

## Can We Talk?

Communication is one of a trustee's greatest protections against costly litigation. Sounds simple. Unfortunately, it often isn't

The most frequently cited reason for lawsuits against attorneys is poor client communication.<sup>1</sup> Comprehensive communication is especially critical in the complex, emotional and often conflict-ridden relationships between trustees and beneficiaries. In an effort to mitigate potential liability associated with the role of trustee, fiduciaries can request instructions from the probate court, purchase malpractice or liability insurance, or retain knowledgeable agents to assist with a trust's administration. Such protections may prove useful. But the best safeguard is effective and frequent communication with beneficiaries.

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At the most basic level, trustees are under a fiduciary duty to share with the beneficiary essential facts relevant to the beneficiary's interest in the trust. That's simple in theory. It becomes problematic when the trust's investments have declined or a trustee's longstanding client asks that one of the other beneficiaries be kept in the dark. Often, there is an added layer of complexity: When the trustee consults his own attorney about trust matters, can the beneficiary pierce the attorney-client privilege to access such communications? The answer is sometimes 'yes' and sometimes 'no.'

Courts around the country issue a constant barrage of decisions on all these issues. Some recent cases provide guidance to fiduciaries on what

information they must communicate, when and to whom.<sup>2</sup>

### OKAY, SPILL

There are some facts trustees must divulge. Trustees must tell beneficiaries of the nature of their interest in trust. (The only exception is blind trusts in which the settlor specifically requests that a beneficiary, who is usually the settlor himself, be kept in the dark.) When the beneficiaries' rights change, even if their identities do not, trustees must let the beneficiaries know. As obvious as this may seem, several recent cases held trustees liable for this very breach. Among them, *Dumont* is a dramatic, cautionary tale.<sup>3</sup>

Last June, the Surrogate's Court of Monroe County in New York faulted a bank trustee for failing to inform a beneficiary that she was entitled to mandatory income distributions.<sup>4</sup> The beneficiary had been receiving discretionary distributions. When her mother died, her interest shifted. Yet the trustee continued to administer the trust as if nothing had changed. The trustee failed to discuss with the beneficiary the terms of the trust, the trust's investments or the beneficiary's income needs. For this and other breaches, the trustee was held liable for more than \$20 million.

Similarly, both the individual and bank trustees in *McNeil*<sup>5</sup> misled a current beneficiary to believe he was only a remainder beneficiary. The trustees kept this information from the beneficiary, despite their fiduciary duties, because of a verbal request from the trust donor, a long-standing client, and, after his death, continued requests from the donor's family. For this breach, the Supreme Court of Delaware removed the trustees from office and surcharged them one-fifth of their commissions from 1987 until 1996. Although the dollar amount of the surcharge was not revealed in the reported decision, surely the commissions paid on a \$300 million trust were significant. The moral of these stories: The fact that someone is a trust beneficiary should never be concealed.

While delivering good news to a beneficiary is usually an easy conversation to have, it can be difficult to let him know the trust's investments are failing. Still, bad news must

be conveyed. In *Dumont*<sup>6</sup> the testator had instructed the trustee to retain his holdings in Eastman Kodak Company and ordered that, absent some "compelling reason other than diversification," the stock not be sold. The stock value dropped; the trustee failed to sell; ultimately, the beneficiary sued. In addition to faulting the trustee's interpretation of what justified a sale of the stock, the Surrogate's Court also expressed its displeasure with the trustee's lack of communication with the beneficiary. The judge scolded the trustee for a lack of ongoing and sufficient communication with the beneficiary and for failing to discuss the terms of the trust or the trustee's rationale for refusing to sell the Kodak stock. Not even the dramatic decline in the value of the Kodak stock—the trust's only asset—prompted the trustee to engage in sufficient dialogue. However unpleasant it may be to tell beneficiaries that the assets in their trusts are performing poorly, trustees should make a special effort to communicate with beneficiaries in these situations.

