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**STATE OF MINNESOTA
IN COURT OF APPEALS
A10-590**

In the Matter of the Trust Created by Lottie P. Silliman,
dated December 29, 1950,
commonly known as The Silliman Trust.

**Filed December 14, 2010
Affirmed in part, reversed in part, and remanded
Shumaker, Judge**

Cottonwood County District Court
File No. 17-CV-06-645

C. Thomas Wilson, Sara N. Wilson, Gislason & Hunter, LLP, New Ulm, Minnesota (for
appellant Ruby S. Gustafson)

George R. Serdar, Messerli & Kramer, P.A., Minneapolis, Minnesota (for respondents)

Considered and decided by Schellhas, Presiding Judge; Klaphake, Judge; and
Shumaker, Judge.

UNPUBLISHED OPINION

SHUMAKER, Judge

In this appeal and cross-appeal, the parties dispute the meaning of trust language,
issues relating to fiduciary duties of the trustees, and damages to appellant as a trust
beneficiary. Because we hold that the district court's conclusion as to the trust settlor's

intent was erroneous, that the district court's finding that the trustees breached their fiduciary duties was correct and supported by the evidence, and that the court's calculation of damages to appellant was premised on an incorrect measure of damages, we affirm in part, reverse in part, and remand.

FACTS

The principal question on appeal is whether the trustees of a trust under which the appellant is a beneficiary are required by the trust instrument to distribute all net income to the beneficiaries or have the discretion to reinvest a portion of trust receipts into corpus.

Lottie Silliman created an irrevocable inter vivos trust in 1950, the corpus of which was income-producing farmland. Her six children were named as life beneficiaries, and they were also designated as the trustees. After the last of the six children died, three of Silliman's grandchildren became successor trustees, and trust beneficiaries.

From the inception of the trust until 1997, the trustees distributed all of the trust's net income, after deducting expenses, to the beneficiaries. Since 1997, however, the successor trustees have distributed approximately 50% of the trust receipts to the beneficiaries and have reinvested the rest into trust corpus.

Appellant Ruby S. Gustafson is a granddaughter of Silliman and a trust beneficiary who began receiving trust distributions in 1972. From that year until 1997, she reported the trust income she received on her income tax returns and paid taxes on that income. Beginning in 1997, she received less than her full share of trust income

because the trustees held back approximately one-half for reinvestment, even though they reported to the IRS that they had distributed all of the income to the trust beneficiaries. Gustafson reported and paid taxes on her full share of trust receipts, thus reporting and paying taxes on what the district court characterized as “phantom income.”

Gustafson sued the trustees in 2006, claiming that they misinterpreted the trust instrument regarding the requirement that they distribute all net income of the trust and that they breached their fiduciary duties in administering the trust. After the district court denied Gustafson’s motion for partial summary judgment, the court held a bifurcated trial.

The first part of the trial pertained to Silliman’s intent regarding the trustees’ authority over trust receipts, the court having determined that the trust language on that issue was ambiguous and that extrinsic evidence was necessary to resolve the question.

After the first part of the bifurcated trial, the district court found, among other things, that the trust instrument provides for the annual distribution of net income to the life beneficiaries; that, prior to 1997, the trustees distributed all net income to the beneficiaries; that since 1997, the trustees chose to distribute only 50% of trust receipts as income and to reinvest the remainder into the trust corpus; that, since 1997, the trust has purchased additional farmland and the trustees have invested trust receipts in an ethanol co-op, a soybean co-op, and a wind-energy generation business; and that, since 1997, the trust has been administered as a “simple trust” under tax law, and that the trust “improperly characterized retained income as distributed income.” The court concluded that it was Silliman’s intent to grant the trustees “broad discretion in determining the

portion of net income which is distributable to income beneficiaries,” subject to the trustees’ unanimous consent and fiduciary obligations. Gustafson contends that the court erred in ruling that the trust instrument is ambiguous on the issue of Silliman’s intent and, in any event, that the evidence adduced at the first part of the trial does not support the conclusion that the court reached. She also contends that the court erred in failing to award damages to her.

