



TRUSTEE CONFLICTS OF INTEREST AND ATTORNEY-CLIENT PRIVILEGE ISSUES

November 15, 2022

Justice Cardozo

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. *** Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd

Authority/Power of Trustees—Missouri

- ▶ RSMo § 458.8-815 – recognizes broad powers
 - E.g., powers conferred by trust instrument
 - E.g., any powers “unmarried competent owner” would have
- ▶ Powers are limited by sections **456.8-801 to 456.8-814.**

Duties Owed by Trustees—Big Picture

- ▶ Impartiality
- ▶ Loyalty
- ▶ To protect and control trust assets, and
- ▶ To keep adequate records of trust activity

Jo Ann Howard & Associates, P.C. v. Cassity, 395 F. Supp. 3d 1022, 1173 (E.D. Mo. 2019)

Duty to Avoid Conflict—Generally

- ▶ Administer trust solely in interest of beneficiaries.
- ▶ Do not favor one beneficiary over another.
- ▶ Do not benefit beyond payment of fees for services as trustee—no self dealing or personal benefit.

Source of Duty to Avoid Conflict of Interest

▶ Rooted in Several Duties

- Duty of Loyalty
- Duty of Impartiality
- Duty to Administer in the Best Interest of the Beneficiaries



Source of Duty - Administering Trust

Upon acceptance of a trusteeship, the trustee shall administer the trust in **good faith, in accordance with** its terms and purposes and **the interests of the beneficiaries**, and in accordance with sections 456.1-101 to 456.11-1106.

RSMo § 456.8-801

Source of Duty — Impartiality

If a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests.

RSMo § 456.8-803

Impartiality

- Duty of impartiality is particularly important where trustee is beneficiary.
- *Russell v. Russell*, 427 S.W.2d 471 (Mo. 1968)
(trustee/beneficiary had conflict of interest in whether to maximize principal or income)

Source of Duty-Loyalty

1. A trustee shall administer the trust solely in the interests of the beneficiaries.

UTC Comment: A trustee owes a duty of loyalty to the beneficiaries, a principle which is sometimes expressed as the obligation of the trustee not to place the trustee's own interests over those of the beneficiaries.

RSMo § 456.8-802

Source of Duty-Loyalty

The duty of loyalty is the fruit of the courts' efforts to regulate the behavior of trustees when their duties as trustee require them to act in ways that may or do conflict with their own personal interests. In a nutshell, the duty of loyalty ordinarily requires trustees to avoid transactions that involve self-dealing, as well as all those that involve or might create a conflict between the trustee's fiduciary and personal interests.

Austin Wakeman Scott, Mark L. Ascher & William Franklin Fratcher, *Scott and Ascher on Trusts* § 17.2. (Fifth and Sixth Editions, 2022 Cum. Supp. 2006-2021)

Source of Duty-Loyalty

A trustee is in a fiduciary relation to the beneficiary and as to matters within the scope of the relation he is under a duty not to profit at the expense of the beneficiary and not to enter into competition with him without his consent, unless authorized to do so by the terms of the trust or by a proper court.

Restatement Second 170

Duty of Loyalty

UTC Comment reminds us that not all breaches concern financial transactions

Callaway v. Willard, 351 Ga. App. 1, 830 S.E.2d 464 (2019), cert. denied, (Feb. 28, 2020) (trustee breached duty by seeking to condition distribution on receipt of releases from beneficiaries)

RSMo § 456.8-802—Duty of Loyalty

And that litigation can be a breach of the duty.

Bronstein v. Bronstein, Fla.App. 4 Dist.2021, 332 So.3d 510 (pursuit of appeal by trustee/beneficiary constituted conflict of interest)

A Closer Look at the Duty of Loyalty

- ▶ Self-Dealing - RSMo § 456.8-802
- ▶ Transaction that personally benefits trustee
- ▶ Transaction that personally benefits someone close to trustee (e.g., spouse, attorney)
- ▶ Non-trust transaction that is unfair to beneficiary
- ▶ Usurping opportunity properly belonging to the trust

