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PUNITIVE SURCHARGES AGAINST DISLOYAL FIDUCIARIES—IS *ROTHKO* RIGHT?

Richard V. Wellman*

Some principles for determining the liability of defaulting fiduciaries are woefully unclear.¹ This lack of clarity breeds litigation and feeds the tendency of knowledgeable fiduciaries to administer estates with extreme caution.

Recent litigation over the estate of artist Mark Rothko illustrates the uncertainty of rules for determining damages in cases of fiduciary breach. In *In re Rothko*,² the New York courts found two of the three executors liable, on account of transactions tainted by conflict of interest, for sums greatly exceeding the normal ceilings of damages proximately caused by breach and restitution of amounts unjustly realized.³ Specifically, the courts held the executors responsible for post-sale appreciation of assets sold under power of sale, *i.e.*, for the fair market value of the estate assets as of the date of the decree.

This Article criticizes the award of a penalty surcharge in the

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1. The vagaries of fiduciary liability are discussed in Niles, *A Contemporary View of Liability for Breach of Trust*, 29 REC. ASSN. B. CITY N.Y. 573 (1974); Niles & Schwartz, *Breach of Trust—Recent Developments*, 20 N.Y.U. L.Q. REV. 165, 182-90 (1944); Note, *Liability of Trustee in the Absence of Causal Relation Between Wrongdoing and Loss*, 50 HARV. L. REV. 317 (1936). Closely-related questions concerning standards and consequences of breach of a fiduciary's duty of loyalty are discussed in Jones, *Unjust Enrichment and the Fiduciary's Duty of Loyalty*, 84 LAW Q. REV. 472 (1968).

2. The most important opinion in the case, that of Surrogate Midonick, the trial judge, is reported in 84 Misc. 2d 830, 379 N.Y.S.2d 923 (1975). The Supreme Court, Appellate Division, modified and affirmed the decree, 56 App. Div. 2d 499, 392 N.Y.S.2d 870 (1977), and the Court of Appeals also affirmed. 43 N.Y.2d 305, 372 N.E.2d 291, 401 N.Y.S.2d 449 (1977). For other accounts of the litigation and for comments, see L. SELDES, *THE LEGACY OF MARK ROTHKO* (1978); Carter, *The Impact of the Rothko Case*, ART NEWS Oct. 1977, at 78; Gardner, *The Ordeal of Kate Rothko: The War Isn't Over in Marlborough Country*, NEW YORK, NEW YORK, Feb. 7, 1977, at 43; Merryman, *The "Straw Man" in the Rothko Case*, ART NEWS, Dec. 1976, at 32; *Challenging Rothko's "Straw Man"*, ART NEWS, March 1977, at 32 (letters to Merryman and his reply); Rosenberg, *Death and the Artist*, THE NEW YORKER, March 24, 1975, at 69; Seldes, *The Passion of Mark Rothko*, ESQUIRE, Nov. 1974, at 118.

3. The court held the disloyal fiduciaries and their collaborating transferee liable for the fair market value of the estate assets as of the time of trial. That value exceeded by more than two-and-three-quarter million dollars the amount the estate would have realized from a lawful administration and the amount which the disloyal fiduciaries actually realized from their breach. See text at notes 16-21, and Part III *infra*.

name of appreciation damages. Contrary to the statements in the *Rothko* opinions, neither precedent nor treatises offers clear support for the shocking awards made against Rothko's disloyal executors. Furthermore, even if appreciation damages were to be viewed, against the thesis here advanced, as an appropriate remedy for some kinds of fiduciary breach, the measure is inappropriate for cases which, like *Rothko*, involve hidden conflicts of interest. This is so because the threat of severe penalties in hidden-conflict cases adds unacceptable legal costs to honest administrations—costs that cannot be justified as a means of deterring undesirable conduct. Finally, *Rothko* illustrates how a court that surcharges a disloyal fiduciary for a sum exceeding amounts causally related to the breach or justified by the principle of restitution may unintentionally punish a merely negligent fiduciary. In sum, this Article urges that other courts repudiate *Rothko*: surcharges for disloyalty should not be governed by unique standards.

I. THE GENERAL RULES

The *Restatement* provides that a breaching fiduciary is liable for damages proximately caused by the breach.⁴ Thus, a beneficiary will recover those values he would have enjoyed had there been no breach. Although some precedents appear to make defaulting fiduciaries insurers against reduced estate values or lost profits,⁵ those precedents are not necessarily inconsistent with the proximate-causation rule. Liability for the full present value of a lost asset or opportunity is appropriate where a fiduciary, by selling an estate asset without authority, deprives the beneficiaries of their interest in the asset. In that circumstance, the asset's value at the time of suit measures the damage proximately caused by the breach, unless the beneficiaries' interests in the asset would have ended even without the wrongful sale.⁶ Some-

4. RESTATEMENT (SECOND) OF TRUSTS § 205 (1959) reads:

Liability in Case of Breach of Trust

If the trustee commits a breach of trust, he is chargeable with

(a) any loss or depreciation in value of the trust estate resulting from the breach of trust; or

(b) any profit made by him through the breach of trust; or

(c) any profit which would have accrued to the trust estate if there had been no breach of trust.

5. See Niles & Schwartz, *supra* note 1, at 182.

6. For example, a trust instrument might direct that a particular security be retained and might preclude the holding of securities in certain other companies or industries. The trustee, though he sells without authority, surely should be relieved of liability for the

what similarly, if a fiduciary invests estate funds in impermissibly speculative assets, the standards for compensatory damages make him liable for a subsequent fall in the investment's market value even if the economic problems besetting the faltering enterprise afflicted other companies issuing less speculative securities. A defaulting fiduciary cannot escape liability because the securities of X company, a prudent investment he did *not* make, have, because of the stock market's vagaries or unanticipated scientific discoveries, depreciated as much as the securities he selected imprudently. If the fiduciary could use such evidence, the beneficiaries could similarly demonstrate that the estate might be intact had the fiduciary invested in government bonds or made interest-bearing deposits in insured accounts. Still, it is generally inappropriate to hold the imprudent fiduciary liable for losses caused by a general business depression or by force or fraud for which he was blameless.⁷

The liability of a breaching fiduciary is not limited to damages proximately caused by the breach: irrespective of breach and any resulting loss, the *Restatement* provides that a fiduciary may not retain unauthorized gains realized from his administration of an estate.⁸ Thus, if a fiduciary uses a power of sale to sell estate assets to himself at a fair market price, the beneficiaries may hold the fiduciary liable for any gain realized from a profitable resale.⁹ If one disregards the usual standard of assessing proximately caused damages by reference to the values beneficiaries would have enjoyed had there been no breach,¹⁰ this recovery of profits

present value of the improperly sold security if a merger with a prohibited company would have made it impossible for the trustee to retain the original security.

7. Cf. *First Natl. Bank of Boston v. Truesdale Hosp.*, 288 Mass. 35, 45-46, 192 N.E. 150, 152-53 (1934), where the court exonerated a trustee who, by failing to diversify, improperly retained stock, from the loss of the stock's market value because the court believed that the loss was less than the loss that would have occurred had the trustee diversified. See *Dickerson v. Camden Trust Co.*, 1 N.J. 459, 64 A.2d 214 (1949), where the court ordered a surcharge in the full amount by which the market value of improperly retained securities fell during the Depression and ignored the effect of the Depression on permitted investments.

8. RESTATEMENT (SECOND) OF TRUSTS § 205(b) (1959), quoted in note 4 *supra*. Section 203 reads:

Accountability for Profits in the Absence of
a Breach of Trust

The trustee is accountable for any profit made by him through or arising out of the administration of the trust, although the profit does not result from a breach of trust.

