COURT OF COMMON PLEAS OF PHILADELPHIA COUNTY
ORPHANS' COURT DIVISION
Mary and Emanuel Rosenfeld Foundation Trust
O.C. No. 1664 IV of 2002
Control No. 040671

Sur account entitled First Account of the Mary and Emanuel Rosenfeld Foundation Trust Established Under Deed Dated December 1, 1952 as Stated by Wachovia Bank, N.A., Lester Rosenfeld, Rita E. Stein and Robert Rosenfeld, Co-trustees

The account was called for Audit May 3, 2004 **Before: Herron, J.**
Counsel appeared as follows:

Ralph G. Wellington, Esquire – for Wachovia Bank, N.A.
Jennifer DuFault James, Esquire – for Wachovia Bank, N.A.
Paul R. Rosen, Esquire – for Rita Stein
David Picker, Esquire – for Rita Stein
Leonard S. Abrams, Esquire – for Lester and Robert Rosenfeld
Charles E. Donohue, Esquire – for the Commonwealth of Pennsylvania
A. James Millar, Esquire – for the Commonwealth of Pennsylvania

ADJUDICATION

By an irrevocable trust agreement dated December 1, 1952 (hereinafter "Rosenfeld trust agreement" or "trust agreement"), Emanuel Rosenfeld created a perpetual charitable trust entitled the Mary and Emanuel Rosenfeld Foundation ("Rosenfeld Trust"). He named 3 individual co-trustees: Lester Rosenfeld (his son), Rita E. Korn (his daughter, presently Rita Stein) and Murray Rosenfeld (his brother). The Rosenfeld trust agreement also named a corporate trustee, Fidelity-Philadelphia Trust Company(hereinafter "bank" or "corporate trustee").[1] After the death of Murray Rosenfeld, he was replaced by Robert Rosenfeld, the settlor's grandson and the son of Lester Rosenfeld. Through a series of mergers, the current corporate trustee is now Wachovia Bank, N.A., as the successor to the Fidelity-Philadelphia Trust Company. On

[1] Because the name of this corporate trustee has changed numerous times over the course of the accounting period due to a series of mergers (i.e. Wachovia Bank, N.A., formerly First Union National Bank, Fidelity-Philadelphia Trust Company), it shall be generally referred to as "bank" or "corporate trustee."

March 31, 2004, Wachovia Bank, as trustee, filed a first account for the Rosenfeld Trust for the period January 9, 1953 through December 24, 2003. Objections were subsequently filed to the account by co-trustee Rita Stein on April 30, 2004. The procedural context behind the filing of this account is complex but significant to the resolution of the objections.

Questions for Adjudication

A. Rita Stein's Objections Asserting that Robert and Lester Rosenfeld Should Be Surcharged

I. Procedural Background

Before the First Account for the Rosenfeld Trust was filed in Orphans' Court, Rita Stein had filed a complaint on April 30 , 2002 in the civil trial division against her co-trustees. The complaint, except for Count VI, was subsequently transferred to the Orphans' Court division by order dated September 27, 2002 after the defendants filed preliminary objections.[2] Count VI, which set forth a claim for reputational damages and mental distress, was dismissed by the Honorable Thomas Watkins by order dated September 3, 2003 in response to summary judgment motions by the bank and the Rosenfelds.

In the civil complaint, Rita Stein sought monetary damages and injunctive relief to remedy the alleged "conflicts of interest, breach of fiduciary duty and negligence of three of the trustees of a charitable foundation, in failing to diversify the foundation's assets."[3] She maintained that the assets of the foundation consisted almost entirely of the

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[2] By order dated September 27, 2002, the Honorable Joseph D. O'Keefe, Administrative Judge of the Orphans' Court Division, ordered the transfer of Counts I-V and VII-VIII of the complaint. Judge O'Keefe's order further specified that Count VI remained wholly and entirely in the Civil Trial Division.

[3] Complaint, ¶ 1.

stock of a single company – the Pep Boys stock which suffered a significant decline by as much as 85% in just over three years after 1997.[4] The remaining counts in the complaint set forth the following claims:

Count I – Breach of Trustees' Fiduciary Duty as against Lester and Robert Rosenfeld
Count II – Breach of Corporate Trustee's Fiduciary Duty as against First Union National Bank (presently Wachovia)
Count III - Negligence as against all defendants
Count IV – Restitution and Unjust Enrichment as against First Union National Bank
Count V – Surcharge as against all defendants
Count VII – Removal of First Union as corporate trustee and removal of Lester and Robert Rosenfeld as individual trustees for misfeasance and malfeasance
Count VIII – Partitioning and Severing the Trust as against all defendants

After the complaint was transferred to the Orphans' Court Division, a motion for judgment on the pleadings was subsequently filed by Lester and Robert Rosenfeld while Wachovia Bank filed a motion for summary judgment. It was during the response period to these various motions that Wachovia Bank filed its First Account of the Rosenfeld Trust. Mrs. Stein responded to the account by filing objections to the trustees' conduct and request for a surcharge that incorporated her civil complaint and her Memorandum of Law in response to Wachovia's Motion for Summary Judgment.[5] The Rosenfelds' motion for judgment on the pleadings was subsequently denied by decree dated May 19, 2004. Wachovia's motion for summary judgment, in contrast, was granted[6] for the reasons set forth in an opinion dated May 19, 2004.

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[4] Complaint, ¶¶ 17 & 34.

[5] The objections stated that "Mrs. Stein adopts and alleges as if fully set forth herein her allegations and objections to the co-trustees conduct, and her request for surcharge and partition, set forth in her Complaint in this Court referenced in the Accounting and a copy which is Exhibit 1 hereto." 4/30/2005 Stein Objections.

[6] The following counts in the complaint were dismissed as to Wachovia:

Lester and Robert Rosenfeld subsequently filed a motion for summary judgment. In their motion, the Rosenfelds correctly observed that since Ms. Stein's objections to the account incorporate her complaint, an adjudication of the account was the appropriate means for addressing those claims. They also presented several vigorous arguments to establish as a matter of law that they had not breached their fiduciary duty as trustees.[7] In response, however, Mrs. Stein presented a deposition by Lester Rosenfeld that raised serious factual issues as to his sense of fiduciary duty as this colloquy suggests:

> Q: Okay. You had indicated to me earlier that you understood one of your duties and responsibilities as a trustee to the foundation I believe your—I think the words you used were to maintain and increase the assets of the foundation:
> A (by Lester Rosenfeld): Yes.
> Q: Do you consider yourself as a trustee of the foundation to have any duties to the beneficiaries of the foundation, and by beneficiaries, I mean the charities that will be receiving…
> A: No.
> Q: … distribution?
> A: No.
> Q: You have no duty to the beneficiaries?
> A: No. I have no commitment to them, they're very appreciative of what we give them and I'm grateful for the fact that we're able to do it.[8]

Mrs. Stein also disputed the Rosenfelds' argument that the Foundation had not suffered a loss due to their conduct. She noted, for instance, that these losses had been documented by their co-trustee Wachovia in a December 13, 1999 letter. Moreover, she asserted that at a hearing "experts will be able to calculate with fair precision the losses caused to the Foundation <u>at least from 1997</u> through 2002, by comparing the

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Count II – Breach of Corporate Trustee's Fiduciary Duty
Count III – Negligence as to Defendant Wachovia, alone
Count IV - Restitution and Unjust Enrichment as to Defendant Wachovia
Count V – Surcharge as to Defendant Wachovia, alone
Count VII – Removal as to Wachovia, alone

Count VIII, which sought a partitioning and severing of the trust, was not decided.

[7] <u>See generally</u> 6/29/2005 Rosenfelds Summary Judgment Memorandum, at 15-26.

[8] 7/29/2004 Stein Response to Rosenfelds Summary Judgment Motion, Ex. 2, 4/23/2003 Depo. of Lester Rosenfeld at 141-42.

performance of the undiversified Foundation with Wachovia's own proposal for reinvestment as well as standard benchmarks such as the Dow Jones Industrial Average and Standard & Poor's 500 index."[9]

The juxtaposition of the Rosenfeld summary judgment motion with Mrs. Stein's response raised issues of fact as to whether a surcharge should be imposed on Lester and Robert Rosenfeld based on a breach of fiduciary duty due to a conflict in interest resulting in poor investment advice. Consequently, by order dated November 30, 2004, this court denied the Rosenfelds' summary judgment motion, but scheduled a hearing for January 2005 "to consider the surcharge issues raised in the summary judgment motion in the context of the objections of Rita Stein to the account." A fee petition filed by Wachovia Bank is also relevant to the adjudication of the account.

Five days of hearings on the issue of liability were thereafter held on January 25, 26, 27, 28 and February 2, 2005. In May, the parties reconvened for two more days of hearings on the issue of damages during which Ms. Stein presented Dr. McCann as her expert witness while the Rosenfelds presented Dr. Postlewaite. Each party subsequently filed memoranda of law on the damages issue. The evidence and testimony as to liability will be addressed first.

II. Factual Background – The Liability Hearings

A. Lester Rosenfeld's Conflict of Interest Between the Pep Boys Company and the Rosenfeld Foundation

The two main protagonists of this surcharge dispute--Rita Stein and Lester Rosenfeld-- had both been named original trustees by their father Emanuel Rosenfeld. Rita Stein, as the wife of a Rabbi, had done "great deal of charity work" throughout her

[9] 7/29/2004 Stein Response to Rosenfeld Summary Judgment Motion at 15.

life.[10] Lester Rosenfeld, in contrast, had spent his life working for the Pep Boys Company that his father had founded. He started "at the very bottom of the warehouse," moved to the stores and then worked as an understudy to his father. He was involved with real estate and security transactions. He was elected as Vice President of the company until his retirement in 1980, but he continued to serve as a consultant. He had been a member of the Board since 1952 until he had reached the mandatory retirement age. Mr. Rosenfeld was still able to attend board meetings as emeritus without the power to vote.[11]

During the hearing, testimony was presented that Rita Stein had been concerned for a long period of time that the Rosenfeld Foundation's sole asset was its Pep Boys stock. Her former attorney, Edward Zwick,[12] testified that "maybe the mid-90's, '93/'94 time frame, Rita became very concerned that the assets in the Foundation were concentrated solely in one investment, in Pep Boys."[13] Mrs. Stein had personally demonstrated her appreciation of the benefits of diversification while serving as Trustee for trusts that had been created for her two children. In 1988, Mary Rosenfeld gave gifts to each of Rita's two children, which were placed in trusts funded with $2 million dollars in Pep Boys stock[14] As trustee of those trusts, Mrs. Stein elected to diversify the fund quickly to the benefit of her two children.[15]

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[10] 1/27/2005 N.T. at 79 (Stein).
[11] 1/28/2005 N.T. at 51-52 (Rosenfeld, Lester).
[12] Zwick retired as Mrs. Stein's attorney around July 1998, and was replaced by Joel Reinstein. 1/25/2005 N.T. at 71-73 (Zwick).
[13] 1/25/2005 N.T. at 27 (Zwick).
[14] 1/25/2005 N.T. at 19-22 (Zwick); 1/27/2005 N.T. at 80 (Stein).
[15] 1/27/2005 N.T. at 80, 162-63 (Stein); 1/25/2005 N.T. at 27(Zwick)(within 3 months after receiving the shares of Pep Boy stocks, they were systematically sold so that no single security represented more than 5 percent of the trust).

Zwick testified that he and Rita believed that Pep Boys was a "fine" company, but that its stock was volatile and not suitable for a charitable foundation. For this reason, they told Lester that "we wanted to see a good portion of this stock sold and maybe put into fixed income, like bonds" or an investment more appropriate for a foundation.[16] According to Zwick, Lester "was absolutely opposed to any sale of Pep Boys stock" and when asked why, "[w]ell, he [Lester Rosenfeld] just said, you know: 'I know. Not now. I'm a director.'"[17] Zwick made persistent efforts to convince Lester to diversify, especially in 1997 or when there was a dip in the price of Pep Boys stock, but each time Lester's response was "something like 'I will tell you' or 'I will know.'"[18] When Pep Boys stock experienced a particularly deep decline, Lester once again refused suggestions to sell and Zwick recalled him saying "it wouldn't look very good if I, you know, if I was part of selling stock, you know, at this time."[19]

Rita recalled that the first time she pressed the Foundation to sell Pep Boys stock was in 1997, though she had been concerned about diversifying for some time.[20] As she explained:

> Firstly, I started to get concerned with my fiduciary responsibility to the charities. And I had asked my brother for years prior to that to sell Pep Boys stock and diversify the Foundation. And he refused. And I think that by 1997, I really had a bellyful and knew that he would never agree and decided to go to an attorney about it.[21]

The corporate trustee was also concerned about the over concentration of the Foundation assets in Pep Boy stock. The objectant presented documentation at the

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[16] 1/25/2005 N.T. at 28-29 (Zwick).
[17] 1/25/2005 N.T. at 31-32 (Zwick).
[18] 1/25/2005 N.T. at 83 (Zwick).
[19] 1/25/2005 N.T. at 84 (Zwick).
[20] 1/27/2005 N.T. at 81(Stein)("I believe the first time I really pressed was in 1997").
[21] 1/27/2005 N.T. at 81 (Stein).

hearing that as early as 1995, First Fidelity bank was interested in diversification of the Rosenfeld trust. A regulation 9 review bank document dated June 30, 1995, for instance, contained the handwritten notation “Have been stressing diversification Pep Boys stock.”[22] Bank documents dated May and July 1997 bear handwritten notes that meetings were scheduled “to obtain either approval for sweeping restructuring or signatures on letters of indemnity,”[23] yet Lester had no recollections of such meetings.[24]

Edward Zwick, however, recalled that around this time both Mrs. Stein and the bank became increasingly concerned about the volatility of the Pep Boys stock and the foundation’s concentration of this single stock.[25] Zwick testified that beginning around mid 1997, the bank attempted to schedule a conference call among all the parties but without success. There was a deadlock with the bank and Mrs. Stein, on the one hand, favoring a sale of the Pep Boys stock, and the Rosenfelds, on the other side, opposing it.[26] According to Zwick, the Rosenfelds did not participate in the conference call because of their general disinterest in any sale of the stock. As he recalled, “Lester told me that the banks were idiots and he didn’t even open their mail.”[27] It was at this point in late September 1997, that the bank sent the following letter to the trustees, lamenting the difficulty in arranging a meeting and urging diversification of the foundation:

> September 30, 1997
>
> Re: M & E Rosenfeld Foundation
>
> Dear Mr. Rosenfeld:

[22] Ex. P-102. When shown this June 30, 1995 document, however, Lester stated that he did not have any recollection of the bank’s urging diversification until perhaps 1996. 1/26/2005 N.T. at 154-56 & 158 (Rosenfeld, Lester).
[23] Ex. P-100 (e-mail dated 5/5/97 with handwritten note). See also Ex. P-103.
[24] 1/26/2005 N.T. at 174-75 (Rosenfeld, Lester).
[25] 1/25/2005 N.T. at 37-40 (Zwick); Ex. P-47 (May 21 ,1997 letter from Zwick to Dubrow noting that Pep Boys stock “has been fluctuating wildly”).
[26] 1/25/2005 N.T. at 40 (Zwick).
[27] 1/25/2005 N.T. at 52-53 (Zwick).

> Due to the difficulty of scheduling a meeting of the co-trustee's (sic.) of the Rosenfeld Foundation I would like to take this occasion to further the discussion of diversifying the above referenced portfolio. In support of this discussion, I have provided a review of the Rosenfeld Foundation performance as well as a booklet reviewing asset allocation.
>
> I would like to focus your attention on the following areas:
>
> - While acknowledging the wealth created by Pep Boys Stock, it is important to recognize the poor performance of the stock in recent years relative to the market. (See Rosenfeld Foundation Book Tab III). The equity component of the portfolio has returned 2.9% annualized over the past three years ending June 30, 1997 versus 28.86% for the S & P 500.
>
> - First Union, in its fiduciary role, believes in the tenants (sic.) of modern portfolio theory and strongly recommends a greater diversification of the portfolio. This would serve to reduce the volatility of the portfolio as well as to protect the trustee against potential liability resulting from a concentration in a limited number of securities.
>
> In order to facilitate this diversification, we recommend reducing Pep Boys Stock to less than 10% of the equity portion of the portfolio within two years, potentially taking advantage of any strength in the stock price of Pep Boys to accelerate this process. In any event, there should be a regular program of divestment.
>
> As to the investment of the proceeds, a contemporary asset allocation for a foundation of this size and sophistication might resemble the following:

	40% Large Cap Blend
	15% Mid/Small Cap
	10% International
Equity	65%
Fixed Income	35%
Total	100%

Ex. P-34

Lester conceded that in refusing to sell the foundation's Pep Boy stock in the fall of 1997, he never gave a price or time frame for when he might be willing to sell. Instead, his refusal stemmed from his faith and knowledge as a director, which he could not divulge because it was privileged.[28] The objectant presented evidence at the hearing in the form of Pep Boys 10-K reports to establish that as a director Lester Rosenfeld was confronted with information about the financial difficulties that had plagued the Pep Boys Company in 1997 as the other trustees urged the sale of Pep Boys stock to diversify the

[28] 1/26/2005 N.T. at 188-89 (Rosenfeld, Lester).

Foundation. According to the 10-K form filed on April 29, 1998 that Lester signed in his capacity as director, during 1997 the company's earnings had suffered a serious blow and had declined by a half. The net earnings for the fiscal year ending January 31, 1998 were reported as $49 million compared to net earnings of nearly $100 million for the prior year.[29] Mr. Rosenfeld sought to explain—and perhaps minimize—this decline as being caused by the closing of a certain type of store although he was evasive as to the extent of his knowledge of these facts as director.[30]

Nonetheless, throughout 1998, the value of the Pep Boys Stock declined to around $22 a share in May 1998 to $14.69 in August 1998.[31] Lester Rosenfeld became aware in June and September 1998 as a director that the company was contemplating the sale of 100 express stores in an attempt to enhance its competitive advantage with short-term consequences that Lester was unable to predict[32] but which he admitted"could have" a negative impact on Pep Boys stock.[33] Despite his knowledge of the company's financial difficulties at the time he was being urged to diversify the foundation's holdings of Pep Boys stock by Mrs. Stein and the bank, Lester did not feel an obligation to abstain on this issue of such key importance to the charitable foundation.[34] As he explained in response to the following question:

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[29] Ex. P-113 (10-K filed on 4/29/1998); 1/26/2005 N.T. at 193 (Rosenfeld, Lester).

