the margin of the book wherein the mortgage is recorded operated as an assignment of the mortgage to the bank." Id. at 411. Kathy contends that "[i]f an assignment of a mortgage can be made by a handwritten note in the margin of the document, then it follows that an assignment was made by the clear language of the Trust Agreement." However, Jones, and the cases cited therein, occurred prior to this jurisdiction's adoption of Article 3 of the Uniform Commercial Code, the controlling statutes on issues involving negotiable instruments. See KRS 355.3-101, et. seq.[7] Further, Jones did not squarely address the issue in the case at bar; rather, Jones, and the cases it cites, are primarily concerned with the recording of a mortgage in a deed book and the corresponding notice to the public.

Karen also argues that "whether or not the trust was created has no real bearing on this appeal." She asserts in this regard that Kathy failed to properly account for the funds, regardless of whether she received the money as trustee or as Robert Rogers' attorney-in-fact. We disagree. The civil

[7] Article 3 was originally enacted in 1958, effective July 1, 1960. In was repealed and reenacted in 1996, effective January 1, 1997.

complaint in this case was filed by Karen as a beneficiary of the trust. If no trust existed, then no duty of a trustee to account existed. However, if Kathy received the funds as Rogers' attorney-in-fact, then any duty to account would be to Rogers' estate, not to Karen.

The last issue is whether the court erred in awarding Karen prejudgment interest. The issue will be moot if the fact finder determines on remand that no trust existed. However, if the fact finder determines that a trust existed, then the issue will not be moot. Thus, we will address it.

The circuit court awarded Karen $119,611.77 "plus interest on said amount at the rate of twelve percent (12%) per annum from July 1, 1990 through December 31, 2000, which totals $98,419.76 . . . plus interest on the total amount of $218,031.53 from January 1, 2001 until paid, at the rate of twelve percent (12%) per annum. . . ." In other words, the court directed that interest on the principal amount begin to run as of the date of the trust agreement. The court relied on Taylor v. Taylor's Executors, 211 Ky. 309, 277 S.W. 278 (1925).

Kathy argues that prejudgment interest should only have been awarded from the date Karen was entitled to performance under the trust (if there was a trust). In support of her argument, she cites the Taylor case and the language of the trust agreement herein which states that the trust property shall be distributed when the notes matured. Because she asserts that the notes were not part of the record, she maintains that the record does not indicate when the notes were to mature. Apparently, the

Howell note was discharged as paid in full on December 19, 1995, but the Sewell note had not yet matured as late as May 10, 1999.

On the other hand, Karen argues that the court correctly awarded prejudgment interest from the date of the trust agreement. She also relies on the Taylor case. Further, she asserts that Kathy should have invested the money and that the money would have been earning interest had Kathy not converted it to her own use.

The court in the Taylor case said, "An agent failing to pay over the money to his principal when he should pay it over and using it in his own business is always chargeable with interest." 211 Ky. at 314, 277 S.W. at 280. We agree that the court would not abuse its discretion in awarding Karen prejudgment interest should it find the existence of a trust and a failure to account for the money. However, it would be improper to award prejudgment interest from the date of the trust agreement. If a trust existed as of that date, there is no indication that the trust would have any money at that time. Rather, the money would likely come into Kathy's hands as each payment was made.

We hold that prejudgment interest is awardable only from the date the notes matured and Karen became entitled to distribution. See Bassett v. Paine's Adm'r, 264 Ky. 495, 95 S.W.2d 8 (1936) ("It is the settled rule that when an obligation is expressly payable at a time certain the debtor is in default if he fails to pay at that time, and interest runs from the time when the money should have been paid." 264 Ky. at 497.).

Interest on the total principal amount could not be owed from the date of the trust agreement since presumably none of the principal amount had been received at that time. Thus, we reverse the circuit court on this issue.

For the foregoing reasons, the judgment of the Franklin Circuit Court is reversed and remanded.

ALL CONCUR.

BRIEFS AND ORAL ARGUMENT FOR APPELLANT:

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