The second part of the bifurcated trial principally concerned the question of whether the trustees breached their fiduciary duties in administering the trust. The district court found abuses of discretion and breaches of fiduciary duties when the trustees erroneously reported to the Internal Revenue Service (IRS) that income had been distributed when in fact it had been accumulated by the trust, and when it accumulated large amounts of tax-free income which produced substantial increases to principal “but failed to produce similar results for the income beneficiaries.” Respondent-trustees challenge these determinations on appeal.

Finally, Gustafson sought to recover from the trustees the state and federal taxes she paid on the “phantom income,” which was not distributed to her but was accumulated by the trust. The court ruled that Gustafson failed to show that she has filed for a tax refund or credit and, further, the court held that it lacks subject-matter jurisdiction over federal tax issues. Gustafson challenges those rulings on appeal.

DECISION

Settlor's Intent

The controlling issue on appeal is that of the trust settlor's intent regarding the trustees' authority to distribute or to retain and reinvest trust income. We review de novo the question of whether a written legal instrument is ambiguous. *Mollico v. Mollico*, 628 N.W.2d 637, 641 (Minn. App. 2001). Ambiguity exists when there is an honest difference of opinion which raises a reasonable doubt about the legal effect of the trust instrument so that resolution by a court is necessary. See *In re Great N. Iron Ore Props.*, 311 N.W.2d 488, 492 (Minn. 1981). If a legal instrument is unambiguous, there is no occasion for interpretation but rather the court must apply and enforce the rights and duties reflected therein. *In re Trust of Campbell*, 258 N.W.2d 856, 864 (Minn. 1977). If, on the other hand, a legal instrument is ambiguous, the district court may consider extrinsic evidence to resolve the ambiguity. *Id.* When the district court considers and relies upon extrinsic evidence to resolve an ambiguity in a legal instrument, we apply a clearly erroneous standard of review. *In re Trust of Hill*, 499 N.W.2d 475, 482 (Minn. App. 1993), review denied (Minn. July 15, 1993).

In Article II of the Silliman Trust, the trustees are granted general powers to “sell, assign, convey, exchange, and otherwise dispose of” trust assets, subject to certain conditions and limitations not in dispute here. Portions of Article V are in dispute, and they relate to both the trustees' obligation to distribute net income and their right to determine income and corpus:

The net income from the trust remaining after the payment of expenses of managing the trust and the taxes due from said trust, shall be paid annually in equal shares to the following during their lifetime.

....

In the making of the distribution of the annual income of this trust, the trustees shall have the right to determine what constitutes income and what constitutes corpus. They shall have the further privilege of reinvesting any proceeds from the sale of trust assets or making a distribution of such proceeds to the then beneficiaries of the trust.

Gustafson contends that the trust language reveals the settlor's clear intent that net income, in its entirety, is to be distributed annually to the beneficiaries. Thus, the trustees have no right to retain any portion of net income and to invest it in trust corpus.

The trustees argue that Gustafson's reading is selective and that it ignores the general powers conferred on them in Article II and the specific rights granted to them in Article V to allocate annual receipts either to income or corpus, and to reinvest proceeds into corpus or to distribute them to the beneficiaries.

The district court found that the trust is ambiguous as to the settlor's intent and concluded, after trial, that the settlor intended that the trustees would have the right to distribute or to reinvest annual income, which right is limited by fiduciary duties and the need to act in the best interests of the beneficiaries.

The standard, broad-powers provision in Article II is not determinative of the settlor's intent because Article V specifically addresses the issue in dispute. *See Weiss v. City of St. Paul*, 211 Minn. 170, 174, 300 N.W. 795, 797 (1941) (stating that contractual provisions containing specific terms control over general provisions). Thus, Article V is

controlling. Under that article, there are arguably two contradictory provisions. First, the trust directs the trustees to pay net income annually to the beneficiaries. This provision is without conditions or qualifications. Second, the trust provides that, in distributing trust income, the trustees “shall have the right to determine what constitutes income and what constitutes corpus.” If the trustees are mandated to distribute all net income, there would be no opportunity to allocate annual income either to income or to corpus.