[30] 1/26/2005 N.T. at 195-96 (Rosenfeld, Lester). According to a footnote in the 10K report, nine stores were closed, the store expansion program was reduced and the all Parts USA stores were converted to a Pep Boys Express format. Ex. P-113, 10-K filed on 4/29/1998, n.1.

[31] 1/26/2005 N.T. at 208; Ex. P-26.

[32] 1/26/2005 N.T. at 209-219. See also Ex. P.111 (Minutes of Pep Boys 9/15/98 Board of Directors Meeting).

[33] 1/26/2005 N.T. at 227 (Rosenfeld, Lester).

[34] 1/26/2005 N.T. at 204 (Rosenfeld, Lester). Zwick recalls warning Lester in 1997 that there were serious conflicts in interest between serving as a trustee of a foundation and as a director of the company whose stock was held by the foundation. In fact, he suggested that Lester should abstain so that the issue of diversification could be decided by the other 3 trustees, but Lester refused. 1/25/2005 N.T. at 61 (Zwick). Moreover, Lester was unwilling to name any stock that he would substitute for Pep Boys, because "[h]e was just obstinate about selling, period."1/25/2005 N.T. at 77-78(Zwick)

> Q: The next question was: As a result of that knowledge, didn't you think it was appropriate for you to abstain in any consideration of diversification by the other trustees?
> A: (by Lester Rosenfeld) No, I wanted the stock to remain as a holding.
> Q: And one of the reasons you wanted the stock to remain as a holding was on your knowledge that you're about to sell a group of stores?
> A: Well, my knowledge that the future earnings of the company would be much better.
> Q: Because you also knew, did you not, that you were attempting to improve the balance sheet through the disposition of the Express stores; isn't that correct?
> A: Yes. Yes.
> Q: And with that knowledge did you ever seek outside professional advice as to whether or not you should participate in decisions on diversification or you should abstain?
> A: No.[35]

In fact, Lester Rosenfeld conceded that around the time period of September 1998, he would not agree with Mrs. Stein's position to sell the Pep Boys Stock "at any time."[36] Unfortunately, at a subsequent board meeting in December 1998 that Lester attended, it was revealed that discussions had taken place with Standard & Poors and Moody's concerning the downgrading of the Pep Boys company's credit rating.[37]

It was during this period that the bank sent a follow-up letter to the trustees on October 22, 1998, requesting that the foundation be permitted to sell Pep Boy stock, but Lester returned the letter and checked the option to "Retain Pep Boys stock less amount required for distribution." Ex. P-38. The Pep Boys Company earnings, however, suffered a significant decline that year, as reported in its 10-K Report filed on April 30, 1999. In fact, the net earnings for 1998 went down to nearly $4 million compared to the $49 million profit reported for the fiscal year ending January 31, 1998.[38]

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[35] 1/26/2005 N.T. at 217-218 (Rosenfeld, Lester)(emphasis added).
[36] 1/26/2005 N.T. at 223 (Rosenfeld, Lester). See also Ex. P-8.
[37] 1/26/2005 N.T. at 233.
[38] 1/27/2005 N.T. at 14-16 (Rosenfeld, Lester). Ex. P-113 (10-K for 4/30/1999). The 10K Report compared net earnings of $4,974 (million) as of January 30, 1999 with net earnings of $49,611 (million) as of January 31, 1998.

Several months later, the bank advocated diversification once again by sending an indemnification letter to the Rosenfeld trustees. In that March 17, 1999 letter, the bank emphasized that the Rosenfeld Foundation held only one asset, Pep Boys stock, which violated the "diversification rules as required by our Trust Compliance Officers."[39] The bank therefore asked the trustees to sign the enclosed letter indemnifying the corporate trustee for loss of value. None of the trustees signed that indemnification letter.[40]

Finally, the bank sent another letter dated December 13, 1999 addressed to the Rosenfelds, in which it reiterated that "it is clearly imprudent as trustees to hold only a single stock as the entire portfolio of the Foundation."[41] Lester responded by writing a December 21, 1999 letter that concluded:

> To sum up, I, as an insider at Pep Boys, feel that to divest at this time and price is absolutely wrong. If the Bank cannot abide by this, perhaps you should consider resigning as trustee. I am sure that the other trustees would not object.[42]

Not only did Lester refuse to sell Pep Boys stock in the period between 1997 through 2000, but he testified that if a sale had occurred, the only stock Lester would have agreed to purchase would have been Pep Boys stock.[43]

In pressing for diversification, the bank was not merely advocating its philosophic adherence to the modern portfolio theory. The bank actively monitored the trust investments to assess their performance as evidenced by documentation presented at the hearing in the form of Regulation 9 Reviews, which are annual administrative and

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[39] Ex. P-29.
[40] 1/26/2005 N.T. at 38 (Middleton).
[41] P-12, 12/13/1999 Letter from Steven Perry to the Rosenfelds.
[42] Ex. P-41 (12/21/1999 Letter from Lester Rosenfeld to Steven Perry).
[43] 1/27/2005 N.T. at 68-71(Rosenfeld, Lester).

investment reviews.[44] In addition, throughout this period the bank prepared investment reviews on a regular basis for the Foundation trustees which included a comparison of the fund's performance to that of the S & P 500. In 1997, for instance, it showed that the trust equities account declined 21.72% while the S & P 500 increased by 33.36%.[45] Throughout this period, these documents show a decline in the market value of the fund assets from $15,094,625 on September 30, 1997 to $2,410,76.43 on September 14, 2000.[46]

A key consideration in analyzing the Rosenfelds' refusal to diversify the foundation's stock assets in the face of the decline in the Pep Boys Stock and the company's financial difficulties between 1997 through 2000 is their awareness that as the value of the portfolio declined, the foundation's ability to give grants likewise suffered.[47] There was a requirement that a minimum of five percent of the annual income be distributed to the charities based on value. If cash was not available for these

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[44] 1/25/2005 N.T. at 120-21 (Middleton). According to the Regulation 9 Review for June 30, 1995, the total portfolio of the foundation as of June 30, 1995 had a market value of $16,172,538.94. Ex. P-102 The foundation's portfolio increased its market value in June 1996 and 1997 according to the Regulation 9 reviews to $19,378,691 and $19,520,202.93 respectively, but by June 1998 the market value of the total fund had decreased to $10,369,404. Exs. P-104; P-103; P-105. Handwritten notes on these Reg. 9 reviews expressed concern about the fund's lack of diversification. See, e.g., Ex. P-102 (6/30/95-"Have been stressing diversification Pep Boys stock"); Ex. P-103 (6/20/1997 – "Concentration in Pep Boys (Founders stock) Scheduling a meeting to recommend diversification or obtain letter of indemnification"). In response to questioning, Reginald Middleton noted that these documents indicated that in June 1997 the fund was invested 99.8% in common stocks. 1/25/2005 N.T. at 128 (Middleton).

[45] 1/26/2005 N.T. at 26-28 (Middleton)(referencing Ex. P-40). The investment review for September 30, 1997 showed a total fund value of $15,037,640 composed 99.97% of common stock. Ex. P-107. By December 31, 1998, the market value of the total portfolio had declined to $7,611,913.90, still composed of 99.72% of common stocks. The bank also included a chart comparing performance of the Foundation to the S & P 500. While the foundation equities declined by 32.93% percent in 1998, the S & P 500 increased by 28.57%. Ex. P-40. See generally 1/26/2005 N.T. at 27-28 (Middleton).

[46] Ex. P-107. Lester Rosenfeld acknowledged this decline in his testimony. 1/27/2005 N.T. at 39-40 (Rosenfeld, Lester). By September 14, 2000, the foundation assets had sunk to a market value of $2,410,766.43. See Ex. P-106 (Reg. 9 Review).

[47] 1/26/2005 N.T. at 33 (Middleton)(outlining relation between decline in fund assets and the foundation's ability to make charitable donations).

distributions, then stock was sold.[48] As a trustee, Lester was aware that the gifts to the charities were ultimately affected by the market value of the fund.[49] He also appreciated that the market value of the stock was used to determine gifts to the foundation's charities[50]and that a decline in the price of Pep Boys stock led to a decline in the overall value of the fund.[51] He conceded, in fact, that the amount of money that could be provided to the charities in 1997 through 2000 declined each year due to the retention of Pep Boys stock.[52] Equally significant, Lester acknowledged that Pep Boys stock is volatile.[53] Such volatility, Reginald Middleton observed, is a particular problem for charitable trusts where there is a need to maintain a consistent amount to distribute to charitable beneficiaries.[54]

When specifically asked about his sense of fiduciary duty to the beneficiaries of the foundation, Lester Rosenfeld was evasive, emphasizing instead his responsibility to increase the value of the Foundation:

> Q: Do you consider yourself as a trustee of the Foundation to have any duties to the beneficiaries of the Foundation? And by beneficiaries, I mean the charities that would be receiving the distributions?
> A: I consider that my duty as a trustee is to increase the value of the Foundation.
> Q: So your answer is yes, you have a duty to the charities?
> A: I have a duty to the Foundation.
> Q: And by—
> A: As I see it.

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48 1/26/2005 N.T. at 101 (Middleton).
49 1/27/2005 N.T. at 22 & 51 (Rosenfeld, Lester).
50 1/27/2005 N.T. at 22 & 51(Rosenfeld, Lester).
51 1/26/2005 N.T. at 182-83; 1/27/2005 N.T. at 50 (Rosenfeld, Lester)..
52 1/27/2005 N.T. at 52-53 (Rosenfeld, Lester).
53 1/28/2005 N.T. at 68 (Rosenfeld, Lester)(noting that in the past year, the Pep Boys stock price had ranged from $11 a share to $29 a share.
54 1/26/2005 N.T. at 89 (Middleton). The volatility of the stock was also a concern for Zwick (1/25/2005 N.T. at 28) and Robert Rosenfeld (1/28/2005 N.T. at 129). Dr. McCann characterized Pep Boys stock as "highly volatile" with "more than twice a risk as the market as a whole." 5/3/2005 N.T. at 131(McCann). The Rosenfeld's financial expert, Dr. Postlewaite, stated in his report that "Pep Boys stock has always been volatile and had numerous price declines, many much more severe than this decline." Ex. R-13 at 7.

> Q: And so your answer to the question is, do you consider yourself as a trustee of the Foundation to have any duties to the beneficiaries of the Foundation? And by beneficiaries I mean the charities that will be receiving the distributions. And your answer to that is yes; is that correct?
> A: I didn't say that though.
> Q: Is your answer to that no?
> A: It's not one that I considered.[55]

When asked to explain his investment philosophy, Lester stated that he followed the teachings of Bernard Baruch; he believed that a person should invest only in those companies that he knows about and not to invest in others.[56] He acknowledged, however, that in addition to the Pep Boys Company, he considered himself knowledgeable about Teleflex, Commerce Bank, the Vanguard Health Fund and tax free bonds. In fact, he had personally invested in those entities. While his Pep Boy stocks had been given to him as gifts—which he never sold—Lester testified that he had purchased interests in these other companies, funds and bonds.[57] Despite his familiarity with these alternative investments, Lester was emphatic in refusing to invest the Rosenfeld foundation assets in these or any alternative stock during the period when Rita was urging that the foundation be diversified.[58]

Lester also testified that he had funded two trusts for Abington Memorial Hospital ("hospital trusts"), one with one million dollars of Pep Boys Stock, the other with $550,000 worth of Pep Boys stock. The hospital trusts, however, were thereafter diversified, with sales of Pep Boys stock and purchases into other investments while Lester and his wife served as trustees together with their attorney Lowell Dubrow. Lester acknowledged that one of the equities purchased was General Electric, "but we leave that

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[55] 1/27/2005 N.T. at 54 (Rosenfeld, Lester).
[56] 1/26/2005 N.T. at 158-59 (Rosenfeld, Lester).
[57] 1/26/2005 N.T. at 162-64 (Rosenfeld, Lester). When pressed on this point, Lester replied that he had never purchased or sold Pep Boys stock. Id. at 164.
[58] 1/26/2005 N.T. at 166(Rosenfeld, Lester).

to Lowell Dubrow because we think that's the fairest way to operate."[59] But as a trustee for the Rosenfeld Foundation, and in refusing to consider diversification of that Foundation in 1996, 1997 or anytime prior to 2002, Lester admitted that he had never consulted any professional (including Lowell Dubrow) for advice.[60]

After the price of Pep Boys stock sank, Lester's refusal to sell the stock was reasonable and justifiable. He naturally did not want to sell at too low a price. Lester's attorney, Leonard Dubrow, recalled that once Lester became receptive to the general idea of diversification, the price of the stock was critical. Lester was thus unwilling to sell Pep Boys stock at a price of $6 per share, but set $12 as a more reasonable benchmark.[61] Not until late 2001 did the trustees agree to sell Pep Boy stock.[62] The first sale in accordance with this agreement took place in March 3, 2002 (10,000 shares) with additional sales on May 6 (10,000 shares), May 8 (500 shares), May 13 (10,000 shares), May 14 (10,000 shares) and May 17 (10,000 shares). The stocks were sold for a price of $18 or $19 dollars. Subsequent sales also occurred. The trustees, however, were unable to decide on how to reinvest the funds and all three rejected every proposal from the bank as to reinvestment. Consequently, approximately $3 million dollars—or 30% of the value of the Trust--is being held in cash.[63]

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[59] 1/28/2005 N.T. at 74, and generally 73-76 (Rosenfeld, Lester).
[60] 1/26/2005 N.T. at 168 (Rosenfeld, Lester).
[61] 1/27/2005 N.T. at 221-22 (Dubrow).
[62] 1/26/2005 N.T. at 114 (Middleton). See also Ex. P-54 (12/20/2001 Memo by Middleton: "The Co-Trustees in the Rosenfeld Foundation have authorized diversification of the above portfolio which is completely invested solely in Pep Boys stock."
[63] 1/26/2005 N.T. at 114, 120-124 (Middleton). See also Rosenfeld Account at 10-11.

B. Robert Rosenfeld's Conflict of Interest Between His Filial Concerns and the Rosenfeld Foundation

Robert Rosenfeld was named as a successor trustee of the Rosenfeld Foundation on July 9, 1980 after the death of Murray Rosenfeld in August 1979.[64] In contrast to his father, Robert's involvement in the foundation's issues was at best passive and disinterested. He stated, for instance, that he was unaware between 1997 through 1999 of his Aunt's concern about the Foundation's lack of diversification.[65] Robert testified that it was not until 1999 that he first became aware of her concerns and of the role of a trustee "really specifically in the letter that was received by me in 1999 from the bank."[66] He recalled the bank taking a strong position in favor of diversification and warning of the possibility of legal action.[67]

Robert thus seemed oblivious to the prior letters the bank had sent in September 1997 and October 22, 1998 urging diversification of the fund. On March 17, 1999, Judy Prendergast, Vice President of First Union, sent another letter to the trustees, warning that the "Rosenfeld Foundation holds only one asset, Pep Boys and as such does not meet the diversification rules as required by our Trust Compliance Officers." Since the bank had been outvoted on the diversification issue "over the course of time," she asked each trustee to sign a letter indemnifying the bank.[68] When the bank received no response, it sent a follow-up letter dated December 13, 1999 reiterating its concern that it was imprudent for the Foundation to hold only one stock and enclosing a chart comparing the performance of Pep Boys stock versus the S & P 500 over a five year period through

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[64] Ex. P-7A.
[65] 2/2/2005 N.T. at 53-54, 49 (Rosenfeld, Robert)
[66] 1/28/2005 N.T. at 123; 2/2/2005 N.T. at 54 (Rosenfeld, Robert) (Robert stated that he first learned of his Aunt's advocacy of the sale of Pep Boys stock when he received the bank's March 1999 letter).
[67] 1/28/2005 N.T. at 123 (Rosenfeld, Robert).
[68] Ex. P-29, 3/17/1999 Letter from Judy Prendergast to Co- Trustees.

October 26, 1999 that showed Pep Boys total return as -67% compared to a total return of 177% for the S & P 500. The bank ended its letter by warning that if no response was received within 10 days, the bank might assume that the trustees were abstaining. It also hinted at potential legal action against the trustees.[69]

That letter alarmed Robert Rosenfeld by suggesting the bank might take legal action on the issue of diversification and that he might have some liability as a trustee.[70] He did not react, however, by doing any independent research about the performance of Pep Boys stock in comparison to the S & P 500.[71] Instead, he wrote a letter in reply, which began by noting that "it seems that your concern over the lack of diversification in the trust has been a recent occurrence,"[72] even though the bank had sent letters to the trustees urging diversification since 1997.[73] Robert took offense at the tone of the bank's letter, and asserted:

> The reasoning behind our investment in Pep Boys has had everything to do with the close knowledge of that stock by one of our trustees. It has been that trustee's opinion that the stock would be an outstanding performer and indeed has until very recently. I am not opposed to diversifying the portfolio, although at Pep Boys current price, I would be against the timing.[74]

The clear import of this language is the Robert relied on his father's faith and knowledge in the Pep Boys stock. He admitted as much in the following colloquy:

> Q: So that in 1999 while this was going on, it was still your position to rely on his (i.e. Lester Rosenfeld's) advice and counsel based on the inside information he had as a director?
> A: Based on his intimate knowledge of the company,
> Q: Including his inside information as a director?

[69] Ex. P-30, (12/13/1999 Letter from Steven Perry, for First Union, to the Rosenfelds with a copy to Rita Stein).
[70] 1/28/2005 N.T. at 124 (Rosenfeld, Robert).
[71] 2/2/2005 N.T. at 62-63 (Rosenfeld, Robert).
[72] Ex P-13 (12/23/99 Letter from Robert Rosenfeld to Steven Perry).
[73] See P-34 (9/30/1997 Letter from Eric Wiegand to Robert Rosenfeld, Lester Rosenfeld, Rita Stein); Ex. P-10 (10/22/1998 letter from Eric Wiegand).
[74] Ex. P-13 (12/23/99 Letter from Robert Rosenfeld to Steven Perry).