Other types of discussions also must take place regularly. Whenever a trustee engages in any type of transaction with a beneficiary, communication is crucial. If a trustee fails to disclose relevant information to a beneficiary and obtain the beneficiary's informed consent, the trustee's actions may be challenged later (even if the statute of limitations has run out). The beneficiaries in *Boyce Family Trust v. Snyder*<sup>7</sup> agreed to buy a supermarket, but their consent was not informed. About five years later, the trustee was held liable for breach of fiduciary duty. The trustee had extensive experience in the grocery industry, but failed to disclose to the beneficiaries information relevant to the sale. The trustee downplayed the impact that the opening of a Walmart nearby would have on their business and misinformed the beneficiaries as to the readiness of their store's manager. The Missouri Court of Appeals emphasized that the trustee had a duty to inform the beneficiaries of all facts known to him so that the beneficiaries could have made an informed decision about purchasing the store. A trustee's actions may be challenged indefinitely if he does not obtain the beneficiaries' informed consent.<sup>8</sup>

More discussions, while they might not have insulated the trustee in *Dumont* from liability, may have led to less severe penalties.

In contrast, when a trustee fully informs a beneficiary, the beneficiary cannot successfully challenge the trustee's actions—even if those actions would otherwise constitute a breach of duty. In February 2004, the New York Surrogate's Court of New York County upheld a fee agreement between a trustee and a beneficiary.<sup>9</sup> After full disclosure and open negotiations, the charitable beneficiary agreed to a fee arrangement in a written document dated 1973. When the charity later complained, documentation demonstrating the beneficiary's informed consent proved crucial to the trustee's success in defeating the lawsuit. In this case, the beneficiary had no grounds on which to challenge the validity of the transaction. However, the state attorney general, who joined in this case but was not a party to the 1973 fee agreement, could challenge the validity of the fee agreement. In the end, the Surrogate's Court found that there had been no fraud or overreaching by the trustee and the trustee had been justified in increasing its fees.

It is important not only to fully inform a beneficiary about transactions, but also to memorialize that disclosure in writing and to obtain and keep evidence of meetings, phone calls, memoranda and the like. Also, when acting as a trustee of a charitable trust, it is important to engage in early communication with the state attorney general and, when appropriate, to obtain his written and informed consent.

### HOW TO DO IT

So what, precisely, should be communicated, when and to whom?

Rule number one: be specific and detailed. Trustees should discuss with the beneficiaries the particulars of their investment decisions, as well as their interpretation of trust language. Although these conversations may be time consuming, trustees should make a concerted effort. In *Dumont*,

the court not only chastised the bank trustee for the infrequency of its communications with the beneficiary, but also for the content of those communications. While the trustee discussed, in general terms, the overall financial situation of the beneficiary's several accounts, it did not communicate the terms of the Dumont Trust or the trustee's interpretation of controversial language. The trustee also failed to articulate its rationale for that particular trust's investment strategy. In addition, the discussions that the trustee had with the beneficiary were poorly documented. If several trusts are managed by one trustee, the trustee should make sure to discuss, with specificity, the terms and investments of each separate trust. The beneficiary's interests should not be managed in totality.

Rule number two: communicate frequently. It is a constant struggle for fiduciaries to find time to conduct enough meetings to sufficiently communicate with beneficiaries. Clearly, the trustee in *Bellows v. Pomplun*<sup>11</sup> should have made more of an effort. Despite numerous requests from the beneficiaries, the trustee provided them with only one informal update on the administration process during her three years as a trustee. Still, it's unclear precisely how many meetings satisfy the frequency requirement. The trustee in *Dumont* was held liable in part for not holding "frequent" communications with the beneficiary.<sup>12</sup> Unfortunately, the judge offered no benchmarks for what would have constituted frequent dialogue. But certainly more discussions, while they may not have insulated the trustee from liability, may have influenced the judge and decreased the penalties he imposed.

