Title

When a written informed consent to a lawyer's or trustee's self-dealing may not be worth the paper it is written on

Text

Assume lawyer (agent) drafts for client (principal) a revocable trust declaration that designates lawyer as successor trustee and confirms trustee's entitlement to compensation. As lawyer seeks to exploit for his own benefit a collateral employment opportunity the lawyer would not have had but for the representation, the lawyer's agency-based fiduciary duty of undivided loyalty is implicated no matter how innocent his intentions. By innocent I mean that fraud, duress, or undue influence is not an issue. In some jurisdictions such a designation, however, would create a presumption of undue influence. What applies to designating the lawyer as successor trustee also would apply to designating as successor trustee a third party with whom the lawyer has some economic affiliation. The duty of loyalty also would be implicated if, following death of our settlor, successor trustee were to direct legitimate trust business to enterprises in which the trustee personally had an economic interest. Such transactions are generally voidable by the beneficiaries. Fiduciaries are always free to obtain the informed consent of those to whom fiduciary duties are owed when questionable actions are contemplated. But what exactly is informed consent when *caveat emptor* is not the rule, such as in the agency and trust contexts? There are two species of informed consent: objective informed consent and subjective informed consent.

Relevant to our fact pattern, objective informed consent is when the competent principal or trust beneficiary, as the case may be, formally records acquiescence to what would otherwise be a breach of the duty of undivided loyalty after having been communicated the relevant facts and the applicable law, even when the consenter lacks a subjective knowledge/understanding/appreciation/awareness of the practical pros and cons of a partial waving of equity's protections from divided loyalties. Subjective informed consent is when the consenter knows/understands/appreciates/is aware of the pros and cons.

In the context of the attorney-client agency relationship, a partial waiver of equity's divided-loyalty proscriptions requires subjective informed consent. *See* Rest. of Restitution §191, cmt. c. *Cf.*, Lawyer's Model Rules of Professional Conduct (MRPC) Rule 1.7 [18], [22]. So too when it comes to the trustee-beneficiary relationship. *See* Rest. (Third) of Trusts §97, cmt. *e*. Having the client or beneficiary merely sign on the fly some consumer-protection disclosure form may be sufficient at law without more, but not in equity. It is inconvenient for the fiduciary to have to ascertain actual state of mind; it is the price, however, of operating in equity's bailiwick, where intent/substance trumps form.

The MRPC regulates the lawyer's relationship with the state, not with the one to whom fiduciary duties are owed: "Violation of a Rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. The Rules are designed to provide guidance to lawyers and to provide structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability." *See* MRPC (Scope). In the fiduciary space, the basis for civil liability is general principles of equity.

As to our lawyer who has finagled a conditional successor trusteeship, as a practical matter his real-world exposure is probably close to nil. The client is always free to terminate the representation, as well as revoke the trust. Upon the client's death, the lawyer could well be in the clear, having owed no fiduciary duties other than to the decedent while decedent was alive. It is not as if the lawyer, say, had been selling confidential information regarding the client's company to its competitor, information gleaned while preparing the trust. In §7.2.8 of *Loring and Rounds: A Trustee's Handbook* (2023) we consider in the trust context equitable remedies for a breach of a fiduciary duty that may be available in absence of economic injury. Section is reproduced in appendix below. Handbook is available for purchase at: https://law-store.wolterskluwer.com/s/product/loring-rounds-trustees-hanbook-2023e/01t4R00000Ojr97QAB.

Appendix

§7.2.8 *Liability Without Economic Injury to the Beneficiary* [from *Loring and Rounds: A Trustee's Handbook* (2023), available for purchase at https://law-store.wolterskluwer.com/s/product/loring-rounds-trustees-hanbook-2023e/01t4R00000Ojr97QAB].