> A: His—I would not say insider. I think "intimate knowledge" of the company is probably a better—
> Q: And what he learned as a director?
> A: Fine.
> Q: Is that correct?
> A: Correct.[75]

Equally telling was Robert's rendition of the questions he posed to his father concerning the status of the Pep Boys company: those questions seemed motivated more by personal self-interest than by concern for the beneficiaries of the charitable trust. As Robert explained, "[o]ver time at the various different times, I would ask my father was he still sure of Pep Boys, did he still think things were going well, was the company doing well, was there any reason to be concerned, because I had a lot of personal money involved in Pep Boys stock." [76]

Testimony from other witnesses likewise underscores how Robert's position on diversification was strongly influenced by his fear of the personal repercussions in deviating from Lester's views regarding any sale of Pep Boys stock. Edward Zwick, for instance, testified that he only spoke to Robert Rosenfeld once about diversification: "And the reason for that is Robert made it very clear that he could do nothing and would do nothing without his dad's approval."[77] Rita Stein likewise stated that Robert called her several times about the sale of Pep Boys stock "and what he said to me was: Aunt Rita, I can't help it, you know I can't help it, I can't do anything to go against my father, it will ruin the rest of my life."[78]

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[75] 2/2/2005 N.T. at 56-57 (Rosenfeld, Robert).
[76] 1/28/2005 N.T. at 129 (Rosenfeld, Robert)(emphasis added).
[77] 1/25/2005 N.T. at 32 (Zwick).
[78] 1/27/2005 N.T. at 87(Stein). See also id. at 143.

Reginald Middleton, the bank's portfolio manager for the Rosenfeld foundation in March 2000,[79] testified that when he took over as the administrator of charitable accounts from Judith Prendergast, he understood that the foundation had a large, single concentration of Pep Boys stock and that efforts had been taken towards diversification but two of the trustees, Robert and Lester Rosenfeld, refused to diversify.[80] To deal with this issue, the bank had devised a strategy of attempting to use Robert as a swing vote since Lester was set in his determination against selling Pep Boys stock.[81] During Middleton's conversation with Robert in April 2000, Robert stated that he did not oppose diversification, but he did not want to appear to be siding with his Aunt over his father. According to Middleton, Robert "indicated that his own personal fortune had been diminished by the value of Pep Boys stock and that there was some concern that if he went up against his father, that he may be disinherited. And that was a concern of his."[82] In the fall of 2000, Middleton had another meeting with Robert to discuss diversification, during which Robert gave several reasons for disfavoring diversification of the foundation's holdings: "He did indicate that his grandmother had passed away at some point in time and he did not think he was going to receive much from her estate, or at least as much as he had expected, so that encouraged him to not disagree with his father because that might increase the chance that he might be disinherited and also not receive anything from his father's estate."[83]

Lester Rosenfeld, however, testified that while he was aware that Robert sided with him on the diversification issue in 1997 through 2000, he did not think his son did so

[79] 1/26/2005 N.T. at 28-29 (Middleton).
[80] 1/26/2005 N.T. at 31 (Middleton).
[81] 1/26/2005 N.T. at 44-45 & 54 (Middleton).
[82] 1/26/2005 N.T. at 43-44 (Middleton).
[83] 1/26/2005 N.T. at 49-50, generally 46-50 (Middleton).

the curry Lester's approval.[84] Lester also maintained that he was not aware that Robert relied on his close knowledge of the inside workings of Pep Boys in refusing to sell the foundation's stock.[85]

By late 2001 or early 2002, the relationship between Robert and Lester was severed over issues that did not involve the Foundation. It was also at that point in 2002—and once Pep Boys stock reached $12 or $15-- that Robert, under the advice of an investment counselor, Ken Gunsberger, began selling his holdings of Pep Boys stock while also agreeing to a sale of the Foundation's stock.[86] At that point, the payments that Robert had previously received[87] from Lester had ceased.[88] Robert testified that he presently favors diversification for the Foundation, but laments that it still has not obtained this goal because "right now it's either all in Pep Boys stock or all (i.e. the Pep Boys stock that was sold) in cash."[89]

III. Legal Analysis of the Surcharge Claim

The Rosenfelds throughout the long course of these proceedings have set forth vigorous factual and legal arguments as to why Robert and Lester should not be surcharged:

(1) The trust document authorizes retention of Pep Boys stock by the Trustees;
(2) Mrs. Stein cannot show that Lester breached a duty of undivided loyalty to the foundation because the settlor waived any conflict of interest based on Lester's relationship to the Pep Boys company;

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[84] 1/27/2005 N.T. at 58-59 (Rosenfeld, Lester).
[85] 1/27/2005 N.T. at 62; 2/2/2005 N.T. at 41-46 (Rosenfeld, Lester).
[86] 1/28/2005 N.T. at 148; 2/2/2005 N.T. at 41-46 (Rosenfeld, Robert). Robert explained that once the price of Pep Boys stock recovered to $12 or $15 dollars a share with his personal trust, "I've been slowly diversifying out of Pep Boys and moving into a variety, what I'll call asset allocations, whether they be, you know, some large cap, some mid cap, some small cap stocks, some managed fund, some managed future funds." 1/28/2005 N.T. at 148.
[87] Robert testified that prior to his break with his father, Lester had given him various cash payments. 2/2/2005 N.T. at 69-71 (Rosenfeld, Robert).
[88] 2/2/2005 N.T. at 99-100 (Rosenfeld, Robert).
[89] 1/28/2005 N.T. at 147 (Rosenfeld, Robert).

(3) Retention of the Pep Boys stock was not imprudent because Pennsylvania law does not require diversification of the Trust, and;
(4) The Rosenfelds cannot be surcharged because the Foundation did not suffer a loss over the course of the entire accounting period.[90]

Upon review of the factual record and the relevant precedent, however, these arguments against liability are unpersuasive as set forth below.

A. The Trust Document Does Not Authorize Unfettered Retention of Pep Boys Stock But Only As a Majority of the Trustees Consider "Advisable"

As a threshold argument, the Rosenfelds assert that Mrs. Stein could not prove a breach of fiduciary duty because the trust document authorizes the retention of Pep Boys Stock.[91] Consequently, they assert, there can be no surcharge.

A surcharge is a "penalty imposed for failure of a trustee to exercise common prudence, skill and caution in the performance of its fiduciary duty, resulting in the want of due care." Estate of Scharlach, 809 A.2d 376, 384 (Pa. Super. 2002). As the Rosenfelds properly assert, the Agreement of Trust created by Emanuel Rosenfeld must be the starting point for determining whether either Lester or Robert Rosenfeld breached their fiduciary duty and should be subjected to a surcharge. In re McCune, 705 A.2d 861, 867, (Pa. Super. 1997), app.denied, 555 Pa. 720, 724 A.2d 935 (1998)("In Pennsylvania, the law honors a settlor's right to determine the disposition of his estate").

In construing a trust instrument, "it is basic that it must be read as a whole and every portion thereof considered in determining its intent and true purpose." In re Alloy

[90] The procedural context of this account adjudication is somewhat complicated since Mrs. Stein's objections to the Account and her claim for a surcharge against Lester and Robert Rosenfeld incorporate her civil complaint. The Rosenfelds, as a consequence, have set forth their most systematic arguments against the imposition of a surcharge both in their motion for summary judgment and in their post-trial brief, and those arguments can now be addressed in the context of the hearings on liability. See generally 6/29/2004 Rosenfelds Summary Judgment Memorandum at 15-26; 7/25/2005 Rosenfelds Post-trial brief at 28-48.
[91] 6/29/2004 Rosenfelds Summary Judgment Memorandum at 15.

Manfg. Co. Employees Trust, 411 Pa. 492, 495-96, 192 A.2d 394, 396 (1963). The intent of the settlor is paramount:

> It is still hornbook law that the pole star in every trust (as in every will) is the settlor's (or testator's) intent and that intent must prevail. It would certainly be unreasonable to construe the proviso as intending to destroy or effectually nullify what has always been considered the inherent basic fundamental right of every owner of property to dispose of his own property as he desires, so long as it is not unlawful.
> Estate of Pew, 440 Pa. Super. 195, 220, 655 A.2d 521, 533 (1994)(citations omitted).

As a general principle, the standard of care imposed on a trustee is that which a person of "ordinary prudence would practice in the care of his own estate." Id., 440 Pa. Super. at 236, 655 A.2d at 541. See also Trust of Mendenhall, 484 Pa. 77, 80, 398 A.2d 951, 953 (1979). In addition, the terms of the trust agreement are nonetheless crucial for determining a trustees' standard of care. The Pennsylvania Supreme Court has thus emphasized the "equally important precept in our law that where a trust instrument is explicit as to the duty owed, it, as evidencing the settlor's (testator's) intent, should govern." Estate of Niessen, 489 Pa. 135, 138, 413 A.2d 1050, 1052 (1980). See also Evans Trust, 3 Fiduc. Rep. 2d 304, 310 (1982) This general principle is also recognized by the Probate, Estates and Fiduciaries Code which provides:

> **General rule. –** The testator or settlor in the instrument establishing a trust may prescribe the powers, duties and liabilities of the fiduciary regarding the investment or noninvestment of principal and income and the acquisition, by purchase or otherwise, retention and disposition, by sale of otherwise, of any property which, at any time or by reason of any circumstance, shall come into his control; and whenever any such provision shall conflict with this chapter, such provision shall control notwithstanding this chapter, unless the court having jurisdiction over the trust shall otherwise decree pursuant to subsection (b) of this section.

20 Pa.C.S.A. § 7319(a)(emphasis added).

By the terms of his trust agreement, Emanuel Rosenfeld's intent was to create a perpetual charitable trust in his name and that of his wife Mary. He initially funded the trust with 200 shares of his company's Pep Boys stock[92] In naming his son, Lester, his daughter, Rita, and his brother, Murray, as the three individual trustees, he underscored the strong familial ties of the trust. In addition, however, Emanuel was careful to provide that there would always be a corporate trustee to which he named Fidelity-Philadelphia Trust Company.

The trust agreement gives the Trustees discretion to "invest and reinvest" the "property" so that the net income could be distributed to "religious, charitable, scientific, literary or education purposes" as the Trustees "in their discretion may from time to time select."[93] The Trust agreement also contains provisions as to the retention of Pep Boy stock used to fund the trust. By "exercise" as "the decision of the majority of them may direct," the trustees could retain those assets "as long as in their discretion they deem it advisable to do so." Specifically, the trust document provides:

> (2) In addition to the powers given by law, the Trustees shall have and exercise the following powers as the decision of the majority of them may direct:
>
> (a) To retain any property delivered to them as long as in their discretion they deem it advisable to do so. For the exercise of this power the Trustees are completely relieved from any responsibility by reason of any loss or shrinkage in value.[94]

The trust agreement contemplates majority action by the co-trustees, but provides no procedure for breaking any deadlock.

The Rosenfeld Trust Document thus does not give the trustees unfettered discretion to retain the Pep Boys stock with impunity as the Rosenfelds have asserted.

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92 See Ex. P-2, Exhibit "A."
93 Ex. P-2, ¶1.
94 Ex. P-2, ¶ 2(a).

Instead, Paragraph 2 of the Trust Document gives the Trustees the "discretion" to retain the Pep Boys stock "as long as" a "majority of them" may direct. Although the document further provides that "for the exercise of this power the Trustees are completely relieved from any responsibility by reason of loss or shrinkage in value," the exercise of the power to retain stock is clearly predicated on the majority concluding that such retention is "advisable." As the Pennsylvania Supreme Court observed, "the test of a fiduciary's liability on the sale or retention of securities is common prudence, common skill and common caution; that failure so to exercise such prudence, skill and caution will not be excused because of a testator's exemption concerning the fiduciary's discretionary sale or retention." Lentz Estate, 364 Pa.304, 308, 72 A.2d 276, 278 (1950)(emphasis added). See also Estate of Knipp, 489 Pa. 509, 513, 414 A.2d 1007, 1009 (1980), superseded by statute as stated in In re Sky Trust, 868 A.2d 464, 483 (Pa. Super. 2005)("where, as in the present case, a testator vests a fiduciary with discretion to retain assets, the fiduciary is not thereby excused from the duty of making the retention decision prudently").

The Rosenfelds invoke The Estate of McCredy, 323 Pa. Super. 268, 470 A.2d 585 (1983) to support their argument that the trust instrument authorizes retention of the Pep Boys stock.[95] That case, however, is distinguishable. The document in McCredy creating a charitable trust gave the individual trustee, who had been the settlor's trusted investment adviser, "complete and absolute control and oversight of the management of said Trust" and required the corporate trustee to "follow his directions blindly and implicitly, doing only the clerical work involved." Estate of McCredy, 323 Pa. Super. at 274, 470 A.2d at 588. The Rosenfeld trust document, in contrast, does not bestow on its

[95] 6/29/2004 Rosenfelds Summary Judgment Memorandum at 15.

trustees such absolute authority to retain property, but instead requires a majority of them to consider its advisability. Hence, this issue cannot be decided as a matter of law but requires careful analysis of the factual record.

B.The Settlor Did Not Waive Any Conflict of Interest When He Named Lester Rosenfeld a Trustee of the Rosenfeld Foundation With Knowledge of His Involvement with the Pep Boys Company Because the Settlor also Appointed a Corporate Trustee and Predicated Retention of the Pep Boys Stock on Its "Advisability"

The Rosenfelds also argue that Mrs. Stein cannot prove that Lester and Robert breached their duty of undivided loyalty to the Foundation because the settlor waived any conflict of interest regarding Lester's involvement with the Pep Boys Company. They concede that a trustee primarily owes a duty of loyalty to a beneficiary of his trust and that "the trustee is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third party." [96] The Rosenfelds acknowledge that while "Lester has always been unwavering in his confidence regarding the Pep Boys company and its common stock,"[97] they claim that he did not put the company's interest above that of the Foundation—as Mrs. Stein asserts. In addition, they argue that as a matter of law the Settlor waived any such conflict of interest when he appointed Lester a trustee with full knowledge of his involvement in the company.[98]

In so arguing, the Rosenfelds once again invoke the McCredy Estate. In McCredy, the attorney general sought to surcharge based on the actions of trustee, Arthur Spellissy, in investing funds from the charitable trust in Photon—a company in which

[96] 6/29/2004 Rosenfelds Summary Judgment Memorandum at 19 (quoting In re Noonan's Estate, 361 Pa. 26, 31, 63 A.2d 80, 83 (1949) and 18-20.
[97] 6/29/2004 Rosenfelds Summary Judgment Memorandum at 20.
[98] 6/29/2004 Rosenfelds Summary Judgment Memorandum at 20-21.

Spellissy was the largest stockholder. The court emphasized that this was a close case, acknowledging:

> When a trustee invests his personal pride and good name, as well as his personal capital, in a corporation whose securities form a substantial part of a trust corpus, he places himself in a position where it is very difficult to remain inflexibly loyal to the trust. At some point a trustees' personal ties to the company will compel the conclusion that investment of trust assets in the company is improper. When that point is reached, we do not stop to inquire whether self-interest actually tinged the trustee's decisions for the trust; the rule of undivided loyalty is not intended to be remedial of any actual wrong but preventive of the possibility of it. McCredy, 323 Pa. Super. at 298, 470 A.2d at 601 (citations omitted).

The McCredy court concluded, however, that the settlor waived any conflict of interest where in her trust document she had given her trustee, who was a trusted long time investment advisor, "paramount, unfettered discretion to make investment decisions…." In fact, the court concluded, the settlor "would have been at a loss to express more emphatically her intention that the final word on trust investments was to be Spellissy's." McCredy, 323 Pa. Super. at 298, 470 A.2d at 601.

The trust document for the Rosenfeld Foundation, in contrast, did not give Lester unfettered discretion to retain Pep Boys stock. Instead, such a decision was to be made by a majority of the trustees. Moreover, the trustees had to consider the advisability of such retention. Evidence at the hearing established that Lester Rosenfeld had "invested his personal pride and good name as well as his personal capital" to such an extent in the Pep Boys Company that Lester crossed the line and breached his fiduciary duty to the charitable beneficiaries when he failed to respond to the bank's clear warnings about the need to diversify the trust in its September 1997 letter. The evidence presented demonstrated that Lester put the interests of his company above those of the charitable beneficiaries, refusing to abstain when he was privy to information suggesting the

dangers or imprudence of keeping the trust fund invested solely in Pep Boys stock. Moreover, Lester's influence over his co-trustee Robert disrupted the process set up by the settlor for reaching a reasoned, majority decision as to the retention of foundation property.

C. Although Pennsylvania Law Does Not Require Diversification for Trusts Revocable Before 1999, the Refusal of Lester and Robert Rosenfeld to Consider the Concerns of their Co-Trustees About the Need to Diversify After the Bank's September 30, 1997 Letter was Imprudent and a Breach of Fiduciary Duty Based on the Facts Presented at the Hearing

The Rosenfelds properly assert that pre-emptive diversification was not required under Pennsylvania law for trusts revocable before December 1999.[99] In the Estate of Knipp, 489 Pa. 509, 414 A.2d 1007 (1980), for instance, the Pennsylvania Supreme Court refused to lay down a per se rule requiring diversification of trust assets. As the Knipp court observed, while "many financial authorities advocate diversity of investment as a desirable course for trust management, a judicial decision declaring non-diversification to be presumptively imprudent would arbitrarily foreclose executors and trustees from opportunities to retain beneficial holdings." Id. , 489 Pa. at 514, 414 A.2d at 1009. It cautioned, however, that even where a testator gives a fiduciary discretion to retain assets, the decision to retain those assets must still be prudent. Id., 489 Pa. at 513. 414 A.2d at 1009.

It was not until 1999 that the Pennsylvania legislature adopted the Prudent Investor Rule presently set forth in 20 Pa.C.S. §§7201-7214. Appeal of Trustee Sky Trust, 868 A.2d 464, 479-80 (Pa. Super. 2005). Section 7204 provides that a "fiduciary shall reasonably diversify investments," but the requirement for "reasonable diversification" does not "impose the 'extreme diversification' mandated by 'modern

[99] 7/25/2005 Rosenfelds Post-Trial Memorandum at 32 (citing Estate of Knipp, 489 Pa. 509 (1980)).

portfolio theory'" Appeal of Trustee Sky Trust, 868 A.2d at 480. In addition, section 7204 by its express terms does not apply to trusts—like the Rosenfeld Trust--that became irrevocable prior to December 2, 1999. See 20 Pa.C.S.§7204 (b)(1). Moreover, the provisions regarding diversification make an explicit exception for retention of "inception assets," pursuant to section 7205 which provides that a "fiduciary, in the exercise of reasonable care, may retain any asset received in kind, even though the asset constitutes a disproportionately large share of the portfolio." 20 Pa.C.S. §7205.