For a particularly useful discussion of this theory of recovery, see Niles, *Trustee Accountability in the Absence of Breach of Trust*, 60 COLUM. L. REV. 141 (1960).

9. RESTATEMENT (SECOND) OF TRUSTS § 206, Comment b (1959).

10. The general rule has been stated in this way:

might be regarded as compensatory in the sense that the beneficiaries could void the sale for self-dealing and claim all amounts realized by the fiduciary. Confusion with general standards of compensatory damages may be avoided, however, if the recovery is viewed more simply as the restitution of unauthorized personal gains. Restitution, which should never exceed what a defendant may have realized, deters disloyal fiduciary conduct efficiently, for it does not require the court to wrestle with the difficult issues of breach and causally related damages.¹¹

Although breaching fiduciaries are normally liable only for damages proximately resulting from default unless the restitutionary principle authorizes a larger recovery, it is not clear that these ceilings should apply in cases of willful misconduct. Specifically, it is uncertain whether the normal rules should apply where an executor, administrator, or trustee has allowed personal conflicts to compromise his efforts on behalf of an estate.¹² That uncertainty contributed to the startling result reached in the widely publicized litigation involving the estate of Mark Rothko.

II. THE *Rothko* CASE

Three months after Rothko's suicide in February 1970, three co-executors with the power of sale entered into two contracts with the Marlborough galleries¹³ covering all the artist's unsold works. One contract sold 100 paintings, selected by the gallery, for \$1.8 million in annual interest-free installments over twelve years. The second contract consigned to the gallery the remaining 698 paintings, to be sold over twelve years at a commission of fifty percent.

The trial court, whose decision was affirmed by the appellate division and the court of appeals,¹⁴ found that two of the executors, Reis and Stamos, had been influenced in approving the transactions by their personal ties with the gallery. It found that

In all cases, then, of civil injury and of breach of contract the declared object of awarding damages is to give compensation for pecuniary loss; that is, to put the plaintiff in the same position, so far as money can do it, as he would have been if the contract had been performed or the tort not committed.

1 T. SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES § 30, at 25 (9th ed. 1920).

11. See Niles, *supra* note 8. However, Jones, *supra* note 1, who includes penalties in his discussion of restitutionary remedies, apparently would disagree.

12. See text beginning at note 30 *infra*.

13. The executors sold 180 paintings to Marlborough A.G., a Liechtenstein corporation, and consigned 658 paintings to Marlborough Gallery, Inc., a domestic corporation. For purposes of simplicity, both corporations will be referred to as the gallery.

14. See note 2 *supra*.

the contracts were improvident: many details of the agreement appeared unusually favorable to the gallery which made substantial profits on the resale of some of the paintings.¹⁵ Accordingly, the court voided the disposition, ordered the remaining 658 paintings returned to the estate (140 works had been sold), and held all three executors as well as the gallery jointly and severally liable for \$6,464,850.¹⁶ The court also held the two disloyal executors and the gallery liable for an additional \$2,787,150 in "appreciation damages." Their total liability was thus \$9,252,000.

The sum of \$6,464,850 represented the fair market value of the sold works at the time of their sale.¹⁷ Of that sum, \$5,476,500 was the price the gallery had received for most of the 140 works it sold to bona fide purchasers in 1970, 1971, and 1972.¹⁸ The gallery had not actually received the remaining \$988,350:¹⁹ the court concluded that certain sales made hastily after the litigation began in November 1971 garnered less than fair market

15. Surrogate Midonick's conclusion that the disloyalty of Reis and Stamos compromised the estate's interests rested on several facts and circumstances summarized in 84 Misc. 2d at 853-55, 379 N.Y.S.2d at 949-50. The Supreme Court, Appellate Division, particularly emphasized the gallery's quick, profitable resales. 56 App. Div. 2d at 501, 392 N.Y.S.2d at 872-73.

16. Surrogate Midonick's recapitulation of the prices and values is reported as \$6,464,880, 84 Misc. 2d at 833, 379 N.Y.S.2d at 975, but figures in his opinion indicate that the sum stated in the text is correct.

17. This sum of \$6,464,850 did not include interest from each sale date. The court, however, did assess this interest against executor Levine, thereby making his total liability higher than \$6,464,850. Because the court assessed appreciation damages—the value of the 140 paintings at the time of the decree—against the two disloyal executors, the court did not similarly charge the disloyal executors with interest. See note 21 *infra*. Thus, the difference between Levine's liability of \$6,464,850 plus interest and Reis's and Stamos's liability of \$9,252,000 is less than the appreciation damages of \$2,787,150.

18. The court also provided that liability should be reduced by the amounts already paid to the estate by the gallery. It further provided that the gallery could get credit, at the average values of \$90,000 per canvas and \$28,000 per paper, for any paintings it might be able to purchase and return to the estate. 84 Misc. 2d at 885, 379 N.Y.S.2d at 974-76. As modified by the Appellate Division, the order required the estate to accept any paintings thus returned. 56 App. Div. 2d at 504, 392 N.Y.S.2d at 875. This portion of the order may have been inspired by the beneficiaries' claim that the gallery had "parked" valuable paintings in friendly hands to place them out of reach of any court. Apparently the trial court guessed correctly; one report indicates that, as of mid-1977, 43 paintings had been returned for credit. See Carter, *supra* note 2, at 78. This feature of the order might temporarily, at least, have prevented any significant drop in the market value of the paintings originally belonging to the estate. On the other hand, if the gallery's promotions increased the value of Rothko's work, the gallery stood to gain from downgrading the importance of some of his works to lower the amounts it might have to pay for paintings it could return for credit.

19. This total appears in none of the reports. It represents the sum of what Surrogate Midonick referred to as "bulk dispositions." 84 Misc. 2d at 879, 379 N.Y.S.2d at 971.

value, and it held the gallery and all three executors liable for the difference between the fair market value of these paintings and the actual resale prices. The appreciation damages of \$2,787,150 levied against the two disloyal executors and the gallery represented the amount by which all the sold (and hence unrecoverable) works had appreciated in value in the hands of the purchasers and their transferees as of the date of the decree. The court declined to assess appreciation damages against the third executor, Levine, who had had no conflict of interest but who had negligently participated in a transaction with knowledge of his co-executors' conflicts.²⁰

Had the award against the two disloyal executors and the gallery been only for the sums received by the gallery for sales and resales of the paintings (\$5,476,500) plus interest from sale dates²¹ it would have been justified by the principle of restitution. Since the gallery received this amount under arrangements contemplating personal benefits of uncertain amounts for the disloyal executors, a lower award might have unjustly enriched persons who collaborated to compromise estate interests. And since the gallery's knowing collaboration in a breach of trust made it liable as a breaching fiduciary,²² the award of \$5,476,500 against it was also appropriate.

It is harder to justify the award of \$5,476,500 against Levine, the negligent but loyal co-executor, and of the additional \$988,350 against all three executors and the gallery. These awards are not restitutionary. Since Levine was not affiliated with the gallery, \$5,476,500—the amount received by the gallery—simply cannot represent Levine's unauthorized gains. Similarly, the additional award of \$988,350 was not even received by the gallery and could

20. The court reasoned that appreciation damages are appropriately assessed against those guilty of disloyalty but not against the merely negligent. It also noted that "Levine's help as a candid witness, his verbal protests, and absence of self-interest or bad faith motives . . . might well be the ground for relieving him of surcharge. But . . . [a]ll we can find in his favor is a lower measure of damages" 84 Misc. 2d at 846, 379 N.Y.S.2d at 942.

21. It should be noted that the court only assessed interest against executor Levine and not against the two disloyal executors. If the court had not assessed appreciation damages against the disloyal executors, it is quite likely that it would have charged them with interest from the sale dates. See note 17 *supra*.

