

Title

The fiduciary exception to the attorney-client privilege: A recent development

Summary

In a suit by the beneficiary against the trustee, is the trustee entitled to assert the attorney-client privilege against the beneficiary, or is there a fiduciary exception to the attorney-client privilege? As to communications with trust counsel uttered after the onset of hostilities, the trustee may effectively assert the privilege. As to communications uttered before the onset of hostilities, he may well not be able to. In June of 2014 the Court of Appeals of Arizona drew a line between legal advice which the trustee seeks in his fiduciary capacity and legal advice which he seeks in his individual or corporate capacity. See *In re The Kipnis Section 3.4 Trust*, 2014 WL 2515207 (Ariz.App. Div. 1). The former is discoverable by the beneficiary under the fiduciary exception to the attorney-client privilege. The latter is not. Thus, advice on “matters of trust administration” is discoverable by the beneficiary while legal advice sought by the trustee “for purposes of ... [the trustee’s]... self-protection” is not. How helpful this distinction will prove to be in practice remains to be seen. One South Carolina court in denying a trustee the right to assert the attorney-client privilege against his beneficiary found persuasive the fact that counsel fees had been paid from the trust estate. *Floyd v. Floyd*, 615 S.E.2d 465, 482 (2005). The Restatement (Third) of Trusts, on the other hand, downplays the significance of “who pays,” as did the Arizona court. See Restatement (Third) of Trusts §82 cmt. f. (Reporter’s Notes). The Arizona court reaffirmed the general principle that all beneficiaries, not just certain beneficiaries such a qualified beneficiaries as defined in the Uniform Trust Code, are entitled to information “that is reasonably necessary to the prevention or redress of a breach of trust or otherwise to the enforcement of the beneficia[r]ies]’ rights under the trust.” Also, “the attorney-client privilege does not permit a trustee to withhold ‘material facts’ from a beneficiary simply because the trustee communicated those facts to an attorney.” The fiduciary exception to the attorney-client privilege is covered generally in §8.8 of *Loring and Rounds: A Trustee’s Handbook* [pages 1015-1017 of the 2014 Edition].

Text

[The following is an edited/updated excerpt from §8.8 of the 2014 Edition of Charles E. Rounds, Jr. and Charles E. Rounds, III, *Loring and Rounds: A Trustee’s Handbook*.]

Topic: **Whether the trustee may assert the attorney-client privilege against the beneficiary**

The attorney-client privilege. Whom trust counsel does and does not represent implicates the attorney-client privilege, which has the following elements: “[1] Where legal advice of any kind is sought (2) from a professional legal advisor in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal advisor...”³¹ Voluntary disclosure by the privilege-holder to a third

³¹United States v. Evans, 113 F.3d 1457, 1461 (7th Cir. 1997) (citing 8 John Henry Wigmore, Evidence in Trials at Common Law §2292 (John T. McNaughton ed., 1961)).

party constitutes a waiver of the privilege.

Whether the trustee may assert the attorney-client privilege against the beneficiary. In a suit by the beneficiary against the trustee, is the trustee entitled to assert the attorney-client privilege *against the beneficiary*, or is there a fiduciary exception to the privilege?³² As to communications with trust counsel uttered *after* the onset of hostilities, the trustee may effectively assert the privilege.³³ As to communications uttered *before* the onset of hostilities, he may well not be able to.³⁴ One Arizona court has drawn a line between legal advice which the trustee seeks in his fiduciary capacity and legal advice which he seeks in his individual or corporate capacity.¹ The former is discoverable by the beneficiary under the fiduciary exception to the attorney-client privilege. The latter is not. Thus, legal advice on “matters of trust administration” is discoverable by the beneficiary while legal advice sought by the trustee “for purposes of ... [the trustee’s]... self-protection” is not.²

One South Carolina court in denying a trustee the right to assert the attorney-client privilege against his beneficiary found persuasive the fact that counsel fees had been paid from the trust estate.³⁵ The Restatement (Third) of Trusts, on the other hand, downplays the significance of “who pays,”³⁶ as did the Arizona court.³