A case that analyzes the interplay of these statutory provisions on a trust that became irrevocable before 1999 is Sky Trust. In that case, the Pennsylvania Superior court emphasized that the decisions of a trustee as to diversification of a trust fund must be evaluated according to the provisions of the trust document "as governed by the standard established by all applicable statutory provisions and the well-settled prior case law." Sky Trust, 868 A.2d at 481.

Under well-settled prior case law, as the Rosenfelds concede,[100] a trustee must act reasonably in retaining trust assets even where the trust document gives a trustee discretion to retain those assets. Estate of Pew, 440 Pa. Super. at 238, 655 A.2d at 542; Estate of Knipp, 489 Pa. at 513, 414 A.2d at 1009, quoting Lentz Estate, 364 Pa. 304, 72 A.2d 276 (1950)("Where, as in the present case, a testator vests a fiduciary with discretion to retain assets, the fiduciary is not thereby excused from the duty to making the retention decision prudently"). The preferable approach therefore is a case by case analysis to determine whether a fiduciary met the standard of care on issues of diversification. See also Trust of Munro, 373 Pa. Super. 448, 457, 541 A.2d 756, 760,

[100] 1/25/2005 Rosenfelds Post-trial Memorandum at 32 ("a trustee has a duty to act prudently even though diversification is not required by the trust instrument or as a matter of law").

app.denied, 520 Pa. 607, 553 A.2d 969 (1988)(suggesting a case by case approach because "[m]ere failure to diversify is not a sufficient basis for the imposition of a surcharge as diversification of investments is not required in Pennsylvania").

In determining whether a trustee breached his duty regarding diversification, the Sky Trust court emphasized that the "real question is whether it appears from the record that the trustees acted in 'that state of mind' contemplated by the grantor of the trust." Sky Trust, 868 A.2d at 481. The Sky Trust court concluded that a trustee had been grossly negligent in his administration of a trust when he failed to consider the settlor's primary objectives or the beneficiaries' specific needs but instead "applied a hypothetically 'good'" strategy of diversification without considering the surrounding factual circumstance. Sky Trust, 868 A.2d at 492. As evidence of this failure to exercise the appropriate level of care, the court emphasized the trustee's decision to extend the investment horizon of the trust without considering the life tenant's declining health and the likelihood of the trust's approaching termination due that decline.[101]

In the instant case, the settlor Emanuel Rosenfeld created his trust to establish a perpetual charitable trust whose trustees were charged with investing the trust property so that the income from these investments could be used for donations to "religious,

[101] Id., 868 A.2d at 492. In Sky Trust, the settlor created a trust that named her husband as the life beneficiary. Upon his death, the trust corpus was to be divided among their children in equal shares. After the settlor died, the life tenant's health rapidly deteriorated and within 6 months he moved into a nursing home. Without consulting any of the beneficiaries about the life tenant's health or circumstances, the corporate trustee decided to change the investment goal from "safety" to "balanced," which meant that the investment horizon was extended. Moreover, the trustee began diversifying the trust assets. When the life tenant died, the trustee had to liquidate the trust assets. In response, the beneficiaries objected and the trial court concluded that the trust had been grossly negligent in managing and diversifying the portfolio without taking into consideration the surrounding circumstances of the life tenant and the settlor's intent which had been primarily to provide income for herself and the life tenant, her husband. See generally Sky Trust, 868 A.2d at 464-91.

charitable, scientific, literary or educational purposes."[102] By decision of the majority, the trustees could hold the trust assets "as long as in their discretion they deem it advisable to do so."[103] The settlor also made sure that there was a corporate trustee assigned an equal role with the three individual trustees as to deciding whether trust property should be retained. Although Mrs. Stein suggests the corporate trustee's role was to mediate family strife, it also offered financial expertise and professional management. [104] No single trustee, however, had authority to decide on his own.

The settlor thus had devised a delicate balance in which the determination of retention of assets hinged on majority consideration of the advisability of such retention. Once this balance broke down and Mrs. Stein turned to litigation, as the Rosenfelds suggest, the "issue has always involved the consequences of the Trustees' decision of whether to remain 100 percent invested in PBY or to divest and reinvest in a more diversified asset allocation." They concede, moreover, that there "is no dispute that after 1997 when Mrs. Stein and Wachovia jointly favored diversification, the Rosenfelds opposed it and the resulting stalemate in the "voting" did preclude the sale of PBY for purposes other than sales that were authorized on an annual basis to meet the five percent charitable distribution requirements until the Spring of 2002."[105]

The record presented established that the corporate trustee had been concerned about the lack of diversification of the Rosenfeld foundation assets at least as early as 1995. What is not clear from those bank documents is exactly when—and to whom—those concerns were expressed prior to the bank's September 30, 1997 letter. Handwritten

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[102] Ex. P-2, ¶.
[103] Ex. P-2, ¶2.
[104] See generally, Complaint ¶ 12.
[105] 7/25/2005 Rosenfelds Post-trial Memorandum at 28.

notes on internal bank documents—the Regulation 9 Reviews—vaguely state "Have been stressing diversification."[106] without indicating how, when, or to whom such concerns were conveyed. No testimony was presented by a bank official who might have drafted these handwritten notes—Judith Prendergast or Eric Wiegand—to clarify the nature and extent of conversations among the various trustees. The only bank official who did testify, Reginald Middleton, did not begin working on the Rosenfeld Trust until March 2000.[107] The first clear evidence of the bank's confrontation with the other trustees on the need to diversify the Rosenfeld Foundation was its September 27, 1997 letter. This letter referenced not only the bank's general policy of favoring diversification, but also its factual analysis of the unfavorable performance of Pep Boys stock over the course of three years ending in June 30, 1997 in comparison to the 28.86% performance of the S & P 500.[108]

Evidence was also presented that the bank had conducted periodic reviews of the performance of the Rosenfeld trust fund in its Regulation 9 Reviews and the Investment Reviews prepared especially for the trustees, outlining the foundation's asset allocation, time weighted rates of return, and investment return analysis.[109] The Investment Review for September 30, 1997 indicated that 99.9% of the assets were in equities,[110] which consisted solely of Pep Boys stock. Instead of this concentration of one stock, the bank recommended a mix of 65% equity (40% Large cap blend; 15% mid/small cap; 10% International) and 35% fixed income so that no more than 10% of the assets would be in

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[106] Ex. P-102 (6/30/1995 Reg. 9 Review).
[107] 1/26/N.T. at 28-29 (Middleton).
[108] Ex. P-34 (9/30/97 Letter by Eric Wiegand).
[109] 1/26/2005 N.T. at 26-28 (Middleton). See, e.g., Ex. P-28 (Investment Review for June 30, 1997); P-107 (Investment Review for September 30, 1997); Ex. P-24 (Investment Review for March 31, 1999).
[110] Ex. P-107 at 00726 (Investment Review for September 30, 1997)

Pep Boys stock. The bank proposed making this transition over the course of two years, while "potentially taking advantage of the strength in the stock price of Pep Boys to accelerate this process."[111]

When confronted with this concrete proposal as to the advisability of diversifying the Foundation's assets, Lester admitted that he was opposed to diversification "per se:"

> Q: Now, I understand from your testimony that it didn't matter what the bank was recommending as to putting the proceeds into, you were against diversification per se, correct?
> A: Yes.[112]

In "explaining" this position, Lester Rosenfeld, like the Trustee in Sky Trust based his investment decisions as to the sale of PBY stock on the "hypothetically good" scheme of never selling Pep Boys stock.[113] He proudly boasted that his investment philosophy was informed by the broad theory of Bernard Baruch. He conceded that Pep Boys stock was highly volatile, he was aware that the Foundation's bequests to the charities were calculated as a 5% of the annual trust income, yet he obstinately rejected any suggestion that the Foundation's equities should not be invested solely invested in Pep Boys. Various witnesses testified as to Lester's obdurate refusal to sell his company's stock or to consider the purchase of other stock to provide a more balanced portfolio. He steadfastly refused to give a reason for this opposition to considering diversification other than general references to his knowledge as a Director of the Pep Boys company.

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[111] Ex. P-34 (9/30/1997 Letter by Eric Wiegand).
[112] 1/27/2005 N.T. at 34 (Rosenfeld, Lester).
[113] The Sky Trust court emphasized that "this is not a case in which Trustee actually exercised its discretion and determined that diversification was necessary in the short term to protect the assets and to preserve the Life Tenant's income stream. The Trustee made no such determination." Sky Trust, 868 A.2d at 492. Ironically, in refusing to diversify, the Rosenfelds succumbed to the same fault of failing to consider the specific needs of the trust beneficiaries in the context of the factual circumstances.

Yet evidence was presented—in the form of the 10-K statements for the Pep Boys company—that as a director, Lester throughout the period after the Bank's September 1997 letter was—or should have been--aware of troubling news about the Pep Boys company's performance. Not only did the Pep Boys stock decline from $27.25 per share in September 1997 to $13.62 in September 1998, and then $9.88 by November 1999,[114] but the 10-K reports revealed that by 1998 closures of stores were planned[115] while during 1997 the company's earnings had declined by a half.[116] Moreover, as a director, Lester was aware that by December 1998, the Pep Boys Board of Directors engaged in discussions about the possible downgrading of the credit rating of the Pep Boys company.[117] There was testimony that Lester had been warned of the potential conflict of interest between his role as a trustee of the Rosenfeld foundation and responsibilities as director of the Pep Boys company,[118] but Lester nonetheless refused to abstain from the sensitive issue of selling the foundation's shares of his company's stock.

An equally serious breach of fiduciary duty occurred due to Lester's sway over Robert Rosenfeld's position on diversification. From his testimony, Robert had a cavalierly negligent attitude towards the Foundation's administration. He conceded that it was not until 1999 that he became aware of the disagreements about diversification—more than two years after the bank's first letter on that issue. Moreover, what seemed to alarm Robert most was his potential liability rather than the well being of the charitable beneficiaries. In the December 23, 1999 letter that Robert wrote in response to the

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[114] Ex. P-26.
[115] Ex. P-113, n. 1 (10-K filed 4/29/1998).
[116] The net earnings for the fiscal year ending January 31, 1998 were reported as $49 million compared to net earnings of nearly $100 million for the prior year. Ex. P-113 (10-K filed on 4/29/1998); 1/26/2005 N.T. at 193 (Rosenfeld, Lester).
[117] 1/26/2005 N.T. at 233-34 (Rosenfeld, Lester).
[118] 1/25/2005 N.T. at 6 (Zwick).

bank's letter advocating diversification, Robert explained that the "reasoning behind our investment in Pep Boys has had everything to do with the close knowledge of the stock by one of our trustees."[119] Not only was Robert influenced by his father's faith in Pep Boys, but various credible witnesses testified that he had expressed a concern that his personal fortunes would be adversely affected if he deviated from his father's position rejecting diversification. Perhaps not coincidentally, after his relationship with Lester was severed, Robert began to follow the investment advice of Ken Gunsberger, which led him to favor diversification of his own portfolio as well as the foundation's portfolio.

Both trustees thus breached their fiduciary duty to the beneficiaries of the Rosenfeld Trust by their obdurate refusal to work together to form a majority view on the advisability of selling Pep Boys stock in response to the September 30, 1997 letter of the bank. Although the Rosenfelds argue that neither the "concerted action of two trustees encouraging diversification" nor a "bank policy such as Wachovia's that favors diversification" establishes a "standard of care for compensable liability,"[120] they overlook the language and intent of the trust document requiring the majority of trustees to consider the advisability of stock retention. Lester's obstinate rejection of any analysis of this issue as required by the trust document in favor of a general theory of never selling stock is exactly the type of behavior that the Sky Trust court found troubling. As that court emphasized, in determining a trustee's good faith as to the sale of a particular investment, "the trustee's action must represent an actual and honest exercise of judgment predicated on a genuine consideration of existing conditions." Sky Trust, 868 A.2d at 492. In their failure respond to the bank's September 30 1997 letter by engaging

[119] Ex. P-13 (12/23/1999 Letter from Robert Rosenfeld to Steven Perry).
[120] 7/25/2005 Rosenfelds Post-trial Memorandum at 30.

in a discourse as to the retention of stocks based on existing conditions, both Robert and Lester breached the duty set forth in the Rosenfeld trust agreement.

D.Where the Investment Decisions of Trustees Are Challenged Contemporaneously Rather Than Retrospectively at the Time of an Accounting, Damages Should be Calculated As of the Date of the Alleged Breach of Fiduciary Rather than From the Beginning of the Accounting Period

The Rosenfelds repeatedly argue that they cannot be surcharged because the Foundation did not suffer a loss. They assert that the proper focus in determining their liability should be the accounting filed by Wachovia and the long term growth of the Foundation's assets. The Foundation, which was established in 1952, according to an account filed in December 1953 showed a principal balance of $33,750. By December 2003 that balance had grown to $8,303,453.80 according to Wachovia's account for the Foundation. Hence, the Rosenfelds claim, there can be no surcharge since there was no loss for the Foundation.[121]

Mrs. Stein, in contrast, argues that the proper measure of damages based on the facts of this case is not the entire accounting period of the Foundation. Instead, damages should be computed "from the date when the breach first began—in our case when the Rosenfelds first should have agreed to diversification."[122] In support she invokes the recent precedent of Sky Trust and Scharlach. Determining the date from which damages—if any—should be calculated is thus critical not just for determining the amount of damages but also whether there is any liability for damages.

[121] See 7/25/2005 Rosenfelds Post-trial Memorandum at 38-49; 6/29/2005 Rosenfelds Summary Judgment Memorandum at 23-26. See also Rosenfeld Account, Petition for Adjudication, ¶8 (fair market value of trust principal is $8,303,453.80)
[122] 6/14/2005 Stein Memorandum at 8, n. 3.

As the Rosenfeld's argue,[123] under Pennsylvania law an essential element of surcharge is proof of loss. In re Mendenhall, 484 Pa. 77, 82 n.3, 398 A.2d 951, 954 n.3 (1959). Mere paper losses or a "short term decline in stock," they assert, cannot "be a basis for finding a breach of duty that caused a loss."[124] Instead, they invoke Estate of Pew, 655 A.2d 521 (Pa. Super. 1994) as a "case directly on point."

What is significant about the Estate of Pew for the Rosenfelds is that court's emphasis on determining loss based on the long term history of the fund from its inception to the time of the accounting. In Pew, the beneficiaries of the Mary Pew Trust sur Trust of Walter Pew asserted that the trustees should be surcharged for the decline in market value of Sun company and Oryx common stock during a period between a third account and a supplemental account. Pew Estate, 440 Pa. Super. at 213-14, 241, 655 A.2d at 530 & 544. The Pew court refused to surcharge the trustees because there had been a long term increase in the size of the trust fund from $800,000 in 1932 to $7.5 million in 1989. Although the account had declined to $4,362,117.54 when the supplemental account was filed for the period ending in August 1991, the Pew court emphasized that the value of the trust principal was still five times greater than when it was established. Pew, 440 Pa. Super. at 213, 241, 655 A.2d at 530, 544. In concluding that there could be no surcharge where the accounting showed such long term growth, the Pew court in large measure was concerned with the unfairness of imposing liability on trustees based on the hindsight of objections raised by beneficiaries at the end of an accounting period:

> It would be manifestly unfair of this court to permit trust beneficiaries, armed with the twenty-twenty laser-like vision of hindsight, to focus in upon any short

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[123] 7/25/2005 Rosenfelds Memorandum at 38.
[124] 7/25/2005 Rosenfelds Memorandum at 40-42.

> term time period during the course of the trust's administration when the price of the stocks forming the trust principal had declined as a basis for subjecting the trustees to a surcharge for failing to sell the stocks, when the overall long-term performance of the same stocks led to a five-fold growth in the value of the trust principal.
> Estate of Pew, 440 Pa. Super. at 242, 655 A.2d at 544.

"The propriety of an investment by a trustee," the Pew court emphasized, "must be judged as it appeared at the time it was made and not as viewed in the light of subsequent events." Pew, 440 Pa. Super. at 240, 655 A.2d at 543.This reluctance to impose a surcharge on trustees based on hindsight is eminently just, where, as in Pew, beneficiaries did not raise objections to the investment decisions of trustees until after the filing of an account. At that point, there is no real opportunity to change investment decisions made in the past.[125] The facts of the Rosenfeld dispute, however, are markedly different. Rita Stein and the bank actively sought to change investment decisions of their fellow trustees long before any account was filed. There was thus a dynamic struggle to change the course of investments to reap future benefits for the charitable trust beneficiaries.

The focus of the bank and Mrs. Stein was on contemporaneous events: declining stock prices and a letter expressing specific concerns about a portfolio consisting solely of Pep Boys stock. These initiatives were in accord with the dictates of the trust document that envisioned a concerted consideration of retention of trust property so that a majority consensus might be achieved as to the advisability of retaining stock. The other two trustees, however, thwarted this process. Lester fell back on a dogmatic, reflexive

[125] In the 2005 decision of Sky Trust, the Superior Court likewise disdained hindsight as a basis for surcharging a trustee. Instead, it emphasized that the "propriety of an investment by a trustee must be judged as it appeared at the time it was made and not as viewed in the light of subsequent events." Sky Trust, 868 A.2d at 493. It was this contemporaneous view of the Rosenfeld Trust's investment that both Mrs. Stein and the bank urged the Rosenfelds to consider.

policy of not selling Pep Boys stock under any circumstances as well as his concern about the effect of such a sale on his company. Robert abdicated any responsibility as a trustee by his inattention to key facts about trust administration, his supine submission to his father's presumed inside knowledge, and his fear of the personal financial repercussions of failing to follow Lester's lead.

Another case that the Rosenfelds invoke as exactly on point[126] to support their claim that loss must be determined based on the long term performance of the fund is In re McCune, 705 A.2d 891 (Pa. Super. 1997). In McCune, the distribution committee of a charitable foundation filed a petition in which they sought to open a first account filed by the corporate trustee. As a threshold issue, the court ruled that the distribution committee lacked standing or a beneficial interest. It then went on to state, arguably in dicta, that the committee's dispute with the corporate trustee lacked merit because it could not show that anyone was adversely affected by the decisions of the trustee in light of the fund's long term performance. The court noted that the value of the foundation's assets had increased from $85,867,997 to approximately $400,000,000. It criticized the theory of liability since the "Committee's entire claim of loss is based on allegations of an unrealized higher rate of return. Estimations of such an unrealized return are inherently uncertain." In re McCune, 705 A.2d at 866.