In responding to Gustafson’s motion for partial summary judgment on the issue of the settlor’s intent, the district court, having made a thorough and plausible analysis of the trust instrument and pertinent principles of the law of trusts, concluded that the trust terms are ambiguous as to “the breadth of the discretion that the trustees have in classifying what is income and what is principal.” The district court denied Gustafson’s motion, stating that “the inconsistent terms within the Trust document” required “collateral evidence, pertaining to the intent of the settlor and the surrounding circumstances at the time of execution”

Citing to *Cartee*, Gustafson argues that “[t]he powers of a trustee are either mandatory or discretionary,” and that “[a] power is mandatory when it authorizes and commands the trustee to perform some positive act, and is discretionary when the trustee may refrain from exercising it.” *Cartee v. Lesley*, 290 S.C. 333, 336, 350 S.E.2d 388, 389 (S.C. 1986). She then points out that Article V mandates the distribution of annual income. Article V surely does that, but it also gives the trustees the “right” to decide what is income and what is corpus when they make the mandatory distribution. If the trustees are mandated to distribute net income entirely, there would be no need for them

to choose between income and corpus in characterizing trust proceeds. Thus, on de novo review, it seems that the district court was correct in concluding that the trust is ambiguous as to the settlor's intent respecting the trustees' authority to distribute or retain income.

After denying Gustafson's motion, the district court then held the first part of a bifurcated trial to determine "the intent of the settlor." Critical to an assessment of the propriety of the court's determination after trial is an understanding of what the court meant by the "settlor's intent." It is clear from the district court's summary-judgment order and memorandum that the focus was not on the question of whether the settlor intended to mandate the distribution of all net income, as opposed to giving the trustees discretion to allocate some income to corpus. Rather, the issue for the court was "the breadth of the trustees' discretion in determining the amount of distributable income." And, in its findings of fact after trial, the court adopted "the factual and legal conclusions / analysis of its" summary-judgment order and memorandum. Implicit in the court's summary-judgment ruling was a determination that the trustees have at least some discretion to determine what amount of income is distributable to the beneficiaries. Thus, the district court's focus was on a different issue from that raised on appeal by Gustafson, and from that which we now address. The question is whether the settlor intended to give the trustees *any* discretion respecting what is to be done with the income left after expenses and taxes, called net income. We do not begin with the assumption that the settlor granted to the trustees at least some discretion to decide whether to distribute or to retain trust income. It is apparent from Article V that the trustees have what the district

court called “allocative discretion,” but it is unclear whether that discretion prevails over the apparent mandate to the trustees to distribute net income to the beneficiaries. The only provision in Article V that expressly gives the trustees discretion to reinvest in corpus appears to limit that discretion to “proceeds from the sale of trust assets” And in Article II, the settlor made it clear that she wanted the trust to retain its primary feature of farmland corpus, stating that, acting “toward the greatest interests of the beneficiaries, diversification of trust funds shall not be deemed to be important, it being my intention that, as much as possible, the trust fund be retained in the form of real estate.”

Considering the issue in the first part of the bifurcated trial to be that of the breadth of the trustees’ discretion, the district court made several supportive findings, none of which is challenged on appeal. The court described conversations among certain original trustees, successor trustees, and the settlor, Lottie Silliman. Some trustees emphasized that the trust was intended as a gift and that income therefrom was to be neither expected nor relied upon; that the trust was not set up to be a source of income for anyone; that the trustees would be allowed to make their own decisions regarding the management of trust assets considering “evolving economic farming conditions”; and that the original trustees believed that the trust instrument gave them broad discretion to make investment decisions. The court found that successor trustees “were faced with issues of concern regarding the changes in the farming business and market, including inflation, increasing overhead costs, the need for vast capital improvements, and volatile crop prices.” The court also found that Gustafson testified that she was raised by the

settlor and that the settlor “told her that the Trust was designed so that she would never have to worry about monies in her lifetime.”

Finally, the court found that the original trustees’ statements regarding the purpose of the trust, and their understanding of the breadth of their discretionary authority, together with the fact that the original trustees were able to communicate with the settlor, indicate that the settlor intended to give the trustees the “broad and sweeping discretionary authority” found in Article II. Thus, the court concluded that Gustafson had failed to prove that the settlor intended “to give the trustees no discretionary authority to withhold net income for the purposes of expanding capital or for the purposes of increasing the profitability of capital assets.”

