

UNITED STATES DISTRICT COURT
DISTRICT OF MAINE

BURNAM LITCHFIELD and)
JOHN LAMBIE,)
)
Plaintiffs)
)
v.) Civil No. 99-97-B
)
THE BANK OF NEW YORK,)
)
Defendant)

**RECOMMENDED DECISION ON DEFENDANT’S
MOTION FOR PARTIAL SUMMARY JUDGMENT
AND PLAINTIFFS’ CROSS MOTION
FOR SUMMARY JUDGMENT**

Plaintiffs, Burnam Litchfield and John Lambie, bring this action against Defendant, The Bank of New York (“BNY”), alleging in Count I that BNY, acting as trustee of a trust to which Plaintiffs are beneficiaries, breached its fiduciary duty when it paid itself \$17,081.29 in commissions it was not entitled to over a ten year period. BNY now moves for partial summary judgment on the scope of damages Plaintiffs are entitled to recover. Plaintiffs filed their own motion for summary judgment on the same issue.¹ Each party has fully briefed the issue and presented their oral arguments before this court. For reasons delineated below, I recommend that Defendant’s Motion be DENIED in part and GRANTED in part and that Plaintiffs’ motion be DENIED.

¹ Plaintiffs filed a five count Complaint alleging: breach of fiduciary duty (Count I); conversion of trust property and unjust enrichment (Count II); unfair and deceptive trade practices (Count III); negligent misrepresentation (Count IV); and punitive damages (Count V). Other than a cursory reference, BNY’s motion did not address Plaintiffs’ claims in Count II-V. I have made no attempt to ascertain what choice of law provisions might apply to these other counts, whether the record supports the allegations in the remaining counts, or what measure of damages might be appropriate under those counts because BNY did not address those issues in its motion. For that reason, at the hearing I indicated to BNY that I construed its motion to limit damages only on Plaintiffs’ breach of fiduciary duty claim.

Summary Judgment Standard

Summary judgment is appropriate only if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). "A material fact is one which has the 'potential to affect the outcome of the suit under applicable law.'" *FDIC v. Anchor Properties*, 13 F.3d 27, 30 (1st Cir. 1994) (quoting *Nereida-Gonzalez v. Tirado-Delgado*, 990 F.2d 701, 703 (1st Cir. 1993)). The Court views the record on summary judgment in the light most favorable to the nonmovant. *Levy v. FDIC*, 7 F.3d 1054, 1056 (1st Cir. 1993).

However, summary judgment is appropriate "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). Once the moving party has presented evidence of the absence of a genuine issue, the nonmoving party must respond by "placing at least one material fact in dispute." *Anchor Properties*, 13 F.3d at 30 (citing *Darr v. Muratore*, 8 F.3d 854, 859 (1st Cir. 1993)).

Facts

The facts are relatively undisputed. Elizabeth Litchfield, a New York resident, created a trust, consisting mainly of securities, at BNY on June 8, 1955. BNY has served as the sole trustee of the trust since that time. At all times relevant to this matter, Plaintiffs, Burnham Litchfield and John Lambie, are the income beneficiaries of the trust. Plaintiff Litchfield is a resident of Northeast Harbor, Maine, and Plaintiff Lambie is a resident of Nakomis, Florida.

The Trust Agreement that governs the trust provides for periodic income disbursements to be made to the beneficiaries on an approximately quarterly basis. The Agreement, in Article Nine, provides a formula for compensation to BNY for managing the trust and, in Article Eleven, provides that the trust shall be governed and construed by New York law.

In August 1997, BNY conducted a review of the trust and discovered that, since 1988 it had overcharged the amount of compensation it was entitled to under the Trust Agreement. This error was the result of BNY charging the trust based on BNY's published fee schedule rather than the formula provided in the Trust Agreement. The incorrect charges totaled \$17,081.29. Of that amount, BNY overcharged \$16,206.39 against the income of the trust and \$874.90 against the trust corpus.

On August 20, 1997, BNY reimbursed the trust corpus and trust beneficiaries \$17,081.29. In a letter dated August 17, 1998, over one year after the discovery of its mistake, BNY offered to pay the beneficiaries six percent interest, compounded, on the amount of overcharged contributions. Plaintiffs rejected that offer.

Analysis

A. Choice of law

The parties first disagree over whether I should apply New York law or Maine law in determining the amount of damages Plaintiffs are entitled to as a result of BNY overcharging the trust. A federal court must apply the choice of law rules of the jurisdiction in which the federal court sits. *See Ferrofluidics Corp. v. Advanced Vacuum Components, Inc.*, 968 F.2d 1463, 1467 (1st Cir. 1992). Where, as here, the agreement contains a choice of law provision, Maine will apply the provision unless:

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice or

(b) the application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue.

