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When trustees engage in untrustworthy acts

Trustees have a legal duty to manage trusts carefully, loyally, and in accordance with the governing document and applicable law—but failing to do so can come at a steep personal cost.

By Clifford L. Klein

Parents designate their children, spouses designate each other, aunts and uncles designate their favorite nieces and nephews. When we draft our trusts, we name trustees and successor trustees with little thought to what could happen down the road or to an assessment of their competence. But without guidance, these individuals are being sent into the jungle without a map.

When the rubber actually meets the road, all kinds of mishaps can occur. The blowups and blowouts might be the result of bad blood or bad intentions, but sometimes they're just the result of sheer ignorance.

When attorneys hand over probate documents to the deceased's best friend or next of kin, they might neglect to fully educate the newly appointed trustee, and any successor trustee, about the rules governing their services. This can be a big mistake.

Trustees have a legal duty to manage trusts carefully, loyally and in accordance with the trust document and applicable law, rather than what they "know is best." If trustees neglect to properly follow the law or administer the trust correctly, they could pay a steep price. Start with the legal requirement for notice. Even relatives who have ignored the family for years must be notified about the trust. Above all, trustees must communicate with beneficiaries and maintain neutrality. They cannot use their positions to settle longstanding feuds that have simmered under seemingly harmonious surfaces.



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It's complicated

Whenever I begin a mediation, I try to assure the aggrieved administrator or trustee that he or she is not a criminal: Trust administration can be complicated, and innocent mistakes often occur. I tell them that it is a thankless job. That's cold comfort for a family member struggling with little guidance and a considerable amount of flak from next of kin.

What trustees don't know can really hurt them. They may be on the hook for legal penalties and risk embittering other trust beneficiaries. For example, I often see an adult child innocently trying to help an elderly parent by adding his name

to a bank account or credit card for shopping and other errands. He does not record on receipts why the money was withdrawn or spent, and now he finds himself defending against claims of theft from other beneficiaries. When his parent dies, believing he is the sole survivor of a joint account (which may or may not be a trust asset) he may quietly help himself to the remaining funds, to the surprise of other family members.

Attorneys should advise laypersons that serving as a trustee is not for the faint of heart. It requires attention, diligence and substantial knowledge. I have seen excellent law firms provide prospective trustees

with multi-page sets of detailed instructions, including deadlines, asset inventories and valuations, real and personal property transfers, insurance, income and estate taxes, accountings and distributions. Suffice it to say that without appropriate legal guidance and oversight, a lot of things can go wrong.

The rules

According to Section 16000 of the Probate Code, a trustee who accepts the trust "has a duty to administer the trust according to the trust instrument and, except to the extent the trust instrument provides otherwise, according to this division."

Too often, a trustee fails to take the first and most important step: reading the trust. Trustees are vested by law with a fiduciary duty to manage trust assets, act in the best interests of all estate beneficiaries, and promptly distribute property as allowed by the trust, or explain why there may be delays before a petition is filed. The specific powers granted to trustees are spelled out in Probate Code Sections 16220 through 16249.

Fiduciary duty

Trustees should hear these specific words from legal counsel: “honesty, care, and good faith, prioritizing beneficiaries’ interests over their own.” They have “a duty to administer the trust solely in the interest of the beneficiaries,” cannot “use or deal with trust property for the trustee’s own profit or for any other purpose unconnected with the trust,” and cannot “take part in any transaction in which the trustee has an interest adverse to the beneficiary.”

From the beginning, trustees should understand that they have clear duties: to gather, safeguard and invest assets, provide mandatory notices to heirs, and account to beneficiaries. They cannot engage in self-dealing with trust property and investments. Hiring a handy relative who lacks a license may not be the best option for rewiring the house, but if that’s their choice, they should set up a separate account. Even though a trustee’s daughter had won “Best Real Estate Agent,” it was still not a good choice to work with her; other beneficiaries were hostile to the idea, despite being disadvantaged by using a different agent.

It can be difficult to communicate these laws with aggrieved trustees, who are often oblivious to how they are using their positions to settle family scores or benefit certain family members. Our clients may be motivated by personal vendettas: “Where were you when I was helping Dad?” “You always took money from our parents!” “Mom loved you more!” They will take hostile positions against certain beneficiaries, doing the minimum possible for them.