In reaching its conclusion, the district court was persuaded primarily by two sets of facts. First, various trustees told various beneficiaries not to rely on the trust to provide them with income. Second, the original trustees told one of the successor trustees that the trustees had broad discretion under the trust to make investment decisions and that there had been discussions among the original trustees and the successor trustees about investments.

In our view, neither set of facts is compelling as support of the proposition that the trustees may choose not to pay out all income annually despite the direction in the trust language that they are to do just that. Statements by trustees that beneficiaries should not count on receiving trust income might equally plausibly reflect their acknowledgement of the vicissitudes of the farm economy and the uncertainty from year to year that any significant income would flow from the trust property. Or it could be sound moral advice

that the beneficiaries should continue to make their own way in the world and not depend on the gift of trust money to support them. And discussions among the trustees about discretion to make investments do not inexorably lead to the conclusion that the trustees believed they could hold back and reinvest trust income, for they might instead have been thinking of the express “privilege of reinvesting any proceeds from the sale of trust assets,” provided in Article V. Thus, the findings on which the district court relied to reach its conclusion that the settlor intended to give broad discretion to the trustees are not inconsistent with the contrary conclusion, namely, that the trustees do not have discretion to hold back annual income from the beneficiaries.

Furthermore, this contrary conclusion is bolstered by the additional, uncontroverted evidence in the record and the legal principle of practical construction.

The additional, uncontroverted evidence is that every year for 47 years, from the inception of the trust, the trustees paid all net income to the beneficiaries and held back none for reinvestment into trust corpus. And when a successor trustee proposed investing in capital assets, an original trustee stated, “There is no way that is going to happen.” No investments were made until 1997 and succeeding years, after all original trustees had died. Further, the trustees throughout the entire history of the trust have treated it as a simple trust for tax purposes, and as such the trustees are required to distribute annual income to the beneficiaries. I.R.C. § 651 (2006); Treas. Reg. § 1.651(a)-1 (1960). There is no evidence in the record as to any statements by the settlor respecting what she intended to allow the trustees to do with trust income. There is simply the opinion of

some trustees that broad discretion was given, and that opinion appears to derive from various cautions trustees gave to beneficiaries not to rely on the trust for their support.

When we apply the rule of practical construction to the uncontroverted evidence in its entirety, we are compelled to hold that the district court's conclusion is not sustainable. "The rule of practical construction is based upon the principle that the parties to an instrument may adopt their own interpretation of obscure or doubtful provisions and as between themselves render clear and certain what their language has left in ambiguity." *Campbell*, 258 N.W.2d at 864 (quoting *First & Am. Nat'l Bank of Duluth v. Higgins*, 208 Minn. 295, 319, 293 N.W. 585, 597 (1940)). It would be improvident to ignore the consistent, longstanding conduct of the original trustees, who lived during the settlor's lifetime and who would presumably be subject to the settlor's scrutiny as they administered the trust, in favor of the conduct of successor trustees who became such after the settlor's death and who radically altered the customary manner of dealing with Silliman Trust income.

The district court's conclusion is less supported by fact than by opinion, fails to account for significant factual evidence as to the undisputed historical treatment of trust assets, and is bereft of any guiding principle of law. It is our view that the rule of practical construction applies here and resolves the ambiguity in the trust language, albeit not perfectly. When we apply that principle to the facts as a whole, we are compelled to hold that the court's conclusion that the trustees enjoy broad allocative discretion as to whether to distribute or to hold back net income is not sustainable. We thus reverse that determination.

Trustees' Breach of Fiduciary Duties

The issue in the second part of the bifurcated trial was whether the trustees breached their fiduciary duty to the beneficiaries. There is no dispute that the trustees of the Silliman Trust stand in a fiduciary relationship to the trust beneficiaries. One feature of that relationship is the requirement that the trustees administer the trust impartially:

(1) A trustee has a duty to administer the trust in a manner that is impartial with respect to the various beneficiaries of the trust, requiring that:

(a) in investing, protecting, and distributing the trust estate, and in other administrative functions, the trustee must act impartially and with due regard for the diverse beneficial interests created by the terms of the trust.

Restatement (Third) of Trusts § 79 (2007).