There is some support for including interest when the court awards compensatory damages against the fiduciary but none for including it when the court makes the fiduciary account for unjustly realized gains. See *Marcus v. Otis*, 169 F.2d 148, 150-51 (2d Cir. 1948). It would seem, however, that the restitutionary principle would permit an award of interest approximating the value of the use of money to the fiduciary before he paid it over to the estate.

22. RESTATEMENT (SECOND) OF TRUSTS § 291, Comments d, e, & f (1959).

not have been realized by Levine, the disloyal executors, or the gallery. These awards could be justified as causally connected damages only if the estate beneficiaries were legally entitled to have the executors delay the disposition of the estate assets until the date of the gallery's sales. That is, *if* the executors had the duty to delay sales of the paintings, it might have been appropriate to measure compensatory damages by the real value of the paintings when sold by the gallery. But the Rothko executors had a power of sale, and the courts should have considered how loyal and non-negligent executors would have handled the estate under the circumstances.²³ Significantly, there was no finding that the timing of the estate contracts was wrongful.

That failure particularly prejudiced executor Levine. In light of the trial court's refusal to assess appreciation damages against Levine and the inapplicability of restitutionary liability, the court should have held Levine liable only for proximately caused damages. The court should have limited Levine's liability, with respect to the 100 paintings sold to the gallery in May 1970, to the difference between the adjusted contract price of \$1.2 million²⁴ and the market value as of that date. If, as some evidence

23. According to the trial court, the complainants' theory was that the executors sold too many paintings too soon for too little and consigned the balance in a way that surrendered control of the marketing of the estate's inventory to the gallery. The complainants' experts favored a more gradual plan of disposition that would have maximized the estate's share of the appreciation that typically follows the death of a highly regarded artist. However, if the court had estimated how loyal and non-negligent executors would have performed, it would have had to consider the problems confronting the Rothko executors in May 1970. For example, a loyal and non-negligent executor would have anticipated tax liabilities; weighed the risks of retaining inventory in the hope that, because of the stature of the artist and the quality of the paintings, its worth would increase; considered whether cash or art best suited the originally stated purpose of the residuary foundation to support deserving artists pending market acceptance of their works; and remembered the conventional wisdom of fiduciary administration that the fiduciary's first obligation is to conserve values which are certain and to avoid speculation. These considerations might well have led the court to conclude that the artist's cash position at death—\$330,000 in bank deposits and \$1.1 million in receivables largely owed by the defendant gallery (according to Seldes, *supra* note 2, at 178)—was probably inadequate to meet both the substantial estate taxes and the \$250,000 bequest to Mrs. Rothko and that the executors were justified in selling when they did in order to establish tax values and to meet these liabilities. Indeed, the original estate tax return of the executors conceded liability of \$546,000; the IRS responded with a deficiency assessment of \$4,611,500. *Art News*, March 1977, at 32 (letter from Franklin Feldman). Furthermore, some have questioned whether a substantial portion of the estate's inventory of paintings was actually of high quality. *See id.* at 32 (letter from John Bernard Myers).

24. Although the contract price was \$1.8 million, the court noted that the contract provided for installment payments without interest, and it discounted the average price per painting from \$18,000 to \$12,000. According to the court, then, the contract price was actually \$1.2 million. 84 Misc. 2d at 850, 379 N.Y.S.2d at 946.

showed, the value of the paintings increased by one-third between May 1970 and January 1972,²⁵ the failure of the trial court to assess only those damages caused by breach increased Levine's liability by about \$4.8 million.²⁶ Thus, the case illustrates that the failure to consider causal connection in fiduciary surcharge situations where the restitutionary principle is inapplicable may result in unintended penalties for those merely negligent.

The courts' treatment of the appreciation-damages issue is equally egregious and will be addressed in the remainder of this Article.

III. APPRECIATION DAMAGES

As noted above, all three courts held the two disloyal fiduciaries and the gallery liable for \$2,787,150 in appreciation damages, thereby bringing their total liability to \$9,252,000. The appreciation damages were neither proximately caused by the breach nor realized by the disloyal fiduciaries or by the gallery. The critical question is whether amounts exceeding both restitution and causally connected damages should be awarded against a disloyal fiduciary. The three opinions rely on several arguments for the surcharge, all of them unsatisfactory.

A. *The Reasoning Behind the Rothko Rulings*

The opinions state that appreciation damages compensate for values the estate would have enjoyed but for the executors' wrongful conduct. Judge Cooke of the court of appeals wrote: "[S]ince the paintings cannot be returned, the estate is therefore entitled to their value at the time of the decree, *i.e.*, appreciation damages. These are not punitive damages in a true sense, rather they are damages intended to make the estate whole."²⁷ Surrogate Midonick's comment is more revealing:

25. The trial court received this evidence, but made no finding.

26. The trial court indicated that of the 140 paintings sold, 71 were from the group of 100 purchased by the gallery and the remaining 69 were from the consigned paintings. Arguably, Levine should have been entirely exonerated from damages relating to the sales from the consigned art, since all of these sales appear to have been made at prices well in excess of market values as of May 1970. The possibly excessive 50% commission for the gallery would be moot once the gallery accounted for all the sales proceeds. At most, Levine's negligence in approving the overly generous commission should have made him a guarantor against the loss arising from the commission. Under this reasoning, Levine's maximum liability should have been about \$1.6 million plus interest, rather than \$6.4 million plus interest. The lower figure is the difference between the adjusted contract price of \$12,000 per painting and an average value of \$34,740 (market price in 1972, less one-third) for 71 paintings sold.

27. 43 N.Y.2d at 332, 372 N.E.2d at 298, 401 N.Y.S.2d at 456.

The question of allowing "lost profits" or "appreciation damages" to beneficiaries of a trust or estate for a breach of fiduciary duty is a difficult one where the fiduciaries have a power of sale. If in the area of trusts and estates the sole purpose of damages is to make the beneficiary whole, it would seem that when a fiduciary is authorized to sell and he sells to himself or to another with whom he is closely associated, the actual injury to the beneficiary is the difference, if any, between the price paid and the price which could have been obtained on the market. On the other hand is the rule that the fiduciary may be directed to reconvey the property at the option of the beneficiary if it remains in his possession and it may be argued that "[a]ppreciation damages represent the monetary equivalent of reconveyance."²⁸

Surrogate Midonick, in other words, argued that appreciation damages are compensatory because the fiduciary had the duty to return the assets in kind. His analysis, however, misses the point. First, estate beneficiaries have the right to restitution in kind only if the breaching fiduciary retains the asset. If the gallery (which was treated as a breaching fiduciary because of its collaboration in the breach) could keep the paintings by showing that the legal expectations of estate beneficiaries were limited to the fair market value of the paintings when sold by the executors, the gallery would be unjustly enriched. But once the gallery sells the paintings to bona fide purchasers, the restitutionary principle requires only that the gallery's liability be measured by the proceeds of the sales. Second, once the asset has been sold, appreciation damages are compensatory only if the fiduciary had the duty to retain the assets until the date of the decree. The Rothko executors, however, had no such duty. Moreover, if the *Rothko* court thought appreciation damages were compensatory, why did it not assess appreciation damages against executor Levine, whose negligence exposed him to claims for compensatory damages? Plainly, the award of appreciation damages is a slightly disguised penalty. If warranted at all, the penalty should be assessed openly, not in the guise of compensatory damages.

Perhaps anticipating this objection, the three opinions cite precedent and treatises in support of the penalty surcharges. Those authorities, however, are either unpersuasive or irrelevant.

The trial court asserted that appreciation damages are appropriate when the breaching fiduciary is guilty of bad faith, disloyalty, or self-dealing, and it cited the *Restatement (Second) of Trusts* (1959) as support.²⁹ The *Restatement*, however, is equiv-

28. 84 Misc. 2d at 876, 379 N.Y.S.2d at 968-69.