Some trustees find it helpful to set up quarterly meetings with beneficiaries. When such meetings have a fairly regular timetable, it is more difficult for the trustee to postpone them, and they take less effort to

schedule. Communicating by telephone or email is a convenient supplement to regular face-to-face meetings as well. Regardless of how communicating with beneficiaries is accomplished, trustees should take care to do so frequently.

It is a good idea to hold these meetings even if there isn't much to say. When trustees make an effort to communicate with beneficiaries, beneficiaries feel valued. This is important because it means that if investments later fail or concerns arise, beneficiaries will be less likely to sue.

Rule number three: communicate with the right party. The trustee in *Hatleberg v. Norwest Bank Wisconsin*<sup>13</sup> notified the attorney who had drafted the trust document of an error he discovered in the trust instrument. But he never told the donor or beneficiary. To make matters worse, this drafting attorney no longer represented the donor. Due to the error in the trust, at the donor's death her estate was liable for an additional \$173,000 in estate taxes. The beneficiary sued the trustee—and won. Disclosures to closely related parties do not suffice. Trustees must sometimes tell beneficiaries about errors that others and even they themselves have committed. Even if such a discussion results in the loss of an account, this loss is preferable to a long and costly lawsuit.

Even when there's a responsible party that still has a relationship with the beneficiary, it's still good practice to communicate directly with the beneficiary. We make this recommendation even though the defendant in the *Locke Family Trust*<sup>14</sup> was not in breach.

In that case, the trustees delegated investment responsibilities to a trust company.<sup>15</sup> The trustees also hired an individual as their agent to work with the trust company. The trustees gave the agent authority regarding all trading and investment decisions. The trust's investments failed and the

trustees sued the trust company. The Minnesota Court of Appeals held that when the trust company communicated with the trustees' agent, it was as if the trust company was communicating directly with the trustees. The trust company was not faulted for not communicating directly with its clients, the trustees. In contrast to *Hatleberg*, when there is an actual agency relationship between parties, communication with the agent is sufficient. In *Hatleberg*, if the beneficiary had been an existing client of the attorney, the communication probably would have been sufficient. Still, in keeping with the adage "better safe than sorry," we recommend direct communication with the party at issue whenever possible and appropriate.

Trustees, beneficiaries, and as demonstrated in the *Locke Family Trust* case, even their agents must communicate with one another. Trustees should not, however, be forced to communicate with third parties. *Sun Trust v. Children's Hospital*<sup>16</sup> involved a trust that was created by a hospital as part of a settlement agreement in a medical malpractice case. The trust was funded with \$100,000 and the trustee was directed to use the trust to pay for the beneficiary's medical expenses. The hospital also was directed to replenish the corpus of the trust as needed. A dispute arose between the trustee and the hospital regarding the definition of "medical expenses" and whether the trust's assets might be used for home nursing care. The hospital charged the trustee with concealing material information in breach of its fiduciary duty. The case dealt with many issues, but on the communication front, a Virginia circuit court held in April 2003 that the trustee was under no duty to communicate with the hospital. Even though the hospital asked to be kept apprised of the trust's management, the trustee was under no obligation to comply; its failure to do so, therefore,

did not constitute bad faith or a breach of trust. Unless set forth in the trust agreement, a trustee is not obligated to share information with a third party who is neither a co-trustee nor a beneficiary.

While trustees understand that they must treat all beneficiaries impartially, this becomes difficult when they are faced with pressure from clients or even the trustee's

own conscience. A familiar conflict arose in *McNeil v. McNeil*.<sup>17</sup> The trust at issue held about \$300 million; the beneficiaries were a surviving spouse and four children. The fourth child became estranged from the family (although the decision doesn't reveal why). While the spouse and the others remained involved in the trust's management, the trustees heeded the family's

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request to keep certain information from the estranged child. The Supreme Court of Delaware held that the trustees breached their fiduciary duties. Despite exculpatory language in the trust instrument, the trustees were not relieved of their duties to inform the beneficiaries and treat them impartially.