The district court found that “the Trust instrument does not clearly permit the Trustees to favor remainder beneficiaries to the detriment of income beneficiaries,” and that the trustees “have breached their fiduciary duty of impartiality by unduly favoring remainder beneficiaries to the detriment of income beneficiaries.” We review the district court’s findings to determine whether any are clearly erroneous. *Pedro v. Pedro*, 489 N.W.2d 798, 801 (Minn. App. 1992), *review denied* (Minn. Oct. 20, 1992).

The district court specifically found that the trustees breached their duty of impartiality by “erroneously reporting income distributions to the IRS that the Trust plainly accumulated from 1997 through 2007.” The consequence of such reporting was that the “income beneficiaries have unduly shouldered the tax burden on all income accumulated by the Trust for tax years 1997 through 2007,” and that “the remainder beneficiaries wholly benefited from said reporting and accounting error.” The court also

specifically found that the trustees breached their fiduciary duty of impartiality “by accumulating large amounts of tax-free income (from 1997 through 2007), which has resulted in substantial increases to the Trust’s principal account but failed to produce similar results for the income beneficiaries.”

The record fully supports the court’s findings that the trustees erroneously reported to the IRS distributed income that had not in fact been distributed; that Gustafson paid taxes for several years on income she had not received; and that the trustees, for ten years, accumulated income that they added to trust principal without producing a comparable benefit for the income beneficiaries. The trustees do not dispute these facts but they contend that the court erred in concluding from these facts that they breached their fiduciary duty to the beneficiaries. They argue that they properly exercised their discretion to allocate some trust income to appropriate investments and that the “so-called ‘accumulations’ included non-cash patronage dividends that the Trust receives from its co-op investments.” They also urge that their investments have in fact increased the value of the trust’s farmland. The trustees further contend that to compare the rate of equity growth (267%) to the rate of income distributions (14%), as the court allegedly did, was “comparing apples to oranges,” because trust income is derived from crop sales and related investments and that cannot be compared to the escalation of non-liquid farm value.

That the trustees erroneously reported undistributed income as having been distributed for the tax years is an unassailable fact in this case. And that such acts by the trustees caused Gustafson to pay taxes on money she did not receive, but which the

trustees reported as having been distributed to her, is also an incontrovertible fact. In finding that the trustees breached their fiduciary duty to Gustafson regarding tax reporting, the district court committed no error.

It is undisputed that the trustees accumulated income that they otherwise might have paid to the beneficiaries, and used it to increase the value of the principal. The district court's concern was that an inequitable benefit inured to trust corpus, and ostensibly to remaindermen, at the expense of income beneficiaries. Although we find no clear error in the district court's ruling, we need not make the nuanced analysis that the trustees offer because we have held that the trustees have no discretion to hold back net income and to reinvest it in corpus. As the trustees concede, "a [t]rustee's discretion may not be exercised in a manner that defeats the settlor's intent or the purposes of the trust." They correctly cite *Norwest Bank Minn. North N.A. v. Beckler*, 663 N.W.2d 571, 580 (Minn. App. 2003), for that proposition. Thus, we affirm the district court's ruling that the trustees breached their fiduciary duty, but a remand is necessary on this issue for a calculation of damages, if any, considering the equalization that has already taken place.

Further, regarding damages, the district court calculated Gustafson's damages as the amount of income taxes she paid for ten years on her "phantom income," but then the court held that it lacked subject-matter jurisdiction over federal tax issues and did not award such damages to her.

The proper measure of damages, however, is the aggregate of the income distributions Gustafson was entitled to receive, and on which she has already paid taxes. The remedy for a trustee's breach of a fiduciary duty is the amount of money necessary to

place the beneficiary in the position she would have been in had the trustee performed the duty. *In re Will of Comstock*, 219 Minn. 325, 338, 17 N.W.2d 656, 664 (1945). The district court appeared to suggest that Gustafson's proper remedy would be to seek a tax refund or credit. But, because the trustees improperly failed to pay to her the appropriate shares of net income, that is what she has lost and over which the district court has jurisdiction. Thus, we reverse the district court's determination that it lacks subject-matter jurisdiction over the issue of Gustafson's damages, and we remand for a determination of such damages.

Affirmed in part, reversed in part, and remanded.