Schroeder v. Rynel, Ltd., 720 A.2d 1164, 1166 (Me. 1998).²

It appears clear that New York does have a substantial relationship to the parties and the transaction. Elizabeth Litchfield, a New York resident, created the trust to be administered by BNY, a New York corporation, which has continued to administer the trust for over 45 years. Further, the actions which gave rise to this Complaint occurred in New York. Therefore, New York has a substantial relationship to the parties and the transaction at issue in this case. Further, based on these

² In their brief, Plaintiffs analyze the choice of law issue by applying the most substantial relationship test to the dispute. *Ashmore v. Northeast Petroleum Div. of Cargill, Inc.*, 843 F.Supp. 759, 772 (D. Me 1994). Plaintiffs point to *Mason v. Southern New England Conference Assoc. of Seventh-Day Adventists*, 696 F.2d 135 (1st Cir. 1982) which applied several factors listed in the Restatement (Second) Conflict of Law § 6 (1971) to determine which state has the most substantial relationship to the dispute. The Court stated:

Section 6 of the Second Restatement lists various general policy considerations relevant to choice of law. **In tort cases**, the Restatement counsels the court to apply the law of the state with the most significant relationship to the parties and event, weighing enumerated contacts in applying the standards of section 6. *Id.* § 145. The Restatement further specifies that in personal injury cases the court should choose the law of the state of injury unless another state's relationship to the injury is more significant, judged by the section 6 criteria. *Id.* § 146. Our task is therefore to determine whether the presumptive applicability of the law of the state of injury (Massachusetts) was overcome by policy considerations or by an imbalance of contacts.

Id. at 137. (Emphasis added). Two distinctions can be made between *Mason* and this case. First, *Mason* was a tort case not a contract case. Second, this case is one in which the agreement contained a choice of law provision and therefore the test set forth in *Schroeder* is applicable.

facts the settlor, Elizabeth Litchfield, had a reasonable basis to choose New York law as the law to apply to the terms of the Trust Agreement.

Plaintiffs next argue that Plaintiff Litchfield, a citizen and resident of Maine, is entitled to the protection of Maine law because “any expectation of Mrs. Litchfield and The Bank of New York regarding New York’s administration of the trust is outweighed by Maine’s fundamental policy that innocent trust beneficiaries, who are without control over the power vested in the trustee, are to be protected by a measure of damages that holds the trustee fully liable for a breach of trust.” Response at p. 11. Basically, Plaintiffs argue that Maine has a fundamental interest in requiring Defendant to pay a greater amount of damages than New York permits.

In *Schroeder*, the Court had to decide whether to apply Delaware or Maine law. In determining to apply Delaware law the Court stated “[w]e will not refuse to apply Delaware law merely because a different result would be reached pursuant to Maine law.” *Schroeder*, 720 A.2d at 1167. Likewise here, the fact that Plaintiffs may be entitled to more damages under Maine law is not a basis to foreclose the application of New York law.

Unfortunately for Plaintiffs, even if I accepted their argument and agreed that a fundamental policy of Maine is at issue, Maine does not have a materially greater interest than New York in the disposition of the issue in this case. Other than the fact that a beneficiary, Mr. Litchfield, lives in Maine, Maine has absolutely no interest in the trust. By contrast, this case arises out of actions taken by a New York corporation and by a New York trustee. Further the settlor created the trust in New York and for the past 46 years the operation, location and administration of the trust have occurred in New York. Based on these facts, it is clear that New York has a materially greater interest than

Maine in the resolution of this matter. Accordingly, I will apply New York law in determining the amount of damages Plaintiffs may seek on their breach of fiduciary duty claim.

B. Damages

BNY next contends that New York limits Plaintiffs' recovery to only the amount of the over payment plus appropriate interest thereon. Neither party nor this court could locate a New York case that directly addressed the issue in this case: what amount of damages must a trustee pay when it mistakenly pays itself a larger commission than it is entitled to under the trust agreement? There are cases that address the amount of damages a trustee must pay when it inadvertently pays itself commissions, but those cases are slightly distinguishable from the one before me. In the most recent case, *In re Matter of Prankard*, 666 N.Y.S. 2d 45 (N.Y. App. Div. 1997) the trustee, pursuant to statute, was entitled to reasonable commissions in managing the trust. The Court remanded the case to the Surrogate and wrote that:

In the event the Surrogate determines that the trustee improperly claimed and paid to itself unreasonably large commissions, the judgment for any sum directed to be paid to the estates shall include an award of interest (*see, In re Matter of Smathers' Will*, 4 A.D.2d 784, 164 N.Y.S.2d 897).