Trustees have a duty to furnish information upon request. Furthermore, even without a request, the trustees have an affirmative duty to communicate essential facts to the beneficiary. In this case, information was denied even after the beneficiary made reasonable requests. To add insult to injury, the trustees shared similar information with the other beneficiaries. While it may be tempting to withhold information from one of the beneficiaries, a trustee may never under any circumstances favor one beneficiary over another, unless the trust instrument so directs.

### WHAT'S PROTECTED?

What critical conversations can a trustee keep private? Communications between attorneys and their clients are privileged. But the protection available to communications between attorneys and their clients serving as fiduciaries is not absolute.<sup>18</sup> Despite a trustee's best efforts to communicate appropriately with beneficiaries, there will be times when conflicts arise. When the trustee consults his attorney on these matters, it's important to know what will be protected by

the attorney-client privilege.

States differ as to whether beneficiaries are entitled access to communications between the trustee and his attorney. In California and Texas, for example, such communications are protected.<sup>19</sup> Other states, such as Delaware, have carved out exceptions to the attorney-client privilege for beneficiaries and have required disclosure of otherwise privileged communications.<sup>20</sup> These states see the professional responsibilities of the attorney of the fiduciary as running through to the beneficiaries.<sup>21</sup> In *Follansbee v. Gerlach*,<sup>22</sup> the Court of Common Pleas of Pennsylvania, Allegheny County, held that there was no attorney-client privilege with respect to communications regarding the management of the trust. The court reasoned that trust law imposes a duty on trustees to share with the beneficiaries information relating to the trust, including opinions of counsel that guide the trustee in his administration of the trust. On the other hand, the decision also stated that if a conflict arose between a beneficiary and a trustee, and the trustee hired his own independent counsel, paid for by his private funds and not out of the trust's assets, their communications would be privileged. Similarly, in a Florida case decided last summer, *Jacob v. Barton*,<sup>23</sup> a beneficiary sued a trustee over alleged mismanagement of a trust's funds. The Florida district court's decision upheld the attorney-client privilege

with respect to the trustee's attorney's billing records. The court reasoned that the trustee hired the attorney to defend her in the dispute with the beneficiary; therefore the trustee, not the beneficiary, was the client.

If a trustee is practicing in a state that protects the privilege, the trustee should take care to preserve the privilege whenever possible. In *Jacob*, if the trustee had shared the billing records with a third party, the records would no longer have been privileged. In a separate hearing in *Dumont*<sup>24</sup> for instance, the beneficiaries argued that the trustee should disclose a certain memorandum prepared by the trustee's internal personnel. The Surrogate's Court did not analyze whether the privilege applied because the trustee had waived the privilege by presenting the memorandum to the judge as part of an *in camera* review.

Whether or not communications between the trustee and his attorney are privileged, their relationship demands additional considerations. First, irrespective of what a trustee tells the attorney in confidence, the trustee is still bound by his fiduciary duty to disclose material facts regarding the administration of the trust to the beneficiaries. Meanwhile, the attorney representing a fiduciary of a trust or an estate should take care to explain to the beneficiaries that they are not his clients, that the attorney represents the fiduciary and that the beneficiaries may obtain their own independent counsel.

### DOING OUR BEST

It is not immediately obvious what courts will see as sufficient communication. But the caselaw provides some guidance. So we must use our best judgment to determine when, how and with which parties to communicate. Then document, document, document. Trustees also must discern when, if at all, their own attorney-client communications



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may be protected. The risk of getting it wrong is enormous. ■