Liability. A trustee is liable for intentional breaches of trust, whether or not the breach caused economic injury to the trust estate.[654] This is particularly the case when it comes to breaches of the duty of loyalty. Lack of economic injury is no more a defense to a trustee's breach of the duty of loyalty than is the failure to steal a defense to the crime of breaking and entering. While money damages may not be an available remedy in the absence of economic harm, there is always injunction, removal, and assessment of costs—and possibly even criminal sanction.[655] Under the UTC, a trustee is accountable to an affected beneficiary for any profit made by the trustee arising from the administration of the trust, even absent a breach of trust.[656] "A typical example of a profit is receipt by the trustee of a commission or bonus from a third party for actions relating to the trust's administration."[657]

Negligent breaches also can bring liability without economic injury to the trust estate.[658] One court, for example, has held a trustee liable for the legal costs that a beneficiary incurred in getting the trustee to properly account.[659] The Restatement (Third) of Trusts is generally in accord.[660] Another court has held a former trustee personally liable for the attorney fees of a beneficiary that were attributable to the beneficiary's successful efforts to have the trustee judicially removed.[661]

The beneficiary's costs of getting a trustee to prudently invest the trust property also should be absorbed by the trustee personally. Let us take, for example, the trustee who negligently concentrates the trust estate in only one stock. Last year the stock's performance was well below the market average; this year its performance is, and continues to be, well above the market average. The beneficiary, concerned that the portfolio is at an unacceptable level of risk, retains counsel who finally manages either by litigation or negotiation to get the trustee to diversify. While ultimately the trust suffered no resulting economic injury, the trustee nonetheless was in breach of the duty to diversify. Thus, while money damages may be inappropriate, it would be appropriate for the trustee personally to bear the burden of all legal fees and associated costs incurred by the beneficiary and others in getting the trustee to prudently diversify.[662] Had

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[654]*See* Tr. Under Will of Ashton, 260 A.3d 81 (Pa. 2021).

[655]*But see* Bogert §861 n.57 and accompanying text. *See generally* §7.2.3.7 of this handbook (the equitable relief of reduction or denial of compensation and/or assessment of attorneys' fees and other costs against the trustee personally).

[656]UTC §1003(a).

[657]UTC §1003 cmt.

[658]*See* Tr. Under Will of Ashton, 260 A.3d 81 (Pa. 2021).

[659]James v. Newington & ors [2004] JRC 059 (R.C. Jersey (Samedi Division)). *See also* McHenry v. McHenry, 2017 Ohio 1534 (Ct. App. 2017).

[660]Restatement (Third) of Trusts §83 cmt. a(1) and §100, cmt. b(2).

[661]McHenry v. McHenry, 2017 Ohio 1534 (Ct. App. 2017). Trustee removal is taken up generally in §7.2.3.6 of this handbook.

[662]*Cf.* McHenry v. McHenry, 2017 Ohio 1534, ¶59 (Ct. App. 2017) ("Likewise, a rule of proportionality in trust cases would make it difficult for beneficiaries with meritorious claims against the trustee, but with relatively small potential damage claims, to seek redress in court."); *see generally* §8.13

the trustee sold when the stock was down, there would have been realized losses that could have formed the basis for an assessment of damages.[663] There is some irony here. Had the stock been sold in a down market in a conscientious—albeit belated—effort to carry out the duty to diversify, the trustee's liability could well be keyed to those losses.[664]

Beneficiary standing in the absence of economic harm. The beneficiary of a trust, *qua* beneficiary, has the requisite standing to bring a breach-of-trust action against the trustee. This is the case even if the beneficiary's particular equitable interest has yet to be harmed economically by the actions of the trustee.[665]

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of this handbook (in litigation pertaining to a trust, when the beneficiary is entitled to reimbursement from the trust estate for legal fees).

[663]*See* Restatement (Third) of Trusts: Prudent Investor Rule §205.

[664]In one case, a bank trustee was held liable for the failure to diversify even though "the value of the trust principal increased and 'substantial income' was earned throughout the bank's tenure as trustee." First Ala. Bank of Huntsville, N.A. v. Spragins, 515 So. 2d 962 (Ala. 1987). Liability was based on the difference between the actual increase and the increase that might have been achieved with a diversified portfolio. *See also* Restatement (Third) of Trusts §§209–211.

[665]*See* Tr. Under Will of Ashton, 260 A.3d 81 (Pa. 2021).