Id. The Court made no mention that the trustee would have to pay the beneficiary any profit it made from the improperly claimed commissions.

In *In re Smathers' Will*, the case cited in *In re Prankard*, the Court addressed what damages a trustee must pay when the court had earlier found that the trustee charged \$67,500 in excess commissions. The Court stated that:

Interest should have been allowed on the various amounts of commissions erroneously taken by said trustee which used the funds for its own purposes, there being no denial that its use of the funds resulted in profit to it (citations omitted). Interest should be computed at the rate of 4% per annum.

In re Matter of Smathers' Will, 164 N.Y.S.2d at 897. As in *Prankard*, no mention was made regarding whether the trustee would have to pay the beneficiary the actual profit made on the commissions.

In *Beard v. Beard*, 140 N.Y. 260, 264 (1893) the trustees took the commissions they were entitled to but prior to receiving approval from the court. The court held:

They [the trustees] acted in good faith, honestly believing that they were entitled to take the commissions. It does not appear, and was not found, that by taking these commissions they caused any injury or damage to the estate . . . It does not even appear that they made a profit from the funds withdrawn for their commissions.

Id. at 266. As a result the Court found that no interest should be charged to the trustees.

Other cases that have addressed the trustee paying itself commissions before court approval have charged the trustee a surcharge of 6% interest from the time it improperly paid itself the commissions. See *In re Crippen's Estate*, 224 N.Y.S. 2d 116, 118 (1971); *In re Mattes Estate*, 172 N.Y.S.2d 303, 306 (1958). Neither case addressed repayment of any profits earned on the commissions.

Defendant points to the line of cases cited above for the proposition that absent the finding of egregious misconduct, Plaintiffs are entitled only to reimbursement of commissions plus interest thereon. While that appears to be true, there is a distinction between the line of cases cited above and this case. In all the cases cited above the trustee was entitled to reasonable commissions under a state statute, not a fixed payment as here. It is perhaps easier to excuse a trustee in good faith misjudging the amount of reasonable commissions it believes it was entitled to than it is a trustee who failed to apply a compensation formula in a written agreement. However, I believe BNY is correct in analogizing *In re Matter of Prankard* and *In re Smathers' Will* to this case. Both

commissions were taken by the trustee in good faith, and in the case of *Smathers*³, was repaid upon learning the error. In fact, in *Smathers* the Court awarded only interest even though the trustee profited from the commissions.

Plaintiffs argue that the BNY breached his fiduciary duty and owes them any profits derived from the commissions.³ In support of that argument Plaintiffs point to the following case that in its discussion cites section 205 of the Restatement of Trusts:

It is clear that where a fiduciary breaches his duty to the beneficiaries any loss to the estate must fall upon his shoulders and any profit derived from the breach, or profit which would have accrued to the estate if there had been no breach, will inure to the benefit of the estate. (*Matter of Tannenbaum*, 30 Misc.2d 743, 219 N.Y.S.2d 149; Restatement of the Law of Trusts 2d, § 205, p. 458; III Scott on Trusts, 3rd Ed. § 205; 49 Harvard Law Rev. 541; *In re Talbot's Estate*, 114 Cal.App.2d 309, 296 P.2d 848). The beneficiaries, therefore, have various options or remedies available to them where there has been a breach of duty by an estate or trust fiduciary. The beneficiaries may have the option of not only charging the fiduciary with a loss *or making him account for a gain* but also of charging him with a gain which was not made but would have been made if the fiduciary had not violated his duty. (III Scott on Trusts, *Supra*).

Estate of Mark Rothko, 379 N.Y.S.2d 923, 965 (1975), *aff'd sub nom. Rothko v. Reis*, 372 N.E.2d 291 (N.Y. 1997).

The issue in *Rothko* was the amount of damages owed by executors to the Rothko estate. The Court had earlier found that the executors misconduct was so substantial that it removed them as executors of the estate. Apparently, Rothko was a well known painter and left many paintings in his estate. The Court found that the executors breached their duties of loyalty to the estate by selling the

³ During oral argument Plaintiffs admitted that while they do know that the \$17,081.29 was placed in BNY's general funds, they do not know whether BNY spent that money or invested it. Nevertheless, Plaintiffs argue that the court should determine the profit reaped by BNY from the commissions by looking at the performance of BNY's stock. In essence Plaintiffs ask me to assume that BNY placed the money it should have paid to them in its stock without any proof that it actually did so. This is entirely too speculative a theory to award damages on.

paintings to a company in which an executor was an officer and it was apparent that self-dealing was involved. This case is quite different than those cases where the trustee in good faith and by mistake, pays itself commissions that it is not entitled to.⁴