29. 84 Misc. 2d at 876-77, 379 N.Y.S.2d at 969.

ocal on appreciation damages.³⁰ On one hand, it rejects those precedents that treat all fiduciary transactions in breach of trust as void and thus make breaching trustees liable routinely for non-causally connected losses. Specifically, section 206 applies the general rules of section 205³¹ to a disloyal trustee.³² Section 205 limits the liability of a breaching trustee to any loss resulting from the breach of trust, or to any profit which would have accrued to the trust estate if there had been no breach.³³ Although that rule would suggest that a disloyal fiduciary is not liable for appreciation damages, neither section 205 nor section 206 directly addresses the liability of a disloyal trustee who buys estate assets and then resells.³⁴

On the other hand, section 205, comment f, of the *Restatement* also asserts that punitive damages are appropriately assessed when the fiduciary is guilty of conversion or some conflict of interest such as self-dealing.³⁵ As a law review note stated:

30. Referring to the *Restatement of Trusts* (1935), the author of a 1958 law review note about appreciation damage against trustees who exercise a power of sale by selling trust assets to themselves noted: "Treatise authority for the imposition of appreciation damages can be found in Scott and the Restatement. Neither authority, however, is free from equivocation; in the Restatement, in fact, the equivocation is so strong that it might be cited as contrary authority." Note, *Appreciation Damages for Self-Purchase by Trustee with Power of Sale*, 25 U. CHI. L. REV. 389, 389 n.3 (1958). This Article argues that *Restatement (Second) of Trusts* (1959) is similarly equivocal.

31. See note 4 *supra*.

32. RESTATEMENT (SECOND) OF TRUSTS § 206 (1959) reads:

Liability for Breach of Duty of Loyalty

The rule stated in § 205 is applicable where the trustee in breach of trust sells trust property to himself individually, or sells his individual property to himself as trustee, or otherwise violates his duty of loyalty.

33. RESTATEMENT (SECOND) OF TRUSTS § 205(b) (1959), *supra* note 4, also provides that a breaching trustee is liable for the restitution of any unjustly realized profits. See text at note 8 *supra*.

34. RESTATEMENT (SECOND) OF TRUSTS § 206 (1959), *supra* note 32, is primarily directed at a trustee who either buys estate assets or sells his own property to the estate.

35. RESTATEMENT (SECOND) OF TRUSTS § 205, Comment f (1959), states:

Loss Not Resulting from Breach of Trust. As is stated in Clause (a), a trustee is liable for a loss resulting from a breach of trust. A question may arise, therefore, as to the causal connection between the breach of trust and the loss. If the trustee commits a breach of trust and if a loss is incurred, the trustee may not be chargeable with the amount of the loss if it would have occurred in the absence of a breach of trust.

Where a trustee has committed a breach of trust in failing to earmark a trust investment, he is not necessarily liable for a loss resulting from the making of the investment. See § 179, Comment d. He is not liable where the loss did not result from the failure to earmark, except in a situation where as a matter of policy an absolute liability is imposed upon the trustee in order to deter him from committing such a breach of trust. The trustee is liable for the loss where he has taken securities in his own name in order that he may subsequently be in a position where he may claim the securities as his own if they go up in value and claim that they are held

[Trustee liability for losses not caused by breach] finds a parallel only in the harshest elements of the technical law of conversion. Where the trustee has acted in bad faith, the necessity of upholding the fiduciary character of the relation may require the imposition of a liability which is mainly punitive.³⁶

Arguably, then, the *Restatement* suggests that appreciation damages may be assessed against disloyal executors. This argument, however, is flawed. First, the *Restatement* mistakenly treats all instances of self-dealing as conversion.³⁷ Unlike conversion, self-dealing need not involve bad faith and may even benefit the estate. The *Restatement* correctly holds liable for any loss resulting from the investment, a trustee who fails to earmark trust assets and willfully arranges both his own and the trust assets so that those that depreciate could be shuffled over to the trust beneficiaries.³⁸ Since the fiduciary has, in effect, stolen the estate's assets, the penalty is appropriate. Contrary to the *Restatement*, however, it is inappropriate to make similarly liable as an insurer against future loss of market value a trustee who purchases for the trust property owned by him individually.³⁹ If

by him as trustee if they go down in value. He is liable for the loss even though he had no such purpose in mind, as long as his failure to earmark puts him in a position where it would be easy for him to make similar claims. On the other hand, if there is no danger that such claims could successfully be made, the breach of trust involved in the merely technical failure to earmark the investment does not render the trustee liable for a loss resulting from the investment.

If a breach of trust consists only in investing too large an amount in a single security or type of security, the trustee is liable only for such loss as results from the investment of the excess beyond the amount which it would have been proper so to invest. See § 228, Comment h.

If a trustee lends on mortgage more than the proper proportion of the value of the property, but the loan is otherwise proper, the trustee is liable only for the loss of the excess. See § 229, Comment b.

On the other hand, where the trustee purchases for the trust, property owned by him individually, and the property depreciates in value, it is immaterial that the trustee could properly have purchased similar property from a third person and that in such a case he would not have been liable for the loss. In order to deter self-dealing by the trustee, he is chargeable with any loss which results. See § 206, Comment d.

As to the liability of the trustee where he has failed to comply with the terms of the trust and has incurred a loss, but a loss would have occurred even though he had complied with the terms of the trust, see § 212.

As to the question of the liability for a loss where there is a subsequent gain, see § 213.

See *Miller v. Pender*, 93 N.H. 1, 34 A.2d 663 (1943).

36. Note, *supra* note 1, at 317.

37. The treatises make the same mistake. See G. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 543, at 217 (2d rev. ed. 1978); 2 A. SCOTT, *LAW OF TRUSTS* § 170.2 (3d ed. 1967).

38. *RESTATEMENT (SECOND) OF TRUSTS* § 205, Comment f (1959), *supra* note 35.

39. See the fifth paragraph of *RESTATEMENT (SECOND) OF TRUSTS* § 205, Comment f (1959), *supra* note 35.

the asset is suitable for trust investment, the price is fair, and the trustee is without hidden personal purpose, this kind of self-dealing is readily distinguishable from deliberate stealing and does not clearly warrant penalty damages.

Second, even if the *Restatement* is correct that some trustee conduct, including innocent or malevolent self-dealing, should be singled out for punitive treatment, appreciation damages are particularly harsh and are not supported even by the *Restatement*. Suppose a trustee sells an estate asset to himself and then resells it. Also, he purchases another asset for the trust from himself. The hypothesis is that the trustee can be penalized⁴⁰ for the subsequent appreciation of the asset sold and for the actual loss in value of the acquired trust asset. But, liability as an insurer against loss of the wrongfully acquired asset is significantly less harsh than liability for the value of the asset sold if it appreciates after it leaves the trustee's control. There is an obvious difference between making a trustee liable for more than he could have realized at any time when the asset was in his hands, and making a trustee liable for the fair market value of the assets when acquired or when sold. Moreover, the trustee as an involuntary insurer against loss of the wrongfully acquired asset can limit his liability by selling the asset for the benefit of the trust. This option, of course, is unavailable to a trustee who wrongfully sold to himself, resold, and accounted to the trust for full value received and who remains liable for subsequent appreciation.

In contrast to the *Restatement*, section 206 of Professor Scott's treatise states that appreciation damages may be assessed when a trustee (presumably with a power of sale) sells trust property to himself and subsequently resells to another.⁴¹ That brief assertion, however, is unpersuasive: the treatise cited no cases

40. The trustee's liability for the loss in value is here deemed a "penalty" only when the liability exceeds that causally related to the breach and restitution of any benefits realized by the trustee. Thus, when the trust might properly have acquired the asset and the trustee did not expect to incur the loss, liability for the loss in value is not causally related to the breach and constitutes a true penalty. In contrast, if the trust should *not* have acquired the asset because, say, the assets were impermissibly speculative, the trustee's liability for the asset's loss in value would normally be deemed causally related to the breach and would not constitute a penalty. See text at notes 5, 6, & 7 *supra*.