Endnotes

1. See David J. Meiselman, *Attorney Malpractice: Law & Procedure*, Section 22:4 (Lawyer's Cooperative Publishing Company, Rochester, N.Y. 1980); John R. Oostema, "Tips for Reducing the Risk of Litigation-Related Legal Malpractice Claims," *LawyerCare Newsletter* (January 2002), [www.pronational.com/news/lawcare/reducingtherisk-jan2002.htm](http://www.pronational.com/news/lawcare/reducingtherisk-jan2002.htm).
2. Some of the cases we've cited are not published and therefore have minimal precedential authority. But they are useful in analyzing and understanding how trustees may avoid liability.
3. *In the Matter of the Judicial Settlement of the Second Intermediate Account of Chase Manhattan Bank, as Trustee of the Testamentary Trust Established Under Will of Charles G. Dumont, Deceased*, No. 1956TT443, 2004 WL 1468746, slip op. (N.Y. Sur. Ct. June 25, 2004) (unpublished decision).
4. The bank trustee, Lincoln First Bank, was appointed by the same court as a trustee in 1956 and Chase Manhattan Bank later inherited the trust from Lincoln First Bank.
5. *McNeil v. McNeil*, 798 A.2d 503 (Del. 2002).
6. *Dumont*, No. 1956TT443, 2004 WL 235187, slip op. (N.Y. Sur. Ct. Jan. 15, 2004) (unpublished decision).
7. 128 S.W.3d 630 (Mo. Ct. App. 2004).
8. See also *Goldston v. Bank of America Corp.*, 577 S.E.2d 864 (Ga. Ct. App. 2003) (tolling the statute of limitations because of the bank's fraudulent actions and its concealment of the trust's existence from the beneficiary; the beneficiary's suit was permitted to proceed over 30 years after the alleged wrongs were committed).
9. *In Re Petition for Judicial Settlement of the Intermediate Accounts of Proceedings by Bankers Trust Company of New York, as Trustee under the Indentures of Trust Established by John D. Rockefeller, Jr.*

*dated Oct. 16, 1922 and Sept. 15, 1927*, No. 1623-1960, slip op. (N.Y. Sur. Ct. Feb. 24, 2004) (not reported in N.Y.S.2d).

10. *Dumont*, No. 1956TT443, 2004 WL 235187, slip op. (N.Y. Sur. Ct. Jan. 15, 2004) (unpublished decision).
11. No. PR146585, 2003 WL 21329867 (Cal. App. 6 Dist. June 10, 2003) (unpublished decision).
12. *Dumont*, No. 1956TT443, 2004 WL 235187, slip op. (N.Y. Sur. Ct. Jan. 15, 2004) (unpublished decision), at \*15.
13. 678 N.W.2d 302 (Wis. Ct. App. 2004).
14. *Locke Family Trust v. Bremer Trust*, No. C5-02-2173, 2003 WL 22388719 (Minn. Ct. App. Oct. 21, 2003) (not reported in N.W.2d).
15. The primary investment of the trust was the agent's start-up company. No allegations of self dealing or breach of fiduciary duty were brought against the agent.
16. No. 01-786, 2003 WL 21085046 (Va. Cir. Ct. Apr. 23, 2003) (not reported in S.E.2d).
17. 798 A.2d 503 (Del. 2002).
18. See generally 81 *Am. Jur.* 2d Witnesses Section 408 (2004); Ronald R. Cresswell, Sarah Patel Pacheco and Marjorie J. Stephens, 2 *Tex. Prac. Guide*, Trusts and Est. Plan, Section 5:386 (2004); John T. Rogers, Jr., "Representing Estate and Trust Beneficiaries and Fiduciaries: Ethics for Fiduciary Counsel," SH002-ALI-ABA 131 (2002).
19. See, for example, *Wells Fargo Bank v. Superior Court*, 990 P.2d 591 (Cal. 2000); *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996).
20. See, for example, *Riggs Nat. Bank of Washington v. Zimmer*, 355 A.2d 709 (Del. Ch. 1976).
21. See, for example, Jule E. Stocker, Jonathan J. Rikoon, Pamela R. Champine and Janine Racanelli, *Stocker and Rikoon on Drawing Wills and Trusts*, PLIREF-WILLS Section 1:7:4 (2002).
22. 56 Pa. D. & C. 4th 483 (2002).
23. 877 So.2d 935 (Fla. Dist. Ct. App. 2004).
24. *Dumont*, No. 1956TT443, 2004 WL 235187, slip op. (N.Y. Sur. Ct. Jan. 15, 2004) (unpublished decision).

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