During oral argument Plaintiffs argued that the plain language of section 205 applies to both knowing conduct, as in *Rothko*, and negligent conduct, as in this case. Therefore, Plaintiffs urge me to apply the measure of damages delineated in section 205 to this case. However, Plaintiffs cannot point to one case where a New York court has applied section 205 to a case with analogous facts to the one here. Instead, as delineated above, New York courts, in cases like this one, have required the trustee to return the principal plus an amount of interest thereon.⁵ The question then becomes what interest should I apply? As stated above, New York Courts have applied as little as four

⁴ In their Response Plaintiffs argue that the line of cases cited by BNY, all decided before *Rothko*, were overruled by the passage cited above in *Rothko*. This is without foundation. First, as stated above *Rothko* addressed a different issue, when a trustee engages in purposeful misconduct. Second, the Court in *In re Matter of Prankard*, decided after *Rothko*, directed the Surrogate to apply only interest to any overcharged commissions and approvingly cited *In Re Smathers' Will*.

⁵ Plaintiffs also argue that damages should be measured more broadly because BNY breached its duty of loyalty to the trust. In *In the Matter of Goldstick*, 581 N.Y.S.2d 165, 172 (1992) the Court held a trustee accountable for a breach of loyalty and pointed to the Restatement (third) of Trusts §170, cmt. 1 (1990) The comment states:

The trustee violates the duty of loyalty not only when the trustee purchases trust property individually but also when the trustee uses trust property for the trustee's own financial or other purposes. Thus, the trustee cannot properly borrow money or lease land held in the trust, or invest trust funds in the trustee's own business.

Id. The comment clearly contemplates some knowing action by the trustee, leasing land held in trust or improperly investing funds, for a duty of loyalty to be violated. In fact in *Goldstick*, the trustee “invested some \$181,125 of trust funds in various real estate partnerships in which he already had a substantial interest. These enterprises yielded Goldstick, his co-venturer wife and his corporate alter egos a handsome profit of more than \$2 ½ million.” *Id.* Here, it is undisputed that BNY’s action was not intentional self-dealing, but a *mistake* that it corrected when it determined that it made the mistake.

percent and as much as six percent interest to inappropriately retained commissions. *In re Matter of Smathers' Will*, 164 N.Y.S.2d at 897 (applying four percent interest)⁶; *In re Crippen's Estate*, 224 N.Y.S. 2d 116, 118 (1971) (applying six percent interest); *In re Mattes Estate*, 172 N.Y.S.2d 303, 306 (1958) (applying six percent interest). At the time the courts decided the cases cited above the statutory rate of interest was six percent. N.Y. CPLR 5004 (McKinney 1999). In 1981 the statute was amended to increase the interest rate from six to nine percent. *Id.* As the statutory interest rate appears to be the appropriate rate of interest New York courts apply in cases analogous to this one, I recommend that Plaintiffs be entitled to the principal plus nine percent interest compounded thereon.

Conclusion

For reasons stated above, I recommend that as to only Count I the Court GRANT that part of BNY's Motion for Summary Judgment seeking to apply New York law and DENY that part BNY's Motion seeking to limit Plaintiffs recovery to the principal plus six percent interest thereon. Instead, I recommend that the Court limit Plaintiffs' recovery in Count I to the principal plus nine percent interest compounded thereon. I further recommend that the Court DENY Plaintiffs' Motion for Summary Judgment.

⁶ At the time the court decided *In re Smathers' Will* the statutory rate of interest was six percent. Apparently determinative in applying the lower interest rate was that the trustee's error was an "honest and excusable mistake of law" and that the trustee repaid the excess commissions as soon as it became aware of its error. *See* NY Jur. 2d Interest and Usury § 35 (1988). In this case, BNY repaid the overcharged amount when it became aware of the error in August 1997. However, BNY's failure to follow the compensation formula laid out in trust agreement cannot be characterized as an honest and excusable mistake of law. Therefore, I do not recommend lowering the statutory interest rate.

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. § 636(b)(1)(B) (1988) for which *de novo* review by the district court is sought, together with a supporting memorandum, within ten (10) days of being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to *de novo* review by the district court and to appeal the district court's order.

Margaret J. Kravchuk
United States Magistrate Judge

Dated on June 1, 2000.

TRLIST STNDRD

U.S. District Court
District of Maine (Bangor)

CIVIL DOCKET FOR CASE #: 99-CV-97

LITCHFIELD, et al v. BANK OF NEW YORK
Assigned to: JUDGE D. BROCK HORNBY
Demand: \$90,000
Lead Docket: None
Dkt# in other court: None

Filed: 04/06/99
Jury demand: Plaintiff
Nature of Suit: 190
Jurisdiction: Diversity

Cause: 28:1332 Diversity-Contract Dispute

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