41. *Rothko*, of course, is now cited by Scott as support for the assessment of appreciation damages. 3 A. SCOTT, *supra* note 37, § 206, at 19-20 (Supp. 1978). *Id.* at 1675-76 (3d ed. 1967) states:

If the trustee sells property to himself individually, and subsequently resells the property to a third person, the beneficiaries have the option of charging him with the value of the property at the time of sale with interest, or with the value of the property at the time of the suit, or they can hold him accountable for the proceeds. (Emphasis added.)

and did not discuss the differences suggested above between liability for controllable loss and liability for subsequent appreciation.

During their discussions of appreciation damages, both Surrogate Midonick and the court of appeals cited section 208(b) of the *Restatement*. That section, however, provides that a trustee who breaches by selling assets he should have retained is liable for the value of the assets at the date of the decree.⁴² Since the executors in *Rothko* were clearly under no duty to retain the paintings, this section is simply inapplicable to them.

Surrogate Midonick⁴³ and the court of appeals⁴⁴ also read *Restatement* section 291, and the companion discussion in Professor Scott's treatise, as supporting the award of appreciation damages. Comment g of section 291 states that a transferee who receives property from a breaching trustee and who knows of that breach is liable for the value of the property at the time of the decree.⁴⁵ Thus, the section deals with the liability, not of a trustee, but of a transferee. Since it is unreasonable to impose a heavier liability on a transferee than on the defaulting trustee, the section only applies when the trustee is liable for appreciation damages. As noted above, a trustee is usually so liable only if he

42. RESTATEMENT (SECOND) OF TRUSTS § 208 (1959) reads:
Liability for Breach of Trust by Selling
Trust Property

(1) If the trustee sells trust property which it is his duty to retain, the beneficiary can

(a) charge him with its value at the time of such sale, with interest thereon; or
(b) charge him with its value at the time of the decree, with the income which would have accrued thereon if he had not sold it, or require him to make specific reparation if this is reasonable under the circumstances; or
(c) require him to account for the proceeds of the sale.

(2) If the trustee sells trust property which it is his duty to retain, the beneficiary can enforce an equitable lien upon the proceeds of the sale as security for his claim under the rules stated in Clauses (a) and (b).

43. 84 Misc. 2d at 835, 379 N.Y.S.2d at 967-68.

44. 43 N.Y.2d at 321-22, 372 N.E.2d at 297-98, 401 N.Y.S.2d at 456 (citing 4 A. SCOTT, *supra* note 37, § 291.2).

45. RESTATEMENT (SECOND) OF TRUSTS § 291, Comment g (1959), states:
§ 291 Extent of Liability of Transferee with Notice

.....
Comment g

If the trustee in breach of trust transfers trust property to a person who takes with notice of the breach of trust and the transferee has disposed of the property, he is liable for its value at the time of the decree with the income earned by the property from the time when it was acquired by the transferee until the time of the decree. Since the transferee has disposed of the property and cannot restore it to the trust, he can be compelled to pay to the trust the equivalent in money of what would have been in the trust if no breach of trust had been committed and the property had been retained in the trust. . . .

must retain the asset.⁴⁶ Thus interpreted, section 291 does not support the assessment of appreciation damages against the disloyal executors; it would, however, support the assessment against the gallery if the executors were otherwise liable.

Finally, the court of appeals offered an unusual interpretation of *Restatement* section 205, comment d, and the related discussion in Scott's treatise.⁴⁷ Both Scott⁴⁸ and the *Restatement*⁴⁹ note that liability for subsequent appreciation is normally proper only where a trustee has sold assets he was under a duty to retain. Both further observe that if the breach consists *only*⁵⁰ in selling the asset for too little, the trustee's liability is limited to the difference between its fair market value and the price received. The court of appeals interpreted the use of the word "only" to mean that appreciation damages are appropriate where the breach consisted of a misfeasance in addition to a sale for too little. That is, the court reasoned that appreciation damages should be assessed "where the breach of trust consists of a serious conflict of interest—which is more than merely selling for too little."⁵¹ Neither Scott nor the *Restatement*, however, supports such an interpretation. The *Restatement* does not discuss the point and Scott cites, as minority authority, only three English cases, none of which involve conversion or disloyalty by the trustees. In one of the cases, the court concluded that the trustee lacked a power to sell under the circumstances;⁵² in the others, a proper sale was found to be linked with an unpermitted investment of the proceeds and was treated as an unpermitted sale.⁵³ Since the latter two cases suggest that a trustee becomes an insurer whenever he breaches his trust—a liability harsher than

46. For example, under a casual reading of *Restatement* § 291, Comment g, a transferee with knowledge of breach by a trustee would be subject to greater liability than a trustee whose breach consisted of, say, selling a trust asset for too little. Section 205, Comment d indicates that such a trustee's liability is not for appreciation damages but for the difference between the fair market value of what the trustee actually received and the amount he should have received. Yet, read without qualification, § 291, Comment g suggests that the transferee with whom the trustee dealt in that situation may be liable for appreciation damages; that is, for the value of the property at the time of suit.

47. 43 N.Y.2d at 321, 372 N.E.2d at 297, 401 N.Y.S.2d at 456.

48. 3 A. SCOTT, *supra* note 37, § 208.3.

49. RESTATEMENT (SECOND) OF TRUSTS § 208, Comment d (1959).

50. 3 A. SCOTT, *supra* note 37, § 208.3 used "merely" instead of "only."

51. 43 N.Y.2d at 321, 372 N.E.2d at 297, 401 N.Y.S.2d at 456.

52. "The result is that the trustees ought not to have sold these bonds; they sold them without excuse, and must make the amount [present value] good so that the plaintiffs are absolutely protected." *Re Walker*, 62 L.T.R. (n.s.) 449, 452 (1890).

53. *Re Massingberd's Settlement*, 63 L.T.R. (n.s.) 296 (1890), *affg.* 60 L.T.R. (n.s.) 620 (1889); *Phillipson v. Gatty*, 7 Hare 516, 68 Eng. Rep. 213 (1848).

even *Restatement* section 205 contemplates—they are unpersuasive.

In sum, neither of these texts persuasively supports the assessment of appreciation damages. The *Restatement* approves those precedents which make disloyal fiduciaries insurers against loss, but is silent on appreciation damages. Although Scott asserts that disloyal fiduciaries are liable for appreciation damages, his statement is unsupported.

The case authority relied on by the *Rothko* opinions is even less compelling than either Scott or the *Restatement*. Although most of the cited cases are readily distinguishable from *Rothko*,⁵⁴

54. Surrogate Midonick cited *In re Talbot's Estate*, 141 Cal. App. 2d 309, 296 P.2d 848 (1956), where the court rejected a claim that a trustee who in good faith but wrongfully disposed of assets was liable for damages measured by the value of the asset at the time of suit. The opinion, however, noted that California statutory law appeared to sanction damages measured by the value of the property at the time of trial where the trustee operated in bad faith and that it limited to compensation damages for wrongful disposition in good faith. In dictum, it also suggested that the *Restatement* similarly supports a penalty recovery where the trustee operated in bad faith. At best, this authority simply restates California statutory law.

A second case Surrogate Midonick cited, *Hart v. Ten Eyck*, 2 Johns. Ch. 62, 116 (N.Y. 1816), involved executors who misappropriated proceeds of estate assets that were sold pursuant to a wrongfully obtained probate court order. Since the estate beneficiaries had a legal right to the assets in kind, the award of damages based on the value of the estate assets at the time of trial was clearly compensatory, and the precedent is not on point.