The McCune case, however, like Pew, also involves an effort to penalize trustees based on hindsight. As the McCune court noted in closing "the appellants as members of the Committee were empowered by the codicil of the will to give written instructions to the corporate trustee as to voting the stock" at issue. Nonetheless, "[t]hroughout their tenure, they raised no objections to alleged breaches of fiduciary duty or self dealing.

[126] 7/25/2005 Rosenfelds Memorandum at 41.

Under well established and recognized rules of equitable estoppel, they are now precluded from objecting." McCune, 705 A.2d at 868 (citations omitted).

The bank and Mrs. Stein, in contrast, raised their objections contemporaneously and vigorously with their fellow co-trustees by September 1997. The intransigent refusal of the two other trustees to consider these initiatives should be the starting point of any assessment of damages. To rule otherwise, would be to immunize such behavior based solely on a long term growth of a fund—which might have been greater had the offending trustees exercised the proper standard of care and diligence.

The concern about or propriety of predicating damages for a trustee's breach of fiduciary duty based on any "unrealized gain in the value of principal" due to improper investments was addressed more recently in the Estate of Scharlach, 809 A.2d 376 (Pa. Super. 2002). In Scharlach, the court concluded that where a guardian inadvisably invested the funds of an incapacitated person solely in federally insured investments or obligations of the United States government rather than in a balanced plan involving equities recommended by its own financial adviser, it could be surcharged for the unrealized gain in the value of principal. A surcharge could be imposed even though a court had directed this conservative approach; in fact, the guardian was specifically faulted for failing to seek relief from these restrictions. In reaching this conclusion, the court invoked Section 205 of the Restatement (Second) of Trusts which provides:

> If the trustee commits a breach of trust, he is chargeable with (a) any loss or depreciation in the 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. Estate of Scharlach, 809 A.2d at 386 (emphasis added)(quoting Restatement (Second) of Trusts, §205).

Based on its conclusion that the corporate guardian had breached its fiduciary duty by not following the financial adviser's investment plan, the Scharlach court concluded that the incapacitated person's loss was apparent because his principal was worth substantially less than would have been realized under the investment plan. It therefore concluded that "if a fiduciary allows principal to remain uninvested, a surcharge would be warranted as to the income that the fiduciary failed to realize due to his failure to invest. Lost income is just as much unrealized gain as unrealized principal growth." Scharlach, 809 A.2d 386 (citing In re Mendenhall). The Superior court remanded the case for a determination of damages based on this analysis.

The recognition in Scharlach that damages for breach of fiduciary duty can be assessed based on unrealized gain was embraced by the 2005 decision of Sky Trust, where the Pennsylvania Superior Court concluded that trust beneficiaries had suffered a loss due to the trustee's imprudent diversification of the fund without regard to the needs of the beneficiaries, the terms of the trust document or the factual circumstances. After emphasizing that a surcharge is intended to compensate a beneficiary for loss caused by a fiduciary's lack of appropriate care, the Sky Trust court concluded:

> Clearly, a trustee cannot be surcharged for a breach of the relevant duty of care unless the breach causes an actual loss to the trust. However, that loss may be in the form of lost interest or unrealized capital gain as well as direct capital loss. The trial court may grant a surcharge for the purpose of providing the beneficiaries with the unrealized gain to the value of principal assets of a trust that was lost because of a trustee's failure to fulfill its duty of care. Furthermore, "lost income" is just as much unrealized gain as unrealized principal growth.
> Sky Trust, 868 A.2d at 493 (citations omitted)(emphasis added).

In outlining this standard for assessing damages, the Sky Trust court was careful to note that such a calculation was not limited, as in Scharlach, to cases where a trustee failed to adhere to a specified or court approved investment plan. Id., 868 A.2d at 493, n. 17.

E. Based on the Facts of Record, Damages Should Be Computed From September 1997 Once the Rosenfelds Were Put Clearly on Notice of the Need to Consider Diversification by the Bank's September 30, 1997 Letter

The parties agree that damages must be determined with a reasonable degree of certainty. Friedman v. Parkway Baking, 147 Pa. Super. 552, 556, 24 A.2d 157, 159 (1942). This is because a fact-finder must be given an adequate framework for reaching a "reasonably certain estimate of the amount of anticipated profits lost due to the breach." Jahanshahi v. Centura Dev. Co., 816 A.2d 1179, 1184 (Pa. Super. 2003)(citing Merion Spring Co. v. Muelles, 315 Pa. Super. 469, 462 A.2d 686 (Pa. Super. 1983). Damages, however, do not have to be determined with mathematical precision. Ashcraft v. Husey, 359 Pa. 129, 132, 58 A.2d 170, 172 (Pa. Super.). As the Pennsylvania Superior Court observed in acknowledging that "mere uncertainty as to the amount" of damages is not fatal since "substantial justice is better than exact injustice." Friedman, 147 Pa. Super. 556, 24 A.2d. at 159.

The present controversy raises the complicated issue of determining damages where two trustees breached their duty in failing to rectify a fund overly concentrated with highly volatile stock once they were confronted on this issue by their co-trustees. Because of the complexities in assessing the various investment possibilities, expert testimony was helpful. As Pennsylvania Rule of Evidence 702 sets forth:

> If scientific, technical or other specialized knowledge beyond that possessed by a layperson will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education may testify thereto in the form of opinion or otherwise.
> Pa.R. Evid. 702.

The testimony of an expert, however, must be based on a proper factual foundation even if mathematical precision is not required. As the Pennsylvania Supreme

Court emphasized, "[a]n expert cannot base his opinion upon facts which are not warranted by the record. No matter how skilled or experienced the witness may be, he will not be permitted to guess or state a judgment based on mere conjecture." Collins v. Hand, 431 Pa. 378, 390, 246 A.2d 398, 404 (Pa. 1968). Courts have concluded that even such seemingly speculative damages as lost profits of a new business "may be established with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises and the like." Jahanshahi, 816 A.2d at 1184 (quoting Merion Spring, Co., 462 A.2d at 696).

In the instant case, Mrs. Stein presented testimony by Dr. Craig McCann, who was accepted without objection as an expert witness on damages calculations for mismanaged portfolios, [127] while the Rosenfelds presented Dr. Andrew Postlewaite as an expert in financial analysis.[128] As a preliminary matter, these experts disagreed on the critical issue of the date for timing a computation for damages. Both experts agree, however, that identifying the point of breach and the timing of damages is critical because the amount of damages will differ—dramatically-- depending both on the date which is selected as the starting point for calculating damages as well as the length of time over which the sale of stock and diversification occurred.

Initially, Dr. McCann based his determination of damages from the starting point of June 30, 1996 as set forth in his expert report, direct testimony, and supporting charts.[129] In re-direct testimony, however, Dr. McCann offered damage testimony beginning with a date of October 1, 1997 with periods of diversification extending for

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[127] 5/3/2005 N.T. at 24.
[128] 5/4/2005 N.T. at 40.
[129] See, e.g., Ex. P-117 at 5 (expert report)("I chose June 30, 1996 as the date to begin diversification in our well-managed portfolio); 5/3/2005 N.T. at 17-73 (McCann); Exs. P-121,P-122, P-123 and P-124.

either 6 months or 1 year into either diversified funds (i.e. 65% stock/35% bonds) or a money market fund.[130]

Dr. Postlewaite, in contrast, asserted that there was no basis in the record for timing computation of damages prior to the September 30, 1997 letter of the bank.[131] He therefore responded to Dr. McCann's testimony by preparing a table that "adjusted" Dr. McCann's estimates based on whether damages were computed with a starting point of late September 1997, November 1997, March 1998 or September 1998 and extending for a two year period.[132] For each of these time periods, Dr. Postlewaite showed varying amounts under the heading "Dr. McCann's Estimates Adjusted for Timing Effects." In his testimony, however, he disputed any characterization that these amounts could be considered as damages because he suggested that McCann's proposed reinvestment scheme of 65% equity and 35% bond did not coincide with the bank's September 30, 1997 scheme.[133]

After review of the expert's testimony and reports, this court agrees with Dr. Postlewaite that the facts of record establish that the breach of duty by the Rosenfelds must be timed from the date of the bank's September 30, 1997 letter. On the other hand, the fund selected by Dr. McCann for the reinvested funds mirrors with a reasonable degree of certainty the investment scheme proposed by the bank. It can therefore serve as

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[130] See, e.g. 5/3/2005 N.T. at 149-55 (McCann) and Exs. P-126, P-127, P-128, P-129.

[131] More generally, Dr. Postlewaite concluded that the record was too vague to calculate loss and that there "is nothing in the record that I reviewed to support a claim that either Lester Rosenfeld or Robert Rosenfeld breached his duty as a trustee to make prudent investment decisions" in light of the overall performance of the Foundation. Ex. R-13 (Postlewaite Report) at 2. In so doing, Dr. Postlewaite strayed from calculating damages to offering a legal opinion on the ultimate issues of liability. It is necessary, however, to distinguish between the expert's opinion as to the computation of damages and his conclusions as to the legal issue of liability for breach of fiduciary duty. In the instant case, both experts intermingle legal conclusions with solid economic analysis. In interpreting their reports and testimony, therefore, weight must be given to their economic analysis, not their legal conclusions.

[132] See Ex. R-15.

[133] 5/4/2005 N.T. at 64 & 67 (Postlewaite).

a basis of assessing damages, once the temporal adjustments made by Dr. Postlewaite are factored into the final analysis.

Both parties complain that in finding the Rosenfelds liable for a breach of fiduciary duty, this court failed to pinpoint the exact date the breach occurred for the purposes of calculating damages. The record, however, stands for itself. Throughout the pre-hearing filings and the liability hearings mid-1997 emerged as the clear focal point both of liability and of damage calculation. Mrs. Stein's pre-hearing filings and objections to the Account focused on the critical significance of the bank's September 30, 1997 letter.[134] During the initial liability hearings, counsel for Mrs. Stein attempted to frame a hypothetical for Lester Rosenfeld predicated, inter alia, on the calculation of damages from the date of the bank's September 30, 1997 letter, which proved too unwieldy for a layperson to calculate.[135] Nonetheless, counsel acknowledged such a computation was based on the record:

> THE COURT: I understand the point that you're driving at but the difficulty in asking the hypothetical in the way you're asking it is that there was a fluctuation in the stock price [during the proposed two year period for selling the stock in the bank's September 1997 letter]. You are essentially asking the witness whether sales over a two year period, September '97 to September '99 or perhaps you want to go to September of '97 to September of 2000, I'm not sure….
> MR. ROSEN: No, September '99, two years. Two years.
> THE COURT: Two years because that's premised on the bank's recommendation to stage sales for two years.
> MR. ROSEN: Yes.
> THE COURT: <u>So your hypothetical has a factual foundation.</u>

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[134] Mrs. Stein's Objections to the Account incorporated her complaint and her response to Wachovia's Summary Judgment Motion. The complaint pinpointed September 1997 as the date the bank acknowledged the need to diversify. Complaint, ¶ 28. It also traced Mrs. Stein's own efforts to urge diversification to "as early as May 7, 1997." Complaint, ¶¶ 19. In her response to Wachovia's summary judgment motion, Mrs. Stein stated that after she began urging diversification in May 1997, the bank "as if awakened" sent a letter urging diversification. See 2/23/2003 Stein Memorandum of Law at 3 (attached as Exhibit 2 to Stein Objections).

[135] 1/27/2005 N.T. at 32-47 (Questions posed to Rosenfeld, Lester). As counsel for the Rosenfelds observed, the question possibly required expert testimony. Id. at 41 (Abrams)("It calls for speculation and possibly expert testimony").

MR. ROSEN: Correct.[136]

At other points when counsel for Mrs. Stein attempted to frame hypotheticals, for example based on a sale of 100% of Pep Boys stock, he was admonished on the need to adhere to the factual record.[137]

It was therefore surprising that during the damages hearings, the objectant's witness, Dr. McCann, premised much of his analysis on the computation of damages by starting his calculations at the date of June 1996. Similarly, Mrs. Stein's post-hearing memoranda argue that damages should be calculated from June 1996. In so doing, she points to discrete pieces of evidence. First, she suggests that the Bank's Reg. Review Statement for June 30, 1995 (Ex. P-102) can be used as a basis for computing damages beginning at June 30, 1996.[138] There are several problems with using this document to pinpoint the Rosenfeld's breach of duty—most obviously that the document was dated a year prior to the proposed date of June 30, 1996 for calculating damages. Moreover, although this 1995 Reg 9 document contains the handwritten note "Have been stressing diversification Pep Boys stock,"[139] no testimony by any bank personnel who might have written the note was presented as a means of clarifying the exact nature of the efforts that were taken and towards whom those efforts were directed. The only bank employee offered to testify was Reginald Middleton, who did not begin working on the Rosenfeld

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[136] 1/27/2005 at 46-47 (emphasis added).

[137] THE COURT: Well, just a moment. I mean I'm struggling with your hypothetical.

Mr. Rosen: Yes.

THE COURT: Putting aside whether it's argument, it's premised on the sale of a hundred percent of Pep Boys stock.

Mr. Rosen: All right.

THE COURT: I don't see any evidence in this case yet that, for example, the bank ever recommended selling one-hundred percent of Pep Boys. 1/27/2005 N.T. at 26.

[138] 8/12/2005 Stein Memorandum at 6; 5/3/2005 N.T. at 74-76 (McCann).

[139] See P-102.

Foundation until March 2000.[140] Moreover, the selection of June 1996 is undermined by an affidavit by Mr. Middleton, in which he stated that the "ongoing dialogue about diversification among the co-trustees began "after 1997."[141]

The Bank's June 30, 1996 Reg. 9 Review Statement which bore the handwritten note "Founding Family of Pep Boys—slow/very reluctant to diversify holdings" (Ex. P-104) suffers from the same lack of clarifying testimony by bank personnel to show a breach by the Rosenfelds. While the objectant points to the testimony by Ed Zwick "that efforts to diversify the Foundation began around 1994/1995 and 'became fairly intense in the mid-90's, in the '95/'96 time period,'"[142]that testimony is too vague. Equally unpersuasive is the objectant's attempt to use Lester's cursory statement when he was asked during his testimony to read the Bank's Reg. 9 Review for June 30, 1996 that his recollection had thereby been refreshed that in 1996 there had been "questions by the bank or pressure on you from any third party, your sister, Mr. Zwick, or anybody, to diversify and you refused."[143] The question posed was too vague, as was the response, to pinpoint a particular date when Lester had been confronted with a concrete proposal to consider diversification and the well being of the Foundation—that he rejected imprudently. Moreover, no facts were presented that at such a time refusal to diversify would have been imprudent based on the circumstances.

Dr. McCann's explanation of why he chose June 30, 1996 as the starting date for computing damages emphasized the same inconclusive factors:

> Well you have to look at the evidence. And you can start at slightly different dates. We started at June 30, 1996 because really three things. One is, I

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140 1/26/2005 N.T. at 28 (Middleton).
141 R-2, Middleton 1/23/2004 Affidavit, ¶9.
142 8/12/2005 Stein Memorandum at 7 (citing 1/25/2005 N.T. at 29-30, and 81).
143 See 1/26/2005 N.T. at 157-58 (Rosenfeld, Lester); 8/12/2005 Memorandum at 7, Ex. P- 104.

> see in the bank's annual account reviews, I think the one dated June 30, 1995, that in 1995 the bank recognized that the account was over concentrated in Pep Boys stock and they needed to focus on diversifying. So there was a recognition by the bank in 1995 that the concentration was a problem. I believe there was testimony by Mrs. Stein that she was urging diversification on her co-trustees as early as 1995. I believe that Mr. Rosenfeld testified that sometime in 1996 he remembered—he remembered that in sometime in 1996 he was being pressed to diversify. So June 30, 1996 is the date we chose because of that evidence, and because there was an account review dated June 30, 1996 that was a sensible place to start the analysis.[144]

This testimony presents a faulty recollection of Rita Stein's testimony since when asked about "the first time you can remember pressing the Foundation to sell Pep Boys stock," she responded, "I believe the first time I really pressed was in 1997."[145]

In contrast to the vagaries of these recollections and handwritten notes on bank documents, the bank's September 30, 1997 letter to the co-trustees stands as a clear beacon both in putting the Rosenfelds firmly on notice of their duty to consider diversifying the Foundation's Fund and as setting forth a possible reinvestment scheme for 90% of the Pep Boys stock "within two years, potentially taking advantage of any strength in the stock price of Pep Boys to accelerate this process." This plan is certainly no less vague than the financial plan in Scharlach, which that court used both to establish a breach of duty due to the guardian's failure to adhere to it and as a basis for computing the resulting damages.[146] In suggesting the timing for selling Pep Boys stock, the bank

[144] 5/3/2005 N.T. at 30-31 (McCann).

[145] 1/27/2005 N.T. at 81 (Stein). Moreover, in her complaint Mrs. Stein stated that "as early as May 7, 1997" she raised the issue of diversification with her co-trustees. See Complaint, ¶ 19.

[146] In Scharlach, the financial adviser (hired by the defendant/guardian) in a letter recommended that the incapacitated person's $800,000 fund be invested as follows: "1) $350,000 invested in tax free municipal bonds; 2) $400,000 invested in an equity investment mutual fund with well-rated growth and income and with a proven track record that would provide protection from inflation; and 3) $50,000 invested in a money market account." Scharlach, 809 A.2d at 301. The court held that the defendant breached its duty "when it failed to implement the plan prepared by Mr. Sykes." Id., 809 A.2d at 384. The court also concluded that this plan be used as a basis for computing damages since "Appellant is entitled to the remedy requested in this action, which is for Mr. Scharlach to be placed in the position in which he would have been had the investment plan been followed." Id., 809 A.2d at 386.

was constrained by its authority under the terms of the trust document, the history of animosity among its co-trustees, and its consequently limited role as intermediary. Based on these facts, it was therefore not imprudent for the bank to suggest a two year span for diversification with the option of accelerating the process since its most pressing goal was to win over the Rosenfelds who might easily be alarmed by a too rapid sale of the Pep Boys stock.