All of these can be costly for them, especially when the mediator advises, or the judge orders, that they have

to give these “ungrateful, opportunistic relatives” more money, even the ones who were too busy to show up at the decedent’s funeral. Practice tip: Make sure they were invited, as they will claim they were never informed.

Trustees face liability for breaching any of their duties, and beneficiaries can sue them for violations such as withholding information, misappropriating trust assets, making improper investments or delaying distribution of assets.

Asset management

In their roles as managers, trustees are required to hold trust assets, preserve them and make them productive. Probate Code Section 16009 imposes a duty to “keep the trust property separate from other property not subject to the trust.” It is therefore a breach of duty to commingle trust assets with personal bank accounts.

I continue, however, to see rents collected for the benefit of a trust property commingled in a trustee’s account, along with withdrawals for property upkeep and taxes, also not specifically recorded. I also see “off the book” loans, especially from the decedent, lacking any documentation.

Probate Code Section 16007 calls upon trustees “to make the trust property productive.” If a trustee fails to diversify investments, concentrating exclusively in high-risk ventures such as department stores and shopping centers, or if he or she leaves a majority of cash in low-interest accounts for lengthy periods of time, this could be considered a serious breach of duty. Often, several relatives will inherit the family business, with inevitably one family member ready to “modernize” the management while others want to preserve its traditional way of running the business.

A trustee who allows heirs to live in the family home without adjusting the rent, to the dismay of the other beneficiaries who have been patiently waiting to raise the rent, or one who holds the rent stable for a long-term reliable tenant, may be yet another source of litigation. With proper communication, the other beneficiaries may be willing to compromise without going to litigation.

Accounts and records

Pursuant to Probate Code Sections 16060-16064, trustees must provide regular, formal accountings to trust beneficiaries. This includes records of such matters as home repairs, bank withdrawals, shopping trips, medical expenses and credit card payments. But ignorance, laziness or sheer incompetence can result in poor or nonexistent records.

A trustee must also ensure that beneficiaries know the status and location of trust assets. When personal effects such as jewelry, photos and artwork are stored or divided, the onus is on the trustee to keep records and to communicate with beneficiaries about where those items are stored and how to access them. The trustee should provide deadlines for any specific requests, and most importantly, should not decide on their own what is rightfully theirs based on private conversations with the trustor.

Communication with beneficiaries is critical. Failure to save receipts, properly account for expenditures, and maintain records of personal items can leave beneficiaries clueless about how and where trust funds were used and where valuable items may be found.

Distributions

Trust assets should be promptly distributed, typically within 12 to 18 months for straightforward trusts. Many trusts are terminating trusts or require that the trustee allocate assets of a surviving spouse, dividing the trust between a family and survivor trust or other subtrusts, but the trustee or successor trustee neglects to follow up. Any such failures on the part of the trustee may be considered a breach of the trustee’s duties.

HEMS (health, education, maintenance or support) trusts are another potential source of litigation. Without proper advice, a trustee may fail to properly manage a HEMS trust that has been set up for the purpose of protecting the assets of a trust beneficiary.

When properly configured, a HEMS distribution combined with a spendthrift provision should protect the beneficiary from creditors’ claims against trust property. If the trust is not properly managed, its asset

protection features may not work as planned. As experienced trust attorneys know, the trustee and the beneficiary often have different ideas about the appropriate amount.

This can be a sensitive issue with beneficiaries who suffer from mental health problems or criminal records. Documentation can be important to explain the trustor’s reasons. Practice tip: Be careful if you are permitting a higher monthly HEMS than the salary of the judge hearing your case.

Conclusion

Serving as a trustee may not require rocket science, but it comes with a high level of responsibility and quite a number of obligations. Because of this, and because failure to adhere to the legal requirements can be so costly, trusteeship should never be taken on lightly. And it should never be assumed without a clear understanding of the duties and obligations associated with this role.

For this reason, it is good practice for estates and trusts attorneys to educate prospective trustees and successor trustees about the trusts they will be managing and the legal requirements attached to their new roles. If the named trustees are unwilling or unable to assume those responsibilities, alternative trustees should be designated, educated and put to work. When I am asked to serve as a trustee, I selfishly refuse this thankless job.

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