The court also cited a United States Supreme Court case, *Buffam v. Peter Barceloux Co.*, 289 U.S. 227 (1933), in support of its decision. In that case, stock in a family corporation had been fraudulently transferred and had come to rest in the hands of defendants. The district court awarded as damages for conversion the highest value attained by the stock up to the time of the decree. 51 F.2d 80 (N.D. Cal. 1929). The California statute on which the award was based was amended shortly thereafter to limit damages from conversion to compensation. The question in the Supreme Court was whether the defendants could return the stock in kind; that option was desirable because the value of the stock was then considerably below the district court's award. The Court held that the plaintiffs had the choice of remedies. This precedent, then, simply fails to address the issue of appreciation damages.

McKim v. Hibbard, 142 Mass. 422, 8 N.E. 152 (1886), which Surrogate Midonick cited without description or explanation, involved a trustee who sold trust assets for the purpose of misappropriating the proceeds and who continued to represent to the beneficiaries that the trust estate was still intact. The court held his sureties liable for the value of the assets as of the date of the trial. The court, noting the lack of evidence concerning the amount realized by the trustee from his misappropriation, treated the case as one where no power of sale existed. *McKim* is distinguishable from *Rothko* both in the degree of chicanery practiced by the fiduciary and in the propriety of the award as a means of avoiding unjust enrichment by an unknown amount. For all the court in *McKim* knew, the defaulting trustee had wrongfully realized amounts as large as the value of the former trust estate at the time of trial. The same plainly cannot be said of the *Rothko* defendants.

Finally, the Surrogate referred to a Texas precedent, *McCord v. Nabours*, 101 Tex. 494, 109 S.W. 913 (1908). That case is on point, but the court's reasoning in it is unpersuasive, for it merely relies on precedents in which the trustee lacked the power of sale.

some warrant specific mention. First, both the court of appeals⁵⁵ and the appellate division⁵⁶ cited *Menzel v. List*⁵⁷ for its assessment of appreciation damages. In that warranty of title action, the court held the seller of a stolen asset liable to the buyer, from whom the owner replevied the asset, for the value of the painting at the time of the decree rather than for the purchase price. The *Menzel* court reasoned that, absent the seller's breach of warranty, the buyer would have been entitled to the assets and that appreciation damages made the buyer whole. The New York Court of Appeals concluded that appreciation damages were similarly appropriate in *Rothko* since the *Rothko* plaintiffs would also have been entitled to the paintings if the defendants had not sold them.⁵⁸ What the court of appeals overlooked is that the *Rothko* beneficiaries—unlike a purchaser, who is legally protected from a title defect—had no legally protected expectation that the asset would remain subject to their interests.⁵⁹ The majority mistakenly considered the appreciation damages compensatory, but the *Rothko* beneficiaries were entitled to restitution of amounts unjustly realized, not to the monetary equivalent of reconveyance.

Second, the trial court relied extensively on *Hopkins v. Loeber*.⁶⁰ In that case, one of the three trustees who sold trust assets subsequently acquired those assets, as he had intended when he authorized the sale. Although the Illinois court limited the liability of the two loyal trustees to the value of the asset at the time of the disposition, it measured damages against the disloyal fiduciary as of the time the assets were later foreclosed. The reported opinion,⁶¹ however, gives no clue as to whether the disloyal trustee continued to hold the assets until the foreclosure. It emphasized that the disloyal trustee, unlike the other trustees, personally benefitted in an uncertain amount by the transaction, and it held that the sum paid at the foreclosure sale was evidence of the amount of the illegal gain. Since *Hopkins* may involve nothing more than restitution, it is insignificant for our inquiry. Further, whereas the *Rothko* trial court made specific findings of

55. 43 N.Y.2d at 322, 372 N.E.2d at 298, 401 N.Y.S.2d at 456.

56. 56 App. Div. 2d at 502, 392 N.Y.S.2d at 873.

57. 24 N.Y.2d 91, 246 N.E.2d 742, 298 N.Y.S.2d 979 (1969).

58. 43 N.Y.2d at 322, 372 N.E.2d at 298, 401 N.Y.S.2d at 456.

59. In the appellate division, Justice Nunez vainly argued this point. 56 App. Div. 2d at 508, 392 N.Y.S.2d at 877 (dissenting opinion).

60. 332 Ill. App. 140, 74 N.E.2d 39 (1947).

61. Although the reported opinion incorporates the facts and findings of an earlier decision in the case, only an abstract of the earlier decision was printed. See *Hopkins v. Loeber*, 323 Ill. App. 652, 56 N.E.2d 490 (1944).

the amounts received by the gallery, *Hopkins*, as precedent for a penalty award, is applicable only where the amount of conceded unjust enrichment cannot be measured.

Finally, Surrogate Midonick cited the New York conversion-of-stock cases.⁶² While under the current rule damages for conversion are measured by the market value of the stock as of a reasonable time after notice of the conversion,⁶³ the old rule held the converter liable for the stock's highest value between the date of conversion and the date of trial.⁶⁴ Although the courts rejected the old punitive rule because it leads to vindictive awards,⁶⁵ Surro-

62. 84 Misc. 2d at 878, 379 N.Y.S.2d at 970-71.

63. *Hartford Accident & Indem. Co. v. Walston & Co.*, 22 N.Y.2d 672, 291 N.Y.S.2d 366, 238 N.E.2d 754 (1968); cf. *German v. Snedeker*, 257 App. Div. 596, 13 N.Y.S.2d 237, *affd.*, 281 N.Y. 832, 24 N.E.2d 492 (1939), where the court held that the appropriate measure of damages was the market value of the stock at the time of the conversion or the market value of the stock within a reasonable time after notice of conversion, whichever was higher.

64. See Annot., *Measure of Damages for Conversion of Corporate Stock or Certificate*, 31 A.L.R.3d 1286 (1970), and cases cited at *id.* 1324 n.12.

65. In *Suydam v. Jackson*, 5 Sup. Ct. (3 Sand.) 614, 629 (N.Y. 1850), the court considered whether the measure of damage in conversion cases should be the highest value the goods attained between the date of the conversion and the entry of judgment. The opinion exhaustively analyzed English and American cases and observed:

Our objections to considering an intermediate higher value as an invariable rule of damages, have already been stated, and need not be repeated. It is perfectly just, when the enhanced price has been realized by the wrongdoer, or it is reasonable to believe would have been realized by the owner, had he retained the possession; but, in all other cases, damages founded upon such an estimate, are either purely speculative, or plainly vindictive. They are conjectural and speculative, when it is barely possible that the owner, had he retained the possession, would have derived a benefit from the higher value. They are vindictive, when it is certain that no such benefit could have resulted to him. It is however proper, and perhaps necessary, to examine the cases that have been cited and relied on, since the construction which has been given them by the defendant's counsel is by no means novel, nor unsupported by authority. It will appear, we think, that the true import of the English decisions has been greatly misunderstood, and that they by no means justify the conclusions which have been drawn from them.