Dr. McCann, however, initially set forth a calculation of damages first by calculating the amount of out-of-pocket loss suffered by the Account between June 30, 1996. Next he calculated the value the trust would have had if it had been well managed, taking into consideration general market forces. He then added these amounts to obtain the market adjusted or well managed account measure of damages.[147] Based on this methodology, Dr. McCann concluded that from June 30, 1996 through December 24, 2003 the trust suffered out-of-pocket losses of $7,399,648 of which $7,241,116 consisted of losses for Pep Boys stock. A well managed portfolio, in contrast, would have increased in value $5,184,696 if it had been diversified as 65% stock and 35% bonds for a total of $12,584,344 in well-managed account damages. Moreover, this well managed portfolio would have been able to make an additional $5,386,858 to its charitable contributions.

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[147] See generally 5/3/2005 N.T. at 27-29(McCann)(explaining methodology). In calculating the account's out-of-pocket loss, any withdrawals from the account was added to the stock's decline in value. In calculating the value of the trust if it had been well managed, Dr. McCann took into account the extent to which any loss in an account is attributable to a general decline in the market as a whole. Id. Courts assessing damages based on the decline of stock portfolios have likewise concluded that in such cases a "plaintiff is entitled to recover the difference between what his account would have had if the account has been handled legitimately and what he in fact had at the time the violation ended with the transfer of the account to a new broker." Miley v. Oppenheimer & Co., 637 F.2d 318, 327 (5th Cir. 1981)(stock portfolio harmed due to "churning" by stock adviser). It is important to factor in the general market forces to avoid giving a windfall to either party in a case involving the decline in stock value.

These calculations were premised on a starting date for diversification of June 30, 1996 over the course of 6 months by selling 90% of the Pep Boys stock.[148]

Fortunately, Dr. McCann did not offer just one series of computations but charts with an array with different starting points and duration of periods for diversification. The results for each varied significantly:

- Diversification beginning in June 30, 1996 over the course of 6 months into 65% stock/35% bond with **market adjusted damages of $12,396, 284 and an additional $5,824,979 available for charitable contributions.** (Ex. P-122)
- Diversification beginning in June 30, 1996 over the course of 6 months into 100% cash with **market adjusted damages of $8,141,713 and an additional $3,851,639 available for charitable contributions.** (Ex. P-123)
- Diversification beginning June 30, 1996, ostensibly into a mix of stocks owned by Lester Rosenfeld (25% Pep Boys; 25% Teleflex; 25% Vanguard healthcare fund; 25% Municipal Bond Fund with **market adjusted damages of $14,440,083 and an additional $5,461,293 for charitable contributions.** (Ex.P-124); 5/3/2005 N.T. at 70-74 (McCann); 8/12/2005 Stein Memorandum at 11.
- Diversification beginning October 1, 1997 over a course of 6 months into 65% stock/35% bond with **market adjusted damages of $3,612,111 and an additional $2,053,241 available for charitable contributions.** (Ex. P.127)
- Diversification beginning October 1, 1997 over a period of 6 months into 100% cash **with market adjusted damages of $3,301,233 and an additional $1,823,593 for charitable contributions.** (Ex. P-128)
- Diversification beginning October 1, 1997 over a period of twelve months into 65% stock/35% bond **with market adjusted damages of $2,012,698 and an additional $1,488,936 available for charitable contributions.** (Ex. P-129)
- Diversification beginning October 1, 1997 over a period of twelve months into 100% cash **with market adjusted damages of $1,985,600 and an additional $1,377,987 available for charitable contributions.** (Ex. P-130)

It is the model Ex. P-129, that most closely adheres to the factual record, by starting the calculations on October 1, 1997, placing the proceeds into a 65% stock/35% bond mix, but it deviates as to period envisioned for diversification. While Ex. P-129 sets forth a one year period of sale of Pep Boys stock, the bank's letter had suggested

[148] See 5/3/2005 N.T. at 26-27 (McCann); Ex. P-117 at 4-5, 13 (McCann Expert report). The figures in McCann's report and testimony differ slightly, presumably because the testimony was intended to present more of a broad view for the purposes of clarity.

"reducing Pep Boys stock to less than 10% of the equity portion of the portfolio within two years, potentially taking advantage of any strength in the stock price of Pep Boys to accelerate this process."[149] Dr. McCann, however, intentionally rejected this proposed 2 year period for selling the Pep Boys stock because, in his opinion, such a long period was imprudent. He concluded that once it was determined that there was a duty to diversify, the prudent course was to diversify as quickly as possible without damaging the value of the stock through an overly precipitous sale. He therefore conducted an analysis of the trading records for Pep Boys stock to conclude that selling the stock within 6 months would not have undermined the value of that stock.[150]

This analysis, however, did not take into account the living breathing individuals who had to effectuate this diversification and the settlor's trust document. The standard of care must emanate from that document which does not impose an absolute duty to diversify but instead requires consensus by a majority of the trustees. The bank's proposal for a two year period of diversification based on the record was an effort to conciliate and entice intransigent co-trustees to sell Pep Boys stock. It is the only solid factual foundation for calculating damages. Otherwise, as Dr. McCann's own analysis demonstrates, there would be wildly disparate measurement of damages.

Fortunately, and perhaps inadvertently, Dr. Postlewaite offered an adjustment of Dr. McCann's calculations to coincide with the bank's proposal of diversification over a two year period beginning October 1997.[151] As he explained:

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[149] Ex. P-34 (9/30/1997 Letter from Eric Wiegand).

[150] Ex. P-117 at 6 (McCann Expert Report).

[151] In his testimony, Dr. Postlewaite identified three problems with McCann's computation of damages: (1) the selection of June 1996 as the starting date for computing damages did not conform to the evidence which pointed to bank's September 1997 letter as the proper focal point; (2) McCann proposed diversification of 90% of the Pep Boys stock over a period of 6 months while the bank had proposed a period of approximately 2 years; and (3) McCann's proposal for investing the proceeds from a sale of Pep

> I went back and redid the calculations using all of his (i.e. McCann's) data from the terms of a particular portfolio that he chose and the amounts of stock to be sold, using the prices of the stock that were in his report, to determine what the difference in his estimates would have been had he, in fact, made the calculations from a period that was consistent with the bank's recommendations to the Rosenfelds; that is a 24 month period beginning in September 30 of 1997.[152]

Dr. Postlewaite presented his calculations as Exhibit R-15, a "Table Summarizing Dr. Postlewaite's Calculations."[153] Based on this recalculation, Dr. Postlewaite concluded that Dr. McCann's result should be "adjusted to timing effects to $593,546."[154] But when questioned as to whether this constituted a "damage" amount, Dr. Postlewaite refused to characterize this figure as "damages;"[155] instead he offered the legal conclusion that technically this figure was not "damages" because he believed Dr. McCann's portfolio was not an accurate reflection of the bank's proposal since "[h]e picked a portfolio that as near as I can see isn't in the evidence at all. He ignored the fact that the bank's recommendation was to use the small cap or mid cap and the international cap as part of the portfolio."[156] The bank in its September 30, 1997 letter, for instance, proposed that proceeds from the sale of Pep Boys stock be reinvested as follows:

> 65% Equity: 40% Large Cap blend; 15% Mid/Small Cap; 10% International
> 35% Fixed income[157]

According to Dr. Postlewaite, the McMann model was defective because it did not accurately reflect the evidence on record by failing to include the international stocks

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Boys stock into a well managed portfolio did not include the exact same mix of assets proposed in the bank's 1997 letter because it did not include small/mid cap or international equities. 5/4/2005 N.T. at 47 & 64-65 (Postlewaite).

[152] 5/4/2005 N.T. at 47 (Postlewaite).

[153] 5/4/2005 N.T. at 46-47 (Postlewaite).

[154] See Ex. R-15.

[155] 5/4/2005 N.T. at 64-65 & 67 (Both times that Dr. Postlewaite was asked to characterize his $593,546 figure as damages, he refused to do so).

[156] 5/4/2005 N.T. at 64 (Postlewaite)

[157] P-34 (9/30/1997 Letter from Wiegand).

or the small/mid cap stocks recommended by the bank's September 30, 1997 letter. Dr. Postlewaite conceded that including such calculations was very difficult because there are nearly 400 small/mid cap funds with varying rates of return. The international stocks created even more challenge of replication because there could be no standard fund since some indices would be weighted towards European markets, while others would be weighted towards Asian markets.[158] However, in offering this opinion as to whether the McCann model accurately represented the evidence of record, Dr. Postlewaite was straying beyond his role as an expert on financial analysis to offer a legal opinion. It is necessary, therefore, to step back and analyze whether the 65% equity / 35% bond mix of the McCann model presented a close enough approximation to the bank's suggested investments that Dr. Postlewaite's "adjustments" to its "timing" could be considered as damages in this case. Mrs. Stein, for instance, argues in her final memorandum that "Prof. Postlewaite confirmed that a diversification over two years beginning with the Bank's September 30, 1997 letter would still have resulted in a loss."[159]

Dr. McCann testified that the 65 equity/35 bond mix of assets in his model for diversification was based on his recollection of the trustees' concerns and his opinion that this represented the best portfolio for a trust. To represent the equity portion of the portfolio, he used a broad based passive mutual fund, the Standard & Poors 500 Index Fund from Vanguard. Because this fund accounts for over 70% of the U.S. stock market savings, Dr. McCann believed that it was a "good broad measure of the returns that investors are earning on average."[160] Other funds, such as a Fidelity S & P 500 fund, would provide a similarly broad index. For the bonds, he used Vanguard's Total Bond

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[158] 5/4/2005 N.T. at 64-66 & 80 (Postlewaite).
[159] 8/12/2005 Stein Memorandum at 18, n.17.
[160] 5/3/2005 N.T. at 44-45 (McCann).

Market Fund "to measure the average returns that investors in the stock market, in the bond market, earned during this period."[161] These broad index funds, he suggested, gave more generalized results than "cherry picking" a benchmark to provide better results for a client. Dr. McCann noted that another fund, the Wiltshire 5000 "caps 99 percent of the U.S. market capitalization."[162]

Dr. McCann conceded that these broad based indexes differed from the bank's more complicated proposal as to the small/mid cap and international stocks, but the bank did specify a 65% equity/35% fixed income breakdown in its September 30, 1997 without specifying specific funds.[163] Moreover, the bank's letter noted that it adhered to the modern portfolio theory, which McCann likewise embraced.[164] When asked how successfully his model reflected the bank's reference to small/mid cap and international stocks, he conceded that the Vanguard S & P 500 was really a large cap blend that did not contain small/mid cap or international stocks but as an indication of what investors were earning on average it did a "good job of capturing the 65% allocation to equities."[165] Moreover, McCann compared the performance of the Vanguard S & P 500 to that of the Wiltshire 5000 and concluded that there was little difference in performance for the July 1996 through December 2003 period. This is significant because the Wiltshire 5000 is a completion portfolio for the S & P 500; "it's the small and mid cap portfolio added to the S & P 500" so that it would reflect the performance of small and mid cap stock.[166]

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[161] 5/3/2005 N.T. at 45 (McCann).
[162] 5/3/2005 N.T. at 47-48 (McCann).
[163] 5/3/2005 N.T. at 58-59, 102-03 (McCann).
[164] 5/3/2005 N.T. at 92 (McCann). In explaining that his opinion was influenced by the modern portfolio theory, McCann noted that the bank's reference to that theory did not affect his opinion.
[165] 5/3/2005 N.T. at 102-03 (McCann).
[166] 5/3/2005 N.T. at 104, 105-06. (McCann).

Consequently, the McCann model only differed from the bank's proposal in its omission of the 10% in international stocks.

This suggestion that Dr. McCann's model by referencing the Wiltshire 5000 reflected small/mid caps as well as large caps was not challenged by Dr. Postlewaite. When asked whether the Wiltshire 5000 was "a reasonable way of mirroring the bank's recommendation" minus the international component, Dr. Postlewaite agreed while expressing concern that he had not personally checked its performance relative to the S & P 500.[167] Despite this key concession as to the Wiltshire 5000, Dr. Postlewaite's main disagreement with the mix of assets within McCann's model remained that it did not incorporate 25% of the bank's recommendations: the 15% mid/cap small cap and the 10% international equity.

Whether the mix of 65% equity/35% bond in Dr. McCann's model reasonably reflected the evidence on record as set forth in the bank's September 30, 1997 is a legal issue that has been more generally addressed in Miley v. Oppenheimer, 637 F.2d 318 (5th Cir. 1981), *disapproved on other grounds,* Dean Witter Reynolds, Inc, v. Byrd, 470 U.S. 213 (1985)[168]—a case both parties cite—albeit for different arguments. Strikingly, the Rosenfelds agree with Mrs. Stein that Miley represents a "case that makes use of fair and reasonable estimates."[169] They part company as to the applicability of Miley to the instant case since Miley involved the offense of churning with an "intent to defraud"

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[167] 5/4/2005 N.T. at 119 & 122-26 (Postlewaite).

[168] The U.S. Supreme Court in Dean Witter disapproved the approach taken by federal courts in the Ninth, Fifth and Sixth Circuits towards compelling arbitration of pendent state law claims when the federal court had jurisdiction over the federal securities claim. While these circuits did not compel the arbitration of the state claims, the Dean Witter court concluded that the Arbitration Act requires federal district courts to compel arbitration of the state pendent arbitrable claims. 470 U.S. at 216-18. The methodology for measuring damages outlined in Miley was not addressed.

[169] Rosenfelds 7/25/2005 Memorandum at 44.

which is not at issue in the Rosenfeld dispute.[170] This objection, however, misses the broad picture. Miley provides a methodology for assessing damages related to the decline in stock values from the time of the fiduciary's breach. It is not dependant on the exact nature of the offense constituting the breach.

In any event, precedent from other jurisdictions is helpful because while the Pennsylvania precedent of Scharlach and Sky Trust recognized that a surcharge could be calculated based on loss "in the form of lost interest or unrealized capital gain as well as direct capital loss,"[171] these cases did not outline how those losses might be calculated. In Miley, however, the court had to calculate damages based on a decline in an investor's portfolio over a period of time due to the improper "churning" of her assets by her investment advisor. In so doing, the Miley court emphasized the difficulty in calculating those damages, where, in theory "the plaintiff is entitled to recover the difference between what he would have had if the account had been handled legitimately and what he in fact had at the time the violation ended with the transfer of the account to a new broker. However, the nature of the churning offense as well as the inherent uncertainties of the operation of the stock market make exact implementation of this elementary legal theory impossible." Id., 637 F.2d at 327. Despite these difficulties, the court emphasized, "neither the difficulty of the task nor the guarantee of imprecision in results can be a basis for judicial abdication from the responsibility to set far and reasonable damages in a case." Id., 637 F.2d at 327.

In attempting to approximate the losses in stock value due to the misconduct of a broker—or a trustee—a first step is to estimate how the portfolio would have performed

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[170] Rosenfelds 7/25/2005 Memorandum at 45-46.
[171] Sky Trust, 868 A.2d at 493 (citing Scharlach, 809 A.2d at 386).

without the misconduct. In so doing, the Miley court emphasized, "[t]he trial judge must be afforded significant discretion to choose the indicia by which such estimation is to be made, based primarily on the types of securities comprising the portfolio." Id., 637 F.2d at 328 (noting that the average performance of the Standard and Poor's Index during the relevant period can provide an indicia of how a particular portfolio would have performed during a certain period).

In exercising its legal discretion, this court concludes that the portfolio selected by Dr. McCann to mirror bank's proposed investment into 65%equity/35% bond was as accurate as possible under the circumstances. The remaining problem with Dr. McCann's analyses, however, was temporal. He did not focus on the 2 year period after September 1997 in assessing damages that would have coincided with the bank's recommended period for diversification. That problem, however, was rectified by Dr. Postlewaite's adjustment of McCann's computations, which resulted a damage figure of $593,546.[172] For this reason, Lester and Robert Rosenfeld should be surcharged in the joint amount of $593,546.

II. Both Lester and Robert Rosenfeld Are Removed as Co-Trustees of the Rosenfeld Foundation

Unfortunately, the deadlock that hindered a timely diversification of the Rosenfeld Foundation, persists and appears irremediable. Upon questioning by the attorney general, Rita Stein acknowledged that she and her co-trustees never meet to discuss business nor do they exchange telephone calls. The last meeting among co-

[172] Ex. R-15. See also 8/12/2005 Stein Memorandum at 18, n.17 (Mrs. Stein cites this chart to argue that Dr. Postlewaite established that diversification over a two year period beginning with the September 30, 1997 letter would still have resulted in a loss. She did not challenge the accuracy of these calculations, and is thus bound by that calculation). In her earlier memorandum, Mrs. Stein likewise maintains: "And even Prof. Postlewaite agreed that if you waited until September 30, 1997 and took 2 full years to diversify then based upon Dr. McCann's alternative investment portfolio damages would have been nearly $600,000." 6/14/2005 Stein Memorandum at 28.

trustees may have been in the early 1960's.[173] Robert admitted that his aunt and father could not discuss business, and that by 2001 his own relationship with Lester had been severed and they no longer spoke.[174] Lester Rosenfeld likewise confirmed that he no longer spoke with either of his co-trustees.[175] Moreover, Lester stated that he would not agree to an amendment of the Trust document to give the corporate trustee authority to break a deadlock.[176]

This breakdown in communication among the trustees has had a profound affect on the welfare of the Foundation. Although Pep Boys stocks was sold to diversify the fund, the trustees were unable to agree on a reinvestment plan. Consequently, as of the time when hearings first began in this matter, a third of the value is in cash.[177] All the parties agree that this warehousing of such a large amount of capital in cash is unwise—yet they seem incapable of ever reaching an accord.