In any case, the prudent trustee should assume that any pre-confrontation communications with counsel are discoverable and act accordingly.³⁷ And if it is any consolation to the trustee, the attorney-client privilege has its limitations.. One court has issued the following general warning: “The attorney-client privilege does not permit a trustee to withhold ‘material facts’ from a beneficiary simply because the trustee has communicated those facts to the attorney.”⁴ Another court, after having ruled that certain documents in the trustee’s file were covered by the privilege, cautioned against employing the privilege as

³²See generally 3 Scott & Ascher §17.5 (Duty to Furnish Information).

³³See generally 3 Scott & Ascher §17.5 (Duty to Furnish Information). See, e.g., First Union Nat’l Bank of Fla. v. Whitener, 715 So. 2d 979, 982 (1998) (the court finding no fraud that would abrogate the trustee’s right to assert the attorney-client privilege). See generally Gibbs & Hanson, *The Fiduciary Exception to a Trustee’s Attorney/Client Privilege*, 21 ACTEC Notes 236 (1995).

³⁴Gibbs & Hanson, *The Fiduciary Exception to a Trustee’s Attorney/Client Privilege*, 21 ACTEC Notes 239; Lewin on Trusts ¶123-08 (England). In New York, a trustee may only invoke the attorney/client privilege for “good cause.” See Hoopes v. Carota, 142 A.D.2d 906, 531 N.Y.S.2d 407 (App. Div. 1988), *aff’d*, 74 N.Y.2d 716, 543 N.E.2d 73, 544 N.Y.S.2d 808 (1989). *But see* Huie, individually and as executor and trustee, v. the Honorable Nikki DeShazo, Judge, 922 S.W.2d 920 (Tex. 1996) (suggesting there is no “fiduciary exception” to the attorney/client privilege); Wells Fargo, N.A. v. Superior Court, 990 P.2d 591 (Cal. 2000) (denying beneficiary access even to attorney-trustee communications that involved routine trust administration matters).

¹ See *In re The Kipnis Section 3.4 Trust*, 2014 WL 2515207 (Ariz.App. Div. 1).

² *In re The Kipnis Section 3.4 Trust*, 2014 WL 2515207 (Ariz.App. Div. 1).

³⁵*Floyd v. Floyd*, 365 S.C. 56, 87–88, 615 S.E.2d 465, 482 (2005).

³⁶Restatement (Third) of Trusts §82 cmt. f, Reporter’s Notes thereto. See also 3 Scott & Ascher §17.5.

³ *In re The Kipnis Section 3.4 Trust*, 2014 WL 2515207 (Ariz.App. Div. 1).

³⁷Gibbs & Hanson, *The Fiduciary Exception to a Trustee’s Attorney/Client Privilege*, 21 ACTEC Notes, 236, 240 (1995) (“Assuming the inchoate existence of some fiduciary exception rule in your jurisdiction, the question for the attorney is: how do my fiduciary clients and I conduct our communications *prior* to the time a beneficiary asserts a claim...? Alertly, carefully, and clearly is the certain answer.”). See generally Desmarais, *The Fiduciary, His Counsel and the Attorney-Client Privilege*, 136 Tr. & Est. 29 (No. 6, May 1997).

⁴ *In re The Kipnis Section 3.4 Trust*, 2014 WL 2515207 (Ariz.App. Div. 1).

a litigation tactic: “Nonetheless, the trustee may not use the privilege as a shield, and then, at trial, surprise the movants by using any of the requested documents as a sword.”³⁸ One court has provided a useful hypothetical to explain how a no-exception approach to the attorney-client privilege arguably squares with the trustee’s fiduciary duty to disclose material facts to the beneficiary:

Assume that a trustee who has misappropriated money from a trust confidentially reveals this fact to his or her attorney for the purpose of obtaining legal advice. The trustee, when asked at trial whether he or she misappropriated the money, cannot claim the attorney-client privilege. The act of misappropriation is a material fact of which the trustee has knowledge independently of the communication. The trustee must therefore disclose the fact (assuming no other privilege applied), even though the trustee confidentially conveyed the fact to the attorney. However, because the attorney’s only knowledge of the misappropriation is through the confidential communication, the attorney cannot be called on to reveal this information.³⁹

As noted above, the drafters of the Uniform Trust Code decided to leave open for further consideration by the courts the extent to which a trustee may claim attorney-client privilege against a beneficiary seeking discovery of attorney-client communications between the trustee and the trustee’s lawyer, the courts now being profoundly split on the question of whom trust counsel represents.⁴⁰

Asserting the privilege against the inquisitive successor trustee. In a suit by a successor trustee against a predecessor trustee, is the predecessor entitled to assert the attorney-client privilege against the successor? Courts have held that when the office of trustee passes from one person to another, the power to assert the attorney-client privilege passes as well.⁴¹ This would include the power to assert the privilege with respect to confidential communications between a predecessor trustee and an attorney on matters of trust administration. Bottom line: The predecessor may not assert the privilege as against the successor. The predecessor, however, would still retain the right to claim the attorney-client privilege as to communications between the predecessor and his, her or its personal attorney.⁵

Asserting the attorney-client privilege against those not party to the trust relationship. Assume the following: (1) counsel renders confidential tax advice to the trustee, which the trustee voluntarily passes on to the beneficiary; (2) the IRS seeks to discover that advice; and (3) the trustee asserts the attorney-client privilege against the IRS. Has the trustee waived the privilege by so informing the beneficiary of that advice? If there is a fiduciary exception to the attorney-client privilege, then the privilege presumably has not been waived, the trustee and the beneficiary being essentially co-clients. Now if trust counsel represents the trustee and only the trustee, then the privilege may have been waived *by the trustee* when he communicated the confidential tax advice to the beneficiary, who would essentially have been a third party to the attorney-client relationship. The waiver might even apply to all the other beneficiaries, as well. “In view of the unsettled state of the law in the US regarding the existence of, and basis for, the fiduciary exception to the attorney-client privilege, trustees should carefully consider the potential waiver implications of disclosing privileged legal advice to beneficiaries. Moreover, in appropriate

³⁸Matter of Will of Poster, 884 N.Y.S.2d 838, 842 (Sur. 2009).

³⁹Huie v. DeShazo, 39 Tex. Sup. Ct. J. 288, 922 S.W.2d 920, 923 (1996). *See generally* §§5.4.1.1 of this handbook (discussing the beneficiary’s right to information) and 6.1.5.1 of this handbook (duty to provide information) (discussing duty of trustee to provide information to the beneficiary).

⁴⁰Uniform Trust Code §813 cmt.

⁴¹*See, e.g.,* In re Estate of Fedor and Catherine M. Fedor Revocable Trust, 356 N.J. Super. 218, 811 A.2d 970 (2001).

⁵ *See, e.g.,* In re The Kipnis Section 3.4 Trust, 2014 WL 2515207 (Ariz.App. Div. 1).

circumstances, trustees may wish to obtain Court directions before disclosing confidential legal advice.”⁴²

In Section 6.1.5.1 of this handbook, we discuss the trustee’s duty to provide information to the beneficiaries of the trust. There is, however, a countervailing duty not to furnish beneficiaries with information if doing so would “not be in the best interests of the beneficiaries as a whole, but...[would]...be prejudicial to the ability of the trustees to discharge their obligations under the trust.”⁴³

⁴²Basil Zirinis, Marina Bezrukova, Richard Corn, & James Gadwood, *Unintended Consequences*, 8(4) Tr. Q. Rev. 15 (2010) [a STEP publication].

⁴³David Hayton, Paul Mathews, & Charles Mitchell, *Underhill and Hayton, Law Relating to Trusts and Trustees* §60.58 (17th ed. 2006).