Subsequently, the court of appeals, in *Baker v. Drake*, 53 N.Y. 211, 224 (1873), overruled *Markham v. Jaudon*, 41 N.Y. 235 (1869), which followed earlier precedents establishing the highest value to the day-of-trial rule for determining damages in stock conversion cases. The *Baker* opinion noted:

The most thorough consideration of the subject to be found in any reported case is contained in the extremely able opinion of Duer, J., in *Suydam v. Jenkins* . . . where that accomplished jurist reviews, with great discrimination, many of the cases here referred to, and others which have not been cited, and arrives substantially at the same conclusion as that reached by Church, Ch. J., in *Matthews v. Coe* . . . that the highest price which the property has borne at any time between its conversion and the trial cannot in all cases be the just measure of damages. The reasoning contained in that opinion is of such force as to outweigh the apparent preponderance of authority in favor of the rule claimed, and demonstrates its fallacy when applied to the facts of the present case, whether the cause of action be deemed for conversion of property or the breach of a contract.

gate Midonick argued that it should be used in disloyal fiduciary cases. He first conceded that a victim's ability to purchase other stocks and minimize his damages made the old rule harsh: it is unjust to "reward" those victims who fail to cover by awarding larger damages if the assets appreciate. He then reasoned that because a trust beneficiary is unlikely to learn of his trustee's breach and thus may be unable to cover purchases, the old rule would not harshly treat a disloyal fiduciary.

This reasoning is questionable. In effect, it uses precedents which New York had rejected because of their severity to justify imposing an extremely harsh liability on disloyal fiduciaries—a liability exceeding any benefit wrongfully obtained or any value the beneficiaries reasonably expected.

Moreover, it is clearly more justifiable to impose the old punitive rule on a converter than on a disloyal fiduciary. In contrast to a disloyal executor who partially benefits from his otherwise beneficial administration of an estate, a converter does nothing for his victim, who is deprived of possession and left with the remedy of damages or replevin. Damages equal to the present value of the chattel are compensatory as against one who refuses to yield possession on demand, and may be no more than compensatory when awarded against the original converter for the chattel's value as of a time soon after the conversion. A trust beneficiary without an enforceable expectation that a trustee will retain a particular asset has no legitimate claim to more than the value of the trustee's proper performance. Surrogate Midonick's reasoning should be rejected.

B. *Policy Arguments Against Appreciation Damages*

Although the authority the courts cited did not compel the assessment of appreciation damages in *Rothko*, one might still argue that the heavy penalty was justifiable, that the disloyal fiduciaries deserved all they got. Moreover, as the *Rothko* opinions say, the penalty deters disloyalty.

Penalty surcharges may be appropriate when they discourage undesired acts without creating factual or legal uncertainties that increase the cost of trust administration and invite complex litigation. Penalties, in other words, should attach only for violations of rules that are easily identified, understood and followed. The rules requiring fiduciaries to earmark trust property, to avoid commingling trust and personal assets, and to avoid self-dealing transfers of assets between themselves and trust estates are examples of such rules. Penalizing violations of them by making

fiduciaries insurers deters potentially harmful conduct by calling attention to obvious acts that should not occur unless specifically sanctioned by the trust instrument. Violations of such rules are readily avoided by fiduciaries and trust draftsmen. It does not follow, of course, that the penalties for these violations should be, as appreciation damages are, potentially unlimited and beyond the control of the errant fiduciary. A trustee who discovers that he has erred should be able to cure his error or to limit the consequences. Thus, a trustee who buys from or sells to himself should be able, by liquidating the assets, to protect the trust from depreciation and to limit his own liability as an insurer. If he cannot, expensive litigation is almost certain to follow, especially where the value of the assets has appreciated significantly.

Moreover, the wisdom of assessing any penalty can be questioned when a trustee has, or later may be said to have had, personal interests which conflict with his fiduciary duty. In such instances, it will usually be unclear whether the fiduciary has breached his duty of loyalty: liability is decided by hindsight and may arise in countless unforeseen ways. A penalty exceeding the liability of an insurer against controllable losses is simply an unjust remedy for conduct of only uncertain impropriety. Even in *Rothko*, the wrongfulness of the executors' conduct was not self-evident. For example, in 1969 Rothko sold a number of paintings to the gallery at prices comparable to those of the executors' 1970 sale and signed a long-term exclusive-consignment contract with the gallery.⁶⁶ Further, Rothko knew that Reis and Stamos had personal ties to the gallery. These facts suggest that Rothko wanted his executors to deal with the gallery. Nor was it clear that executor Reis profited financially from his connection with the gallery: the surrogate found that his prestige was enhanced.⁶⁷

66. None of the prevailing opinions mentioned the 1969 sale. Justice Nunez's dissenting opinion in the appellate division described a 1969 sale by Rothko to the gallery of 87 paintings for \$1,050,000. 56 App. Div. 2d at 508, 392 N.Y.S.2d at 877. Rosenberg, *supra* note 2, at 71, asserted: "In contrast to his earlier clenched hold on his paintings, Rothko seems to have manifested, in 1969, the year before his death, a sudden letting go: to Marlborough [the defendant gallery] he made the first big sales of his career, amounting to about \$1,700,000."

67. Counsel for executor Reis contended that his client's own considerable wealth, his advanced age (79 in 1974), and the small size of his \$8,000 per annum salary from the gallery made it unlikely that the desire for personal aggrandizement induced him to compromise the interests of the estate in a transaction with the gallery. Surrogate Midonick's response included the following: "This court finds that the prestige and status of Reis as a director, secretary and treasurer of [the gallery], apart from his salary . . . , and his fringe benefits and perquisites, were quite important to Reis' life style." 84 Misc. 2d 842-43, 379 N.Y.S.2d at 939.

Finally, while the court concluded that the 1970 sale and consignment was unfavorable in light of the gallery's highly profitable resales, much of the profit was generated by the gallery's vigorous promotion and by publicity from the litigation.⁶⁸

The costs of penalty awards in cases where a fiduciary's conduct is not obviously wrongful are most severe for estates consisting of unique assets where potential conflicts of interest are common. Testators and settlors whose estates include real property, closely held corporate stock, stamps, books, automobiles, coins, or art understandably select as fiduciaries persons knowledgeable about those assets. As these persons accept fiduciary positions or deal with associates or potential associates who are fiduciaries, conflicts or potential conflicts of interest must arise. A rule which discourages the selection of persons who are experienced and successful in the handling of the testator's kind of assets is clearly unwise.

68. The surrogate noted:

Before the contracts with the estate were executed, Marlborough [the gallery] undertook a comprehensive plan to promote Rothko paintings. The formulation of this plan was begun prior to the signing of the contracts in anticipation of the successful acquisition of estate paintings by Marlborough and the consignment of paintings for sale through Marlborough. This promotion consisted in the main of the arrangement of exhibitions of Rothko paintings throughout various countries and it must be recognized that such efforts enhanced the sales values of the paintings and accomplished sales at prices in excess of those obtainable in the artist's lifetime. The experts who testified at the trial were not in agreement upon the question as to whether or not the death of an artist, and the consequent limitation of his available works, would result in higher valuations, but it cannot be gainsaid that the promotional efforts of Marlborough had a major effect in publicizing Rothko works and in creating a market for his product at higher prices, far higher than date of death values.

84 Misc. 2d 860-61, 379 N.Y.S.2d at 955.

The dissenting opinion of appellate division Judge Nunez added:

Nor can it be gainsaid that Marlborough deserves much credit for creating a market for Rothko paintings during the artist's lifetime. And some of us are of the opinion that the extensive publicity given to this litigation which has become somewhat of a "cause célèbre" also enhanced the value of Mr. Rothko's works. The price of \$1,800,000 for 100 paintings does not compare unfavorably with the value of the decedent's paintings set by him in February, 1969 when he sold 87 of his paintings to Marlborough for \$1,050,000 payable over 14 years under two contracts which gave Marlborough the exclusive right to sell Mr. Rothko's works of art for a period of eight years. I note that although no relief was sought by petitioner-respondent with respect to these contracts, the Surrogate found that "from their conduct" the parties "intended to abandon and abrogate" them. Thus, the Surrogate *sua sponte* disposed of the 1969 *inter vivos* agreements which were a significant obstacle to the executors to sell the estate's paintings to any dealer other than Marlborough. Surely the exclusive covenant affected adversely the executors' bargaining power and the sale price of the property.