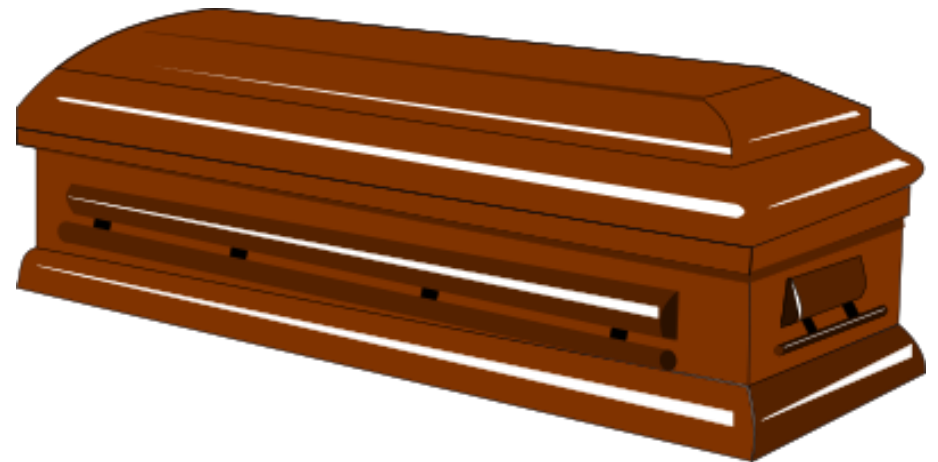
Carve-outs from Duty of Loyalty

- ▶ RSMo § 456.8-802
 - **Transaction must be fair to the beneficiaries**
 - (1) an agreement ... relating to the appointment or compensation of the trustee;
 - (2) payment of reasonable compensation to the trustee;
 - (3) a transaction between a trust and another trust, decedent's estate, or conservatorship of which the trustee is a fiduciary or in which a beneficiary has an interest;
 - (4) a deposit of trust money in a financial institution operated by the trustee or an affiliate;
 - (5) a delegation and any transaction made pursuant to the delegation from a trustee to an agent that is affiliated or associated with the trustee, provided that notice of any compensation paid pursuant to the delegation is given as provided in subdivision (3) of subsection 6 of this section; or
 - (6) any loan from the trustee or its affiliate.

A Closer Look at the Duty of Loyalty

► Self-Dealing-Worst Case Scenario

Jo Ann Howard & Associates, P.C. v. Cassity, 395 F. Supp. 3d 1022 (E.D. Mo. 2019), *aff'd sub nom. Jo Ann Howard & Associates, P.C. v. Nat'l City Bank*, 11 F.4th 876 (8th Cir. 2021) (finding breach of duty of loyalty where trustee prioritized its finances over protecting beneficiaries from Ponzi scheme).



A Closer Look at the Duty of Loyalty

▶ **Inaction or—Refusal to Act—Can Breach the Duty**

In re Estate of Mueller, 933 S.W.2d 903 (Mo.App. E.D. 1996)
(refusal to sign amendment reducing trustee's interest in trust corpus was violation of duty of loyalty).

A Closer Look at the Duty of Loyalty

- ▶ **Co-Trustee May be Liable for Other Trustee's Breach**
 - *Ramsey v. Boatmen's First Nat. Bank of Kansas City, N.A.*, 914 S.W.2d 384, 389 (Mo. Ct. App. 1996)
 - Corporate trustee liable where co-trustee, son of grantor, invested in companies the son had an interest in and made loans to himself from the trust, which he did not repay.

A Closer Look at the Duty of Loyalty

▶ Trustee May Breach Duty Even Where Transaction Benefited Beneficiary

- *Deutsch v. Wolff*, 994 S.W.2d 561, 570 (Mo. 1999)
- Disbursement of trust assets to a partnership in which the trustee and beneficiary were both members was improper self-dealing. Trustee was obligated to manage the trust *solely* for the benefit of the beneficiary and so breached duty by benefitting himself.