One solution that has been suggested to break this deadlock is to partition the Trust. The parties, however, do not agree on how the trust would be partitioned. Mrs. Stein, for instance, argues that the Foundation should be partitioned so that she would have control over 50% of the current assets rather than the current one-third division of assets among the three trustees.[178] The Rosenfelds reject this proposal because there is "no merit to her arguments advocating a relocation that would favor her and certainly

[173] 1/27/2005 N.T. at 175-76 (Stein, Rita).
[174] 1/28/2005 N.T. at 155, 165 (Rosenfeld, Robert).
[175] 1/27/2005 N.T. at 71-72 (Rosenfeld, Robert).
[176] 1/28/2005 N.T. at 68 (Rosenfeld, Lester)(He never speaks with Mrs. Stein and only occasionally with Robert).
[177] 1/27/2005 N.T. at 31 (Abrams); 1/26/2005 N.T. at 123 (Middleton). According Middleton, all three trustees have rejected proposals for reinvestment of the funds derived by the sale of Pep Boys stock. Due to the evidence presented of the Rosenfelds breach of fiduciary duty and the long history of ill will among the trustees, the fault for this inability to administer the Foundation effectively must be assigned to the Rosenfelds.
[178] 8/5/2005 Stein Memorandum on Partition at 1.

nothing that establishes cause for that outcome."[179] In light of this inability to agree even as to partition, adopting that approach seems likely to lead to more discontent, litigation and expense. It might also harm the charitable beneficiaries by creating additional administrative costs. Finally, since this court has determined that both Robert and Lester place other interests above those of the charitable beneficiaries, it would be unwise to give either Robert or Lester unfettered control over a partitioned Trust.

The better solution, therefore, is to remove both Lester and Robert Rosenfeld as Mrs. Stein initially requested in her complaint and objections.[180] This court has the jurisdiction to remove these trustees pursuant to 20 Pa.C.S. § 711(12). The grounds for removing a personal representative are set forth in Section 3182 of the PEF and include the following:

> The court shall have exclusive power to remove a personal representative when he:
> (1) is wasting or mismanaging the estate, or is likely to become insolvent, or has failed to perform any duty imposed by law….
> (5) when, for any other reason, the interests of the estate are likely to be jeopardized.
> 20 Pa.C.S. §3182.

It is well established that mere friction among a trustee and beneficiary may not justify removal of a trustee, but where this friction reaches such a level that it interferes with the administration of the trust it can justify removal. Estate of Nassar, 467 Pa. 325, 331-32, 356 A.2d 773, 775-76 (1976). Moreover, a conflict of interest between a fiduciary and the trust or estate is another grounds for removal. Estate of Jonathan Mills Westin, 874 A.2d 139,143-43 (Pa. Super. 2005); Rafferty Estate, 377 Pa. 304, 305, 105

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[179] 7/22/2005 Rosenfelds Memorandum on Partition at 5.
[180] See Objections of Rita Stein, Ex. 1, Complaint, Count VII.

A.2d 147, 148 (1954)("The personal interest of a fiduciary and the unfriendly feeling between the heirs constitute sufficient cause for removal").

Undoubtedly, the decision to remove a trustee is drastic—especially when, as in this case, the trustee was specifically named by a settlor. Estate of Lux, 480 Pa. 256, 269, 389 A.2d 1053,1059 (1978)(citations omitted). Where a settlor appoints a particular trustee, the "need for such action must be clear." In re White, 506 Pa. 218, 223, 484 A.2d 763, 765 (1984). As the Pennsylvania Supreme Court cautioned, the drastic action of removing a trustee "should only be taken where the estate is actually endangered and intervention is necessary to protect trust property." McGillick Foundation, 537 Pa. 194, 200, 642 A.2d 467, 470 (1994).

Overwhelming evidence presented during the hearing established that the welfare of the Foundation is endangered both by the Rosenfelds' breach of fiduciary duty and by the total dysfunctional breakdown in communications among the individual trustees. Lester breached his fiduciary duty to the charitable beneficiaries when he placed the interests of the Pep Boys company above the needs to the charitable beneficiaries. Robert likewise placed his own economic self interest first, with scant concern or awareness of his duties as a trustee of a charitable trust. Moreover, neither is able to communicate with the other--or with Mrs. Stein-- as to vital matters of interest to the Foundation. This total breakdown in communication in conjunction with the Rosenfelds' breach of fiduciary duty constitutes the degree of hostility and dysfunction that would justify removal of Robert and Lester Rosenfeld as trustees. Estate of Nassar, 467 Pa. at 332-33, 356 A.2d at 776-77 (quoting II A. Scott, Law of Trusts, § 107: "Where there is such friction or hostility as to impede the proper performance of the trust….the

trustee shall be removed”). Such removal is justified both under Section 3182 (1) for the Rosenfelds “failure to perform any duty imposed by law,” and under Section 3182(5) because the “interests of the estate are likely to be jeopardized” by their continued tenure as trustees.

III. Wachovia’s Fee Petition

Three months after summary judgment was entered into its favor, the bank (Wachovia) filed a petition requesting that the legal fees and costs it incurred in defending itself successfully against the surcharge action and related claims be paid by the Trustees of the Rosenfeld Trust. Initially, the bank sought to recover $297,194.77,[181] but a few day later it filed an amended petition seeking to recover a slightly smaller amount, $290,714.77.[182] This fee petition was greeted by strenuous objections by Mrs. Stein. While she did not deny that a trustee who successfully defends itself from a surcharge action is entitled to an allowance from the trust to pay for counsel fees and expenditures necessary for its defense, she emphasized that the fees claimed must be reasonable.[183] She asserted that the fees claimed by Wachovia were unreasonable, and to establish this she contrasted the fees claimed by Wachovia’s counsel with those charged by her own counsel. The bank’s defense, she claimed, “had been over-staffed and over-lawyered—from the start.”[184] The bank only had to face one adversary, while Mrs. Stein was forced to assert varying claims against both the bank and the Rosenfelds, each of which were represented by separate counsel. While Mrs. Stein had to respond to two sets of preliminary objections, two motions for judgment on the pleadings and four summary

[181] 8/16/2004 Wachovia Fee Petition.
[182] 8/20/2004 Wachovia Fee Petition.
[183] 9/9/2004 Stein Answer to Wachovia Fee Petition, ¶ 8.
[184] 9/9/2004 Stein Answer to Wachovia Fee Petition, New Matter at ¶2.

judgment motions (two in the civil division and two in the Orphans' Court), Wachovia only to deal with one of each motion. Nonetheless, Wachovia's counsel had four attorneys (two senior, two junior) assigned to the case, while Mrs. Stein only had two attorneys. During the period 2002 through late 2004, Mrs. Stein's attorneys charged her for a total of 365.1 hours, while Wachovia's counsel charged for more than 1200 hours. Mrs. Stein also objected to the $14,000 claim for preparing the accounting.[185]

The Commonwealth, through its deputy attorney general, likewise objected to Wachovia's fee petition. It merely asserted, however, that the fees claimed were excessive and demanded strict proof.[186] The Rosenfelds filed no objections to this initial fee petition.

Wachovia filed a Supplemental Attorney fee petition four months later, seeking an additional $18,349.90 for total fees and costs in the amount of $309,064.67. Wachovia warned that it would also incur additional fees in preparation for a hearing on its fee petition and that it would thereafter submit another supplement.[187]

The Attorney General filed objections to this supplemental fee request.[188] Likewise, Mrs. Stein responded by reiterating her previous objections and by focusing on particular motions filed by Wachovia in the civil division which she characterized as unsuccessful and wasteful. She also suggested that these motions in the civil trial division dealt only with her defamation claim and not with the surcharge issues that were raised in the Orphans' Court proceedings.[189]

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[185] 9/9/2004 Stein Answer to Wachovia Fee Petition, New Matter at ¶¶ 3-5 & 8.
[186] 9/9/2004 Attorney General Answer to Wachovia's Amended fee petition.
[187] 12/23/2004 Wachovia Supplemental Fee Petition.
[188] 1/11/2005 Attorney General Answer to Wachovia's Supplemental fee petition.
[189] 1/11/2005 Stein Answer to Wachovia Fee Petition, New Matter at ¶¶1-7.

The day after Mrs. Stein filed this response, the fee petition hearing was held. Counsel for the Rosenfelds made two preliminary arguments. First, he argued that consideration of the fee petition was premature since the order granting summary judgment to Wachovia was interlocutory and the surcharge action against the Rosenfelds was still pending. Second, he objected to placing the burden of the attorney fees on the trust, arguing instead that Rita Stein as the unsuccessful party seeking the surcharge should bear that burden. Once the Trust is partitioned, he suggested, it would be equitable to assess Wachovia's attorney fees against Mrs. Stein's portion of the Trust. Otherwise, the Rosenfelds would offer no evidence as to the reasonableness of the fees claimed by Wachovia.[190] The Attorney General also raised the issue of which party should bear the burden of Wachovia's fees, and requested that once this court made a determination of the reasonableness of the costs claimed that the Commonwealth be given an opportunity to argue as to who should bear that cost.[191]

In support of its fees and costs, Wachovia offered testimony from Ralph Wellington, the senior supervising attorney and chairman of the firm, Jennifer Dufault James, the Junior Partner in charge of the litigation, and Lawrence Fox, an expert as to the reasonableness of the attorney fees and costs. Mr. Wellington explained the firm's strategy in defending Wachovia in "contentiously fought litigation. Many motions, many places."[192] He stated that the strategy was to entrust the litigation to a Junior Partner under his supervision. Initially, that partner was from the Trust department, but as it became clear that the matter would be intensely litigated, Ms. James assumed the junior partner role, with the support of a litigation associate, Chad Cooper. When the bank was

[190] 1/12/2005 N.T. at 3-5 (Abrams).
[191] 1/12/2005 N.T. at 8 (Donahue).
[192] 1//1/2005 N.T. at 79 (Wellington).

ordered to file an account, Ms. Newman, from the firm's trust and estates department, was called back because of her special expertise in that area. When asked by the Attorney General how many attorneys worked on this case, Mr. Wellington stated that there had been essentially five attorneys "over the course of the time who spent the bulk of the time"[193] with research back up also from two research librarians.[194] Finally, documentation of the fees charged were all set forth in the firm's time sheets that were submitted as Ex. D-l.[195]

On cross-examination, Mrs. Stein's attorney focused on whether the discovery conducted and the motions filed in the civil trial division were distinct from the surcharge issues raised later in Orphans' Court. Mr. Wellington responded that all of those motions and discovery related to the bank's alleged misconduct in its investment advice.[196] In her testimony, Ms. James likewise emphasized that all of the litigation efforts in the civil trial division were intimately related to the Orphans' Court issues of the bank's alleged breach of its fiduciary duty. All the discovery and research that they conducted in the civil trial division, she maintained, was utilized in the subsequent successful defense of the bank in Orphans' Court.[197] When asked about the large bills that were charged for June and July 2003, Ms. James explained that they were incurred in responding to Mrs. Stein's various discovery requests.[198]

The expert offered by Wachovia, Lawrence Fox, emphasized that the bank had been confronted by novel, challenging theories and arguments by a tenacious, esteemed

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[193] 1/12/2005 N.T. at 59 (Wellington).
[194] 1/12/2005 N.T. at 10-18 & 59-61 (Wellington).
[195] 1/12/2005 N.T. at 12-18 (Wellington).
[196] See generally 1/12/2005 N.T. at 19-46.
[197] 1/12/2005 N.T. at 96 (James).
[198] 1/12/2005 N.T. at 96 (James).

litigator.[199] The billing rate charged by Wachovia's law firm was commensurate with the rates of comparable large firms.[200] He was impressed by the low hours charged by the Senior Partner, Mr. Wellington, and by the delegation of work to attorneys working at a lower rate.[201] He noted as well that Wachovia was confronted with the potential for an enormous $14 million dollar liability and that the firm made vigorous efforts to resolve the matter without a trial.[202]

Finally, the testimony of one of Mrs. Stein's attorneys, David Picker, was offered to contrast the fees incurred by her attorneys with those of the bank's counsel. He also suggested that the bank's efforts in the civil division-- its discovery, motion for judgment on the pleadings and summary judgment motion-- related to Rita's reputational claims and were thus distinct from the bank's defense of the surcharge action.[203]
On cross-examination, Mr. Picker conceded that while litigating in the civil division, he had filed motions to compel documents from Wachovia related to its alleged financial mismanagement and corporate trustee performance.[204] Moreover, in opposing the bank's summary judgment motion in the civil division relating to the reputational issue, Mrs. Stein had attached the same documents obtained in the discovery before the civil division that she attached to her response to the bank's summary judgment motion before Orphans' Court.[205] Those responses were presented as exhibits D-4 and D-5.[206]

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[199] 1/12/2005 N.T. at 125 (Fox).
[200] 1/12/2003 N.T. at 160 (Fox).
[201] 1/12/2005 N.T. at 126 (Fox).
[202] 1/12/2005 N.T at 127 (Fox).
[203] 1/12/2005 N.T. at 176-184 (Picker).
[204] 1/12/2005 N.T. at 191-92 (Picker).
[205] 1/12/2005N.T. at 192-93 (Picker).
[206] 1/12/2005 N.T. at 199-200 (Wellington).

After the fee petition hearing, the Rosenfelds filed a response, once again asserting that the petition was premature.[207] In addition, the Rosenfelds reiterated their concern that it would be inequitable for the Trust to be held accountable for the litigation "occasioned" by co-trustee Rita Stein.

Wachovia's Second Supplemental Fee Request for $425,506.54

Six months after the fee petition hearing, Wachovia filed a second supplemental fee petition. In that petition, it seeks an additional $116,441.87 in fees. Wachovia claimed these fees based on the following four events:

1. Preparation and attendance at the fee petition hearing;
2. Retention of an expert to testify at that hearing;
3. Attendance at the liability hearing for the Rosenfelds, during which a Wachovia employee, Reginald Middleton, was called to testify;
4. Research and briefing to oppose a Motion for Reconsideration of the order granting Wachovia's summary judgment motion.[208]

As a consequence, the total fees Wachovia claims is $425,506.54. Not surprisingly, the Attorney General objected to these additional fees and requested a hearing. Mrs. Stein raised more specific objections to the request for $116,441.87 in additional fees. She noted that this additional fee is nearly 40% of the fees requested for services rendered prior to the fee petition hearing. Moreover, even though summary judgment had been granted in its favor, Wachovia's attorneys spent nearly 80 hours preparing for the five days of hearings as to the Rosenfeld's liability. Although one of Wachovia's employees—Reginald Middleton-- had been called to testify, he testified for less than one day. Despite this, Wachovia's counsel attended every day of hearings involving the Rosenfelds. Moreover, Wachovia's counsel spent 121 hours or $31,238.40

[207] 1/19/2005 Rosenfeld Objections.
[208] 6/10/2005 Wachovia Second Supplemental Fee Petition at 4.

in responding to Mrs. Stein's Motion for Reconsideration. The Foundation, she maintained, should not be subjected to these excessive fees.[209]

The Rosenfelds, likewise, offered specific objections to the supplemental fee petition in addition to reiterating their prior argument that the fee petition is premature and that Mrs. Stein, rather than the Foundation, should assume the burden of those fees. The Rosenfelds identified three ways in which the supplemental fee request was excessive: (1) the time charged for the fee petition and the presentation of expert testimony; (2) Wachovia's decision to have counsel present during the entire five days of liability hearing when it was not actively defending the claim; and (3) the time spent on responding to Mrs. Stein's motion for reconsideration.[210]

Analysis of Wachovia's Fee Petition

A. The Reasonableness of Wachovia's Fee Petition For Its Services From May 2002 Through December 2004

"It is well established," the Pennsylvania Supreme Court has observed, that "whenever there is an unsuccessful attempt by a beneficiary to surcharge a fiduciary, the latter is entitled to an allowance out of the estate to pay for counsel fees and necessary expenses in defending himself against the attack." Browarsky Estate, 437 Pa. 282, 285, 263 A.2d 365, 366 (1970)(citations omitted). Questions have been raised, however, as to whether the fees and costs claimed by Wachovia are reasonable. That threshold issue must be addressed. In addition, the Rosenfelds have argued that Mrs. Stein, rather than the Trust, should bear the cost of Wachovia's fees while the Attorney General more cryptically has requested permission to express an opinion as to who should bear these costs. The general issue of who should be charged with Wachovia's fees and costs in its

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[209] 6/30/2005 Stein Opposition to Wachovia's Second Supplemental Fee Petition, New Matter ¶¶ 1-8.
[210] 7/28/2005 Rosenfeld Objections to Wachovia's Supplemental Fee Petition at ¶ 11.

successful surcharge defense must therefore be addressed after a determination of the reasonableness of Wachovia's fees and costs.

Under Pennsylvania law, an attorney seeking compensation for services and costs has the burden of presenting facts to support that claim. Estate of Sonovick, 373 Pa. Super. 396, 400, 541 A.2d 374, 376 (1988). The fees must be reasonable and based on actual services provided and not some arbitrary formula. Estate of Preston, 385 Pa. Super. 48, 56, 560 A.2d 160, 164 (1989)(citation omitted). The primary responsibility for determining the reasonableness of attorney fees rests with the auditing judge. Estate of Burch, 402 Pa. Super. 314, 317, 586 A.2d 986, 987 (1991). In determining the reasonableness of attorney fees, Pennsylvania courts consider the following facts and factors:

> the amount of work performed; the character of the services rendered; the difficulty of the problems involved; the importance of the litigation; the amount of money or value of the property in question; the degree of responsibility incurred; whether the fund involved was 'created' by the attorney; the professional skill and standing of the attorney in his profession; the results he was able to obtain; the ability of the client to pay a reasonable fee for the services rendered; and, very importantly, the amount of money or the value of the property in question. LaRocca Estate, 431 Pa. 542, 546, 246 A.2d 337, 339 (1968); Estate of Burch, 402 Pa. Super. 314, 318, 586 A.2d 986, 988 (1991).

The litigation launched in April 2002 when Rita Stein filed her complaint in the civil trial division against Robert and Lester Rosenfeld and First Union Bank persisted for more than three years. It eventually culminated in 5 days of liability hearings in January-February 2005 and 2 days of hearings in May 2005 for the Rosenfelds. This intensely fought dispute spanned two forums: first the civil trial division, and then

orphans' court. The amount at stake was claimed to be at least $ 14,000,000 million dollars in potential surcharge.[211]

Without exception, the attorneys for all three sides were peerless: they fought with logic, passion and imagination. As the expert witness for Wachovia observed, the case involved novel theories and formidable advocates. At no point could the defense for either the Rosenfelds or the bank rest at ease. Significantly, the attorneys achieved significant results for their clients within the complex nuance of facts presented: Rita Stein obtained a ruling that the Rosenfelds had breached their fiduciary duty; the Rosenfelds were able to limit the surcharge imposed for that breach; the bank obtained a summary judgment ruling in its favor on May 19, 2004.

