

Trustee Obligations: Avoiding Beneficiary Lawsuits

Published in the April 2005 issue of Connection published by the New Hampshire Society of Certified Public Accountants

By: David P. Eby

New Hampshire Courts broadly define fiduciary relationships as comprehensive and case-specific, with liability existing whenever influence has been acquired and abused, or confidence has been reposed and betrayed. The law places a fiduciary "in the role of a moral person and pressures him to behave in selfless fashion." The New Hampshire Supreme Court has recognized fiduciary relationships under many circumstances, including within the context of joint ventures and partners, as well as in the employee - employer context. The trustee of a Trust likewise serves as a fiduciary to the Trust beneficiaries. As a result, a trustee must behave in a "selfless fashion," strictly avoiding any conflict of interest, and avoiding decisions that might in any way inure to the benefit of the trustee.

This article explores the basic fiduciary duties owed by a trustee to the Trust beneficiaries, and provides some simple practical pointers for those serving as or working with trustees, all with an eye toward avoiding the beneficiary lawsuit.

Duty to Administer the Trust in Accordance With Its Terms

The first step in analyzing the duties of the trustee is to carefully review the Trust document itself. It is the trust document that generally governs the actions of the trustee and the trustee has a duty to administer the Trust consistent with the Trust terms. The Trust document terms, for example, may define a trustee's duty regarding investment strategies. In general, the standards set forth in the Trust document itself will govern the trustee's actions unless such standards are contrary to public policy. The New Hampshire Supreme Court has stated: "the purpose is to effectuate the settlor's intention in creating the trust. [I]t is well established in this jurisdiction that our courts have shown a single regard for the intention of a settlor of a trust....he will give effect to the settlor's intent unless that intent is contrary to statute or public policy."

When the Trust document provides discretionary powers, which is often the case, generally the courts in New Hampshire will not intervene. Court approval for specific actions is not necessary. However, a court will intervene to prevent an abuse of discretion by the trustee, a relatively high burden to demonstrate. Accordingly, although the discretion held by a trustee, as set forth in the Trust document, may be subject to supervision by the courts, the court, at most, may only determine the bounds of reasonableness within which the trustee must act. Trustee discretion is broad, but not unlimited—the trustee still must use reasonable prudence. Essentially, any discretion must be exercised with (a) a regard for a particular purpose and (b) a regard to the general purpose in establishing the Trust. Indeed, this brings us back to the over-riding governing document that governs the trustee's actions - the Trust document itself.

Duty of Loyalty

Not only must a trustee allow the Trust terms to govern his or her actions, the trustee has an affirmative duty to administer the Trust solely in the interest of the beneficiaries. Pursuant to the "duty of loyalty," the trustee is under the duty not to act in his own self interest and the trustee must completely avoid any conflict of interest in his actions. For example, a trustee is under a duty not to sell Trust property to

himself. This is true even if it is done in good-faith and the Trust receives fair consideration for the property. Essentially, the court may disallow any such dealings upon any showing of conflicting personal interest. Such self-dealing will likely invite a claim from a beneficiary for breach of the duty of loyalty, and should be avoided.

Despite the prohibition against self dealings found within this duty of loyalty, a trustee can, under certain circumstances, be relieved of this duty. RSA 564-A:5 allows the probate court, for cause shown, and upon petition of the trustee or beneficiaries, to relieve a trustee from restrictions from the trustee's power that would otherwise be placed upon the trustee. Under this provision, the probate court may allow or direct a trustee to sell Trust assets to him or herself, so long as such actions are not contrary to public policy. In addition, once again highlighting the importance of the Trust document itself, the Trust terms may relieve the trustee of this duty of loyalty. However, for the terms to override this duty of loyalty, the Trust must specifically refer to the conflict of interest section of the New Hampshire Uniform Trustees' Powers Act and must expressly allow the trustee to act in a manner that otherwise would be considered a conflict of interest and a breach of the duty of loyalty. Again, it is the Trust document that governs.

Duty to Keep Property Separate

A trustee, in the capacity of a fiduciary, has the affirmative duty to keep Trust property separate from individual or other properties. The trustee must earmark the Trust assets. Compliance with this responsibility is critical. Should losses to a Trust portfolio stem from the failure to earmark and separate Trust assets, the trustee can be charged for those losses. Although a causal relationship must be established between the failure to earmark assets, and the loss of asset value, defending a claim of failure to segregate on the grounds that the breach did not cause any harm is certainly not an enviable defense to present. Simply put—carefully segregate trust accounts to avoid claims of this nature.

Duty to Keep Accurate Records and to Provide an Accounting

In line with the duty to segregate accounts, a trustee has a duty to file annual accountings of the Trust administration with the New Hampshire Probate Court. Along with this specific duty of annual accounting, a trustee has a general duty to keep accurate records. For accountants, who are used to maintaining accurate and complete records as part of their own professional responsibilities, this responsibility will be second nature. However, reminders to clients, who serve as trustees, may go a long way toward litigation avoidance.

Liability of Trustees

In the capacity of a fiduciary, the trustee can be held personally liable for any breach of duty owed to the Trust or to Trust beneficiaries. As noted above, if commingling of Trust assets with personal or other assets results in damages or loss to the Trust portfolio, a trustee may be held personally liable. As another example, a breach of duty to a Trust-controlled corporation, when such a breach causes a diminution of corporate value, can result in liability to the trustee either as a corporate officer, or as a trustee of the Trust. In such circumstances, claims may be brought against the trustee by the corporate shareholders or by the beneficiaries. It is also important to understand that, generally speaking, if the acts can reasonably be performed by the trustee personally, a trustee may not delegate the above-referenced duties to others to avoid liability for any breach.

Practice Pointers

Whether you serve as a trustee yourself or advise or work with individual or institutional trustees, it is important to keep in mind the various trustee duties and the important role of this fiduciary officer. Any trustee must take the position seriously – the failure to do so may result in claims by the beneficiaries. The trustee should keep detailed and accurate records of all transactions performed on behalf of the

trust and the beneficiaries. Not only will sound recordkeeping assist the trustee should any claim be brought by beneficiaries, complete recordkeeping will also assist the trustee in submitting the request for trustee fees to the probate court. It is also wise to have open discussions with the Trust beneficiaries regarding fees for the trustee's work. This dialogue should include a recitation of the duties and obligations of the trustee to conform with the Trust document and an overview of the work to be performed. Keeping the beneficiaries informed may go a long way in preventing future challenges to the trustee's actions.

Finally, and perhaps most important of all, a trustee should carefully read, and re-read, the Trust document. As the Trust terms govern the trustee's duties and actions, it is imperative that a trustee always have in mind the purpose of the Trust and the intent of the settlor.

David P. Eby, Esq. is an Officer of Devine, Millimet & Branch, P.A. David is a member of the Commercial Litigation and Probate Litigation Practice Groups. He can be reached at 603-669-1000, or at deby@devinemillimet.com.