56 App. Div. 2d at 508, 392 N.Y.S.2d 870, 877.

Rothko will increase the complexity and cost of these trusteeships. As a precedent, it will encourage fiduciaries to consult their attorneys prior to any transaction possibly tainted with conflict of interest. And, if the attorneys read Surrogate Midonick's opinion carefully, the fiduciaries will be advised to seek a court proceeding with notice for and an opportunity to be heard by all persons interested in the estate, including appropriate state officials if charitable bequests are involved. What could be more wasteful? Expedited transactions will become impossible; transactions with the fiduciary's friends, associates, or any persons from whom some future favors might be predicted, no matter how favorable for the estate, will be too dangerous without test litigation and thus too expensive to be practical. For settlors and testators who would rather keep their estates out of court, the message of *Rothko* is obvious: they should either rearrange their estates so that they include only fungible and readily marketable assets or select fiduciaries without prior experience in handling the testator's unique assets. Conceivably, a settlor or testator might select an experienced fiduciary and expressly approve of the fiduciary's possible conflicts of interest. But this would be inviting trouble: broadly drawn exculpatory language may be held inapplicable, if not invalid, when tested against difficult facts. Finally, although a testator's draftsman might obviate the problem by providing that the fiduciary could sell to himself or to his associates at prices fixed by a committee of experts, a rule that penalizes all who fail to use the most innovative draftsmen surely can be questioned. It would be far better to permit the testator to select an honest and experienced fiduciary and to have rules which enable the fiduciary to operate in the estate's best interest without incurring grotesque legal risks.

All of this is not to quarrel with the *Rothko* courts' findings of liability, but rather to point out that the award of appreciation damages to deter acts potentially injurious to the economic interests of trust beneficiaries is a cure worse than the problem. It tends to produce high legal costs, uneconomic selections of fiduciaries, and exotic drafting.⁶⁹

69. Practically, it matters little to a trustee who is concerned about possible liability for conflicts of interest whether the high price of an adverse result is attributable to dubious rules for determining breach or to dubious penalty surcharges. Niles and Schwartz, *supra* note 1, at 169-70, observed:

No trustee lives in a vacuum. If, as Judge Thacher suggests, a beneficiary may avoid any transaction in which a possible conflict might exist—however remote the conflict, however unlikely the self-interest—private and professional trustees have a difficult future in New York. May a beneficiary surcharge a trustee for any decline

Moreover, estate beneficiaries have adequate remedies against disloyal fiduciaries: the standard combination of restitution of unjustly realized benefits, causally related damages, and conventional sanctions against defaulting fiduciaries adequately deters unpermitted conduct. In *Rothko*, for example, the restitutionary principle authorized an award of over \$5,476,500 against the disloyal executors and the gallery. The court also removed all the executors from office, presumably without compensation for their efforts from early 1970 until the trial-court order in late 1975, and charged them for the petitioners' attorney fees. Finally, the heavy burden of proof placed on a fiduciary who may have had personal reasons for his transactions in behalf of an estate also deters a fiduciary from engaging in questionable transactions.

Against the argument that *Rothko* may increase a fiduciary's legal costs, it might be argued that a fiduciary faced with possible conflicts of interest will incur these legal costs whether or not *Rothko* penalties are assessed. That is, the standard remedies for disloyalty may induce fiduciaries, before every transaction, to seek legal advice or court instructions concerning possible conflicts of interest. If that is true, the argument runs, the additional risk of liability for appreciation damages will not increase the legal costs of a fiduciary who may have a personal interest in conflict with that of the estate.

This argument is unpersuasive. First, those honest and able fiduciaries in a position of possible conflict may well be willing to administer the estate without extraordinary legal advice or court instructions if they know that the estate's fair market value at the time of its disposition will provide a ceiling on their liability. Honest fiduciaries will be overly cautious only when threatened with surcharges they can neither estimate nor control. Second, if costs will be the same without regard to the fiduciary's honesty, there is absolutely no justification for the award of any penalty surcharge in the name of deterrence.

Even if these considerations are unpersuasive and fail to end the judicial thirst to penalize disloyal fiduciaries, a penalty

in value if the trustee buys stock in a corporation of which he is an officer, a director, or even a stockholder? If a trustee is a lawyer, is he surchargeable for all loss if he buys shares or bonds of a corporation which he has advised or represented? Must a trust company avoid purchasing for its trust estates securities of corporations having officers or directors who are also directors of the trust company? In any of these cases there could be a selfish interest to be served, and if any were shown there would be a breach of trust. But should the mere disclosure of the relationship, without more, permit an avoidance of the transaction in every case?

measured by the value at the time of trial of an asset that is beyond the defendant's control is a bizarre punishment. When a court assesses appreciation damages, it admits, contrary to the usual rule that the penalty fit the misdeed, that the size of the penalty need not be related to the degree of culpability. Yet, one violation of the duty of undivided loyalty is not necessarily as unethical or immoral as another.⁷⁰ There is a significant difference between stealing another's property, thereby leaving him nothing, and partially benefitting from a position of trust in a way that may have been contemplated and condoned by a gift-maker. Rothko's executors, who were guilty of guessing wrong about the legality of self-aggrandizing acts that Rothko may have anticipated, were treated as thieves by the New York courts.

Finally, as *Rothko* vividly illustrated, disguising appreciation damages as a form of compensation may lead to shattering liabilities that would never be levied in the name of pure punishment. Few if any courts or juries in the land would have assessed a two-million dollar fine against executor Stamos. Stamos was a close friend of Rothko, a fellow artist and the guardian of Rothko's minor children. His disloyalty was simply that he wanted to favor the gallery because the gallery might help him gain recognition for his own works.

IV. CONCLUSION

Trust law has progressed in the last several decades toward eliminating surcharges against breaching trustees for sums unrelated to restitution of benefits illegally received or to damages proximately caused by the breach. *Rothko* is a step backward: it seems more likely to increase expense and inefficiency in fiduciary handlings of unique and speculative assets than to accomplish its avowed purpose of deterring disloyalty.

Perhaps the decision will not be followed. In contrast to the outstanding quality of the trial judge's opinion concerning liability, the portion of the opinion concerning damages is clearly strained. Perhaps the liability issue and the chore of tracing the paintings so preoccupied the court and counsel that they simply failed to pay adequate attention to the damage issue. The difference between personal liabilities of a small number of millions and several more millions may also have made the issue some-

70. Compare the case of a nonprofessional trustee who foolishly but innocently purchases assets for a fair price from an estate he manages as fiduciary with deliberate and concealed embezzlement of the sort that occurred in *McKim v. Hubbard*, 142 Mass. 422, 8 N.E. 152 (1886), *supra* note 54.

what insignificant to defendants who may well have been bankrupted by the smaller liability. What else could explain the staggering liabilities erroneously charged to Levine, the loyal executor?

That three of the five appellate division justices doubted or disagreed with the surrogate's conclusions regarding damages further weakens *Rothko's* strength as precedent. One of the three, Justice Kupferman, concluded that the importance of the case warranted the earliest possible review of the surrogate's findings on all issues by the court of appeals and so subdued his doubts and voted to affirm. Obviously, the size of the potential liabilities and the widespread publicity affected this stage of the proceeding. The failure of the court of appeals to consider damages more carefully is disappointing, to say the least. Surely, that court's opinion on damages is the least satisfactory of all of the opinions filed in the case.

My hope is that the startling high liabilities assessed in *Rothko* will induce other courts to reexamine the necessity and persuasiveness of the *Rothko* rulings on the size of the awards. In sum, the courts should reject *Rothko* and limit recoveries against disloyal fiduciaries to restitution and causally related damages.