In re Joyce C. Dalton Tr., No. 4:20CV302
JCH, 2020 U.S. Dist. LEXIS 104412
(E.D. Mo. June 15, 2020)

- ▶ Corporate trustee of special needs trust resigned, citing inability to work effectively with co-trustee.
- ▶ Remaining trustee sued corporate trustee. Primary claim was for failure to apply for government benefits on behalf of a beneficiary while both trustees were acting as such.
- ▶ Holding: case dismissed because remaining trustee suffered from conflict of interest and thus lacked standing

In re Joyce C. Dalton Tr.,
No. 4:20CV1406 JCH, 2020 U.S. Dist. LEXIS
241672 (E.D. Mo. Dec. 23, 2020)

- ▶ After dismissal of suit brought by remaining trustee, guardian for beneficiary filed suit only against (former) corporate trustee, also alleging corporate trustee was obligated to ensure beneficiary received federal benefits she was entitled to.
- ▶ Again, court found that plaintiff (now the guardian) suffered from a conflict of interest that precluded her from suing on behalf of the beneficiary.

Beneficiary Remedies

- ▶ RSMo §§ 456.7–706.2(1) & 456.10–1001.2
 - Void Transaction
 - Removal of Trustee
 - Disgorgement of Profits
 - Return of property
 - Damages
 - Attorneys' Fees



Best Practices

▶ Check the Terms of Your Trust

- Transaction is not void if authorized by the terms of the trust
RSMo § 456.8-802.2
- *Barnett v. Rogers*, 400 S.W.3d 38 (Mo.App. S.D. 2013)
(conduct that may otherwise constitute a conflict of interest is ok if that conduct was established by settlors)
- Matter of Heisserer, 797 S.W.2d 864, 874 (Mo. Ct. App. 1990)
(“if there was a conflict between Friedrich's position as tenant of the ... farm and the discharge of his duties as trustee, that conflict was created and authorized by the trust instrument”).

Best Practices

- ▶ Disclose transaction and conflict fully and inform beneficiaries of thirty-day right to object.
 - *Matter of Wilma G. James Tr.*, 487 S.W.3d 37 (Mo.App. S.D. 2016)
- ▶ Get a Release or Consent from Beneficiary. § 456.8-802.2
- ▶ Seek judicial approval of the transaction. § 456.8-802.2
- ▶ Request Appointment of special fiduciary. § 456.8-802.9

Best Practices

- ▶ **But be cautious if beneficiary is a minor or incapacitated.**
 - *Matter of T.R. Potter, Jr. Exempt Tr.*, 593 S.W.3d 556 (Mo.App. E.D. 2019)
 - Mother of minor beneficiary benefitted from her husband's (also a beneficiary) receipt of trust assets and so could not ratify the transaction on behalf of her son.

Attorney Client Privilege for Fiduciaries Remains Unclear

- ▶ A majority of jurisdictions have recognized that attorney client privilege and confidentiality are available to a fiduciary
- ▶ However, 21 states have no guidance on whether a fiduciary can claim attorney client privilege or whether the court will recognize a fiduciary exception.
- ▶ Missouri Courts have not yet addressed whether a fiduciary can claim attorney client privilege or whether the court will recognize a fiduciary exception.

Attorney Client Privilege in Fiduciary Litigation

- ▶ Twenty-one (21) states have either had Court rulings refusing to adopt a fiduciary exception to the attorney-client privilege for a trustee or personal representative or have enacted legislation providing attorney client privilege for trustees and personal representatives:
 - AL, CA, CT, D.C., FL, GA, HI, ID, IL, KS, KY, ME, MD, MN, NV, NY, OR, SC, TX, VA, WA

Attorney Client Privilege in Fiduciary Litigation

- ▶ Eight (8) states and the federal judiciary have had Court rulings recognizing some form of fiduciary exception to the attorney-client privilege:
 - AZ, AR, DE, IN, IA, OH, PA, RI, Federal Courts

Best Practices In Undecided and Exception States

- ▶ Keep separate files for administration of estates/trusts and other advice given to the fiduciary.
- ▶ Keep communications regarding administration and other matters separate.
- ▶ Keep billing for administration and other matters separate.
- ▶ Although the source of payment has not been determinative as to whether a fiduciary exception exists in each state, it has been a factor in some states. Thus, advise fiduciaries on the risk of paying for attorney advice from trust/estate funds.



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