The fees claimed by Wachovia, which must be analyzed based on the facts and time frame, can be divided into those fees claimed prior to the fee petition hearing on January 12, 2005 and those claimed afterwards in its Second Supplemental fee petition. Prior to obtaining a favorable summary judgment order, the bank had fought tenaciously to have this matter transferred from the civil division-- where Mrs. Stein first filed her complaint-- to orphans' court. To obtain that result, the bank filed preliminary objections. While in the civil trial division, the parties engaged in discovery and depositions of five witnesses. By order dated September 27, 2002, the claims raised in the complaint were transferred to Orphans' Court except for claim VI for reputational damages and mental distress. In attempting to obtain an early determination of that issue, the bank (then First Union) filed first a judgment on the pleadings and then a motion for

[211] In her complaint, Mrs. Stein claimed the Foundation had lost at least $14.5 million. Complaint, ¶ 34. After the liability and damages hearing, she claimed damages of $18,221,263. 8/12/2005 Stein Memorandum at 20.

summary judgment, which was eventually granted in its favor by order dated September 3, 2003 by Judge Watkins.

During the fee petition hearing, counsel for Mrs. Stein argued that the bank's claim for compensation must be limited to costs incurred as to the surcharge action; it was not entitled to recover for costs incurred for its efforts against the defamation action and the attendant discovery that took place entirely within the civil trial division.[212] This effort to disconnect the litigation in the civil trial division over the remaining defamation claim from the bank's defense of the surcharge claim in orphans' court is unpersuasive based on the record. First, Mrs. Stein's complaint clearly linked the claimed reputational damage to the actions by the bank in its capacity as trustee. Not only did Count IV incorporate the prior factual allegations, but in fleshing out the basis for her claimed reputational damage in paragraph 64, Mrs. Stein maintained: "As a proximate result of Defendants' breach of duty and negligence, resulting in the calamitous decline in value of the Foundation and of the funds available to her to give to the charities of her choice as she has regularly and habitually done, Mrs. Stein has suffered loss of standing and esteem and damage to her reputation, as well as extreme emotional and mental distress, for which she is entitled to compensation in an amount to be proven at trial." Complaint, ¶64. With these words, she thus explicitly linked her alleged reputational damage to the bank's conduct as trustee of the Foundation. It would have been derelict if the bank's counsel had not fought vigorously to disprove those allegations in whatever forum it was forced to fight.

The argument that the discovery conducted in the civil trial division should somehow be severed as a compensable cost as to the surcharge action is also without

[212] 1/12/2005 N.T. at 162-63 (Rosen).

merit. As the bank points out, that discovery was utilized by both parties in the Orphans' court surcharge proceedings. In fact, Mrs. Stein used these documents in responding to the bank's summary judgment motion in both her civil and orphans' court filings.[213] The fees and costs incurred therefore should not be severed between the civil and orphans' court filings.

The main objection Mrs. Stein presents to Wachovia's initial, amended and supplemental fees incurred incurred prior to January 2005 is that the fee was excessive and "was overstaffed and over-lawyered from the start."[214] To drive home this point, she compared the challenges and costs she incurred in confronting 2 different defendants, with the "lesser" challenge facing the bank in defending itself against only one petitioner. Only two attorneys worked on her case, while the bank had as many as five attorneys working at once. While Mrs. Stein's counsel generated fees and costs of $104,187 from November 2001 through November 2004, the bank "spent more than 2 ½ times in attorney's fees and expenses."[215]

This equivalency analysis of the respective fees is not dispositive. Under LaRocca, the facts to consider involve such issues as the amount of work performed. Wachovia documented that extensive work both by an outline of the voluminous pleadings in this case (Ex. D-2) and by the invoices the bank presented at the hearing (Ex. D-1). Moreover, the testimony of Mr. Wellington and Ms. James underscored the careful litigation strategy that was adopted to bring in attorneys with particular expertise in estate

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[213] See, e.g. Exs. D-4 and D-5.

[214] 1/11/2005 Stein Objection, New Matter at ¶ 2. Mrs. Stein focuses on the fee request of $293,714.77 for the period ending November 2004, when, in fact, Wachovia's supplemental fee petition was filed on December 23, 2004 seeks an additional $18,349.90 in fees for a total as of that date of $309,064.67. See 12/23/2004 Wachovia Supplemental Fee Petition.

[215] 1/11/2005 Stein Objection, New Matter at ¶ 4.

matters when necessary while maintaining a core litigation team as it became clear that this "was really becoming a contentious litigation."[216] There was an appropriate balance between using a junior partner under the guidance of a senior partner to oversee the general case, with litigation or estate associates providing essential yeomen support as needed.[217] Moreover, according to expert testimony, the fees charged by the bank's law firm were commensurate with comparable Philadelphia firms.[218]

LaRocca also requires consideration of the character of services rendered, the difficulty of the problems presented and the importance of the litigation—all of which would support the bank's pre-hearing fee petitions. The issues were complex, novel and evolving. The defense was at once assertive and responsive. The work product set forth in the various motions was of the highest quality. Finally, the bank achieved a clear victory—at least on the trial level—when summary judgment was granted in its favor.

A unique difficulty presented by this litigation was the contentious family relationships among the three individual trustees which forced the bank to play the role of intermediary. Under the terms of the trust document, it lacked a unilateral authority to impose its investment advice. Moreover, the trustees became so deadlocked that the three individual trustees would not meet or talk directly with each other.

Mrs. Stein also objects to the fees claimed for the preparation of the account. It is clear, however, that the costs of filing an account would be chargeable to the trust estate

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[216] 1/12/2005 N.T. at 13 (Wellington).

[217] Ralph Wellington, as Senior Partner, oversaw the entire litigation, while Jennifer Default James, who billed at a lower rate, was charged with the daily litigation and discovery responsibilities. Wendy Beetlestone was Ms. James's predecessor. Chad Cooper served as the litigation associate. When appropriate, Amy Newman, a midlevel associate, provided substantive estates and trust expertise. Occasional assistance in that area was provided by Margaret Thompson, a partner, and Jennifer Stoudt, an associate, in the Trust and Estates department of the Schrader law firm. 11/25/2004 Wachovia Memorandum at ¶ 2(b).

[218] 1/12/2005 N.T. at 126 (Fox).

and it "is the right, and generally the duty, of a trustee to secure legal advice and assistance in preparing and presenting an account to the Orphans' Court." Band Estate, 182 Pa. Super. 8, 12-13, 124 A.2d 498, 500-01 (1956). For these reasons, the fees and costs sought by Wachovia in its initial and amended accounts in the amount of $309,064.67 are reasonable based on the facts presented by the bank's counsel.[219]

2. The Reasonableness of Wachovia's Second Supplemental Fee Petition Seeking an Additional

Six months after the fee petition hearing, Wachovia filed a second supplemental fee petition seeking an additional $116,441.87 in fees and costs which it incurred due to the following four events or exigencies:

(1) Preparing and participating in its fee petition hearing in January 2005;
(2) Retaining of an expert witness, Lawrence Fox, to testify in support of its petition;
(3) Attending the 5 days of hearings as to the liability of the Rosenfelds, during which a Wachovia employee, Reginald Middleton, had been called to testify;
(4) Preparing a response to Mrs. Stein's Motion for Reconsideration of the summary judgment granted to Wachovia.[220]

Consequently, the total fee sought by Wachovia is $425,506.54.

Mrs. Stein, the Rosenfelds and the Attorney General are united in their opposition to these additional fees as excessive. The Attorney General requests another hearing on this fee petition, which unfortunately would serve merely to increase the expense of this

[219] Wachovia presented invoices spanning the period May 2002 through December 20, 2004. See Ex. D-1. The amended fee petition filed on August 20, 2004 covered the period up to July 31, 2004. In the supplemental fee petition filed December 23, 2004, Wachovia sought an additional $18,349 which is supported by the invoices for the period between August 2, 2004 through November 15, 2004: $7,803.08 (for 8/2 through 8/22/2004); $1,166.00(for 9/7 through 9/27/2004); $7,614.17 (for 10/1 through 10/22/2004); $1,766.65 (for 10/24 through 11/15/2004). These invoices total the requested $18,349.90.
[220] 6/10/2005 Wachovia Second Supplemental Fee Petition at ¶ 11.

litigation. Because Wachovia has attached its billing invoices in support of this petition[221] and this court is familiar with the record, an additional hearing is unnecessary.

Mrs. Stein argues that the fees charged by Wachovia for its counsel's attendance at the Rosenfeld liability hearing were excessive since "nothing related to Wachovia was at issue as a result of the court's prior grant of summary judgment to Wachovia," which, she points out, at "Wachovia's counsel's insistence, this was confirmed on the record on the second morning of the trial."[222] Indeed, at that hearing both counsel for Mrs. Stein expressed their opinion on the record that the liability of the bank was no longer at issue.[223] Nonetheless, despite these assurances, just a few weeks after the liability hearing Mrs. Stein filed a memorandum, warning that testimony by Middleton the February 2, 2005 liability hearing "may justify consideration of the court's prior holding on summary judgment that Wachovia did not breach its fiduciary duty."[224] When she followed up on this threat in April 2005 by filing a motion to reconsider the summary judgment order in Wachovia's favor, she thus provided justification for the bank's continued and wary defense as well as its counsel's attendance at the Rosenfeld liability hearings. The motion for reconsideration vindicates both the bank's defensive actions and its fee request.

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[221] The invoices span the period of January 3, 2005 through May 31, 2005.
[222] 6/30/2005 Stein Objections to Wachovia's Second Supplemental Fee Petition, New Matter at ¶ 3 & n. 1.
[223] See 1/26/2005 N.T. at 9-12 (Rosen). When asked what he was pursuing with the bank, Mr. Rosen stated: "We are claiming with respect to the (sic) only issue that we have with respect to the bank that is remaining is our request to partition the trust into two separate trusts, the Lester and Mary trust. To that extent, they're a nominal party, <u>but not a responsible party as far as conduct is concerned. The Court addressed their conduct.</u> Id. at 11. (emphasis added). Similarly, Mr. Picker offered assurances that the bank's liability was no longer at issue when he observed: "I don't believe there is any exposure on the bank on the account. We had objected to the account based upon our request for a surcharge and based upon the argument that the bank hadn't earned its fees based upon their conduct. And in all candor, I don't think that objection stands, if the court has ruled that the bank did not breach any duty that it had to the Foundation." Id. at 13 (Picker).
[224] 2/4/2005 Stein Memorandum at 1.

Similarly, the bank's preparation and attendance at the fee petition hearing was justified by the opposition its fee petition had encountered from both Mrs. Stein and the Attorney General. The expert testimony was also helpful in providing a context for the rate of fees charged with the Philadelphia legal community.

Finally, the objections by Mrs. Stein, the Rosenfelds and the attorney general to the time spent on responding to the motion for reconsideration overlooks the key point: that motion was defeated and, at least at the trial division, the bank emerged unscathed from its years of litigation over its conduct as a trustee for the Rosenfeld Foundation. Under the factors stressed by LaRocca, this was a significant achievement since the complaint had threatened the bank and its fellow defendants with more than $14 million dollars in damages. Complaint, ¶¶ 34. In fact, after the liability and damages hearing, Mrs. Stein sought damages in the amount of $18,221,263.[225]

VI. Because the Prolonged Litigation Was Due to Lester and Robert Rosenfeld's Breach of Fiduciary Duty to the Charitable Beneficiaries of the Foundation, Wachovia's Costs and Attorney Fees Should Be Charged to the Rosenfelds

All the parties agree that, as a general principle, the costs and attorney fees incurred by trustee in its successful defense of a surcharge action may be charged to the fund of the trust. As the Pennsylvania Supreme Court observed in Browarsky Estate, 437 Pa. 282, 285,263 A. 2d 365, 366 (1970), "[i]t is well established that whenever there is an unsuccessful attempt by a beneficiary to surcharge a fiduciary, the latter is entitled to an allowance out of the estate to pay for counsel fees and necessary expenditures in defending himself against the attack."(citations omitted). The fees thus charged must nonetheless be reasonable. Id.

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[225] 8/12/2005 Stein Memorandum on Damages at 20.

This allowance for the payment of attorney fees in the context of a surcharge action is a deviation from the so-called "American Rule" followed by Pennsylvania courts under which each party to adversary litigation is required to pay its own counsel fees. Estate of Wanamaker, 314 Pa. Super. 177, 179, 460 A.2d 824, 825 (1983). See generally Dardovitch v. Haltzman, 190 F.3d 125, 145-147(3d Cir.)(Becker, J.)("One of the more common exceptions to the American Rule is that attorney fees are available at the discretion of the court in cases involving trusts"). The Wanamaker court explained that in "the absence of a statute allowing counsel fees, recovery of such fees will be permitted only in exceptional circumstances." Wanamaker, 314 Pa. Super. at 179, 460 A.2d at 825.

A statutory right of participants to receive counsel fees is set forth in 42 Pa.C.S. § 2503, which outlines specific instances in which a litigant may receive counsel fees as part of the "taxable costs of the matter." One such instance provides for attorney fees to "as a sanction against another participant for dilatory, obdurate or vexatious conduct during the pendency of a matter." 42 Pa.C.S. §2503(7). This statute has been interpreted as applying to litigation initiated in bad faith. As the Superior Court noted in Estate of Liscio, 432 Pa. Super. 440, 446, 638 A.2d 1019, 1022 (1994), the "aim of the rule is to sanction those who knowingly raise, in bad faith, frivolous claims which have no reasonable possibility of success, for the purpose of harassing, obstructing or delaying the opposing party." Several courts have suggested, however, that the scope of this rule might extend to vexatious or obdurate behavior prior to the initiation of litigation. The Orphan's Court in Shoemaker Estate, 6 Fid. Rep. 2d 128, 135 (OC. Allegheny Cty.), for instance, imposed counsel fees on the decedent's widow where her refusal to return

accounts and business records "was a major cause of litigation and constituted bad faith, and vexatious conduct" as defined by 42 Pa.C.S. § 2503(9). In Brenckle v. Arblaster, 320 Pa. Super. 87, 466 A.2d 1075 (1983), the court imposed counsel fees on a decedent's two daughters, who were the executors of his estate, for behavior that thwarted a family settlement agreement prior to litigation commenced by the decedent's wife. The main rationale for imposing the counsel fees, however, was the vexatious conduct during the actual course of the litigation. The litigation strategy adopted by the Rosenfelds, in contrast, was vigorous and straightforward. It was not their litigation behavior that was vexatious; rather it was their conduct prior to the litigation that is at issue.

A firmer basis for imposing attorney fees on the Rosenfelds is the general equity power of Orphans' Court. In Weiss Estate, 4 Fid. Rep. 2d 71, 77 (Phila. O.C. 1983), for instance, Judge Shoyer observed:

> ….the orphans' court, as a court of equity, has always had the power to surcharge a party for counsel fees when it is apparent that the conduct of a party has been the cause of additional legal expenses.

In the instant case, it was the obdurate refusal of the Rosenfelds to perform their duties as Trustees of the Foundation that necessitated the prolonged litigation. As a matter of equity, it would be unconscionably unjust to charge the charitable beneficiaries with the costs incurred due to the dysfunctional breakdown of communication and cooperation among the Trustees whose duty it was to safeguard the interests of the beneficiaries. If the costs of defending a surcharge action among trustees can be passed on to the charitable beneficiaries of a trust, there is no incentive for the trustees to make rational compromises and decisions. They would thus immunized from costs of venting their discord through endless litigation.

Support for charging the Rosenfelds with the bank's attorney fees can be found in Kline's Estate, 280 Pa. 41, 124 A. 280 (1924). In Kline, a bank/trustee was surcharged for its supine negligence in failing to garner the assets of a trust from the estate's executor. In addition to the surcharge, the trustee was charged both for the account and for the costs of the beneficiaries' appeal. Id., 280 Pa. at 49, 124 A.2d at 284 ("the costs of this appeal to be paid" by the surcharged trustee). Similarly, in Estate of Geniviva, 450 Pa. Super. 54, 61, 675 A.2d 306, 309 (1996), a trial court surcharged an executor for mismanaging estate assets, and ordered the executor to pay the beneficiaries their $20,675 in counsel fees. The appellate court approved the sanctions imposed on the executor without specifically addressing the propriety of this charge of beneficiaries' attorney fees, presumably because that issue was not raised by the executor. The Geniviva Court did deny the executor's request that the fees of the second attorney he hired be charged to the estate. In so doing, the court emphasized, that "[b]ecause these additional fees are a direct result of the executor's negligence in the administration of the estate, we find that it would be inequitable for the estate to assume these legal fees." Id., 450 Pa. Super. at 69, 675A.2d at 313. Similarly, charging the Rosenfeld Trust with the attorney fees incurred in this case would be inequitable because the litigation was prompted by the Rosenfelds' breach of their fiduciary duties as trustees. For these reasons, Wachovia's fees and costs in the amount of $425,506.54 shall not be charged against the Rosenfeld trust fund but instead shall be charged equally to Lester and Robert Rosenfeld.

A. James Millar, Attorney for the Pennsylvania Department of Revenue, made an entry of appearance for the Commonwealth of Pennsylvania claiming such Transfer

Inheritance Tax as may be due and assesses without prejudice to the right of the Commonwealth to pass on DEBTS and DEDUCTIONS. Any award shall be subject to this claim.

The account for the period January 9, 1953 through December 24, 2003 shows a balance of principal before distribution of $1,175,815.49 with a balance of income before distribution of $9,965,119.26 for a total of $11,140,934.75. This sum, together with the surcharge of $593,546 assessed against Lester and Robert Rosenfeld, shall be distributed to the Trustees of the Mary and Emanuel Rosenfeld Foundation for charitable uses and purposes as set forth in the Agreement of Trust dated December 1, 1952.

Leave is hereby granted to the accountants to make all transfers and assignments necessary to effect distribution in accordance with this adjudication.

The certificate of the Official Examiner of the examination of assets awarded in further trust shall be submitted, and, when approved by the Auditing Judge, will be annexed.

AND NOW, this______ day of JULY 2006, the account is confirmed absolutely, with the addition of the surcharge.

Exceptions to this Adjudication may be filed within twenty (20) days from the date of the issuance of the Adjudication. An Appeal from this Adjudication may be taken to the appropriate Appellate Court within thirty (30) days from the issuance of the Adjudication. See Phila. O.C. Rule 7.1A. and Pa. O.C. Rule 7.1 as amended, and Pa.R.A.P. 902 and 903.

